VENTURE CAPITAL

Meaning

- Venture capital means funds made available for startup firms and small businesses with exceptional growth potential.

- Venture capital is money provided by professionals who alongside management invest in young, rapidly growing companies that have the potential to develop into significant economic contributors.

Venture Capitalists generally:

- Finance new and rapidly growing companies
- Purchase equity securities
- Assist in the development of new products or services
- Add value to the company through active participation.

The SEBI has defined Venture Capital Fund in its Regulation 1996 as ‘a fund established in the form of a company or trust which raises money through loans, donations, issue of securities or units as the case may be and makes or proposes to make investments in accordance with the regulations’.

Characteristics

- Long time horizon
- Lack of liquidity
- High risk
- Equity participation
- Participation in management

Advantages

- It injects long term equity finance which provides a solid capital base for future growth.

- The venture capitalist is a business partner, sharing both the risks and rewards. Venture capitalists are rewarded by business success and the capital gain.

- The venture capitalist is able to provide practical advice and assistance to the company based on past experience with other companies which were in similar situations.

Advantages (Cont.)

- The venture capitalist also has a network of contacts in many areas that can add value to the company.
- The venture capitalist may be capable of providing additional rounds of funding should it be required to finance growth.
- Venture capitalists are experienced in the process of preparing a company for an initial public offering (IPO) of its shares onto the stock exchanges or overseas stock exchange such as NASDAQ.
  They can also facilitate a trade sale.

Stages of financing

1. Seed Money:

   Low level financing needed to prove a new idea.

2. Start-up:

   Early stage firms that need funding for expenses associated with marketing and product development.

3. First-Round:

   Early sales and manufacturing funds.

4. Second-Round:

   Working capital for early stage companies that are selling product, but not yet turning a profit .

5. <u>Third-Round</u>:

Also called Mezzanine financing, this is expansion money for a newly profitable company

6. <u>Fourth-Round</u>:

Also called bridge financing, it is intended to finance the "going public" process

VC investment process

Deal origination

Screening

Due diligence
(Evaluation)

Deal structuring

Post investment activity

Exit plan

Methods of Venture Financing

The financing pattern of the deal is the most important element. Following are the various methods of venture financing:

- Equity
- Conditional loan
- Income note
- Participating debentures
- Quasi equity

Exit route

- Initial public offer(IPOs)
- Trade sale
- Promoter buy back
- Acquisition by another company

Venture capital funds in India

VCFs in India can be categorized into following five groups:

1) Those promoted by the Central Government controlled development finance institutions. For example:
   - ICICI Venture Funds Ltd.
   - IFCI Venture Capital Funds Ltd (IVCF)
   - SIDBI Venture Capital Ltd (SVCL)

2) Those promoted by State Government controlled development finance institutions.

For example:

- Punjab Infotech Venture Fund
- Gujarat Venture Finance Ltd (GVFL)
- Kerala Venture Capital Fund Pvt Ltd.

3) Those promoted by public banks.

For example:

- Canbank Venture Capital Fund
- SBI Capital Market Ltd

4)Those promoted by private sector companies.

For example:

- IL&FS Trust Company Ltd
- Infinity Venture India Fund

5)Those established as an overseas venture capital fund.

For example:

- Walden International Investment Group
- HSBC Private Equity management Mauritius Ltd