

**Venture Capital And Its Function Performed In Financing****Keshav Lengare**Associate Professor,  
SCS College, Omerga,  
Osmanabad(MS) India**Abstract:**

*The Venture capital fund is a vital equity source for start-up industries, for the growth of the Indian economy and provides a lifesaving support for new industries in the prevailing financial markets. So there emerges an enormous opportunity for organizations offering financial support. Probably triggered by the financial needs of young entrepreneurs, venture capital firms came into existence. They catered the financial demands of the newly set-up organizations to a great extent and still they continue to do so. A major developments in venture capital was noticed during late 1990s. The development was the spurt in formal venture capital markets which not only resulted in emergence of dynamic new industries but also gave birth to excessive behavior and costly mistakes. Venture capital markets around the globe have kept maturing and deepening in varying degrees. Similarly, the venture capitalists vary strongly in features and performance between countries.*

*In my present article, an attempt has been made to observe the performance of the venture capital firms by analyzing their profit after tax and net assets value. Further, in order to judge the overall performance of the venture capital as an activity, the analysis is being done on global basis, region-wise and funding of mergers and acquisitions by venture capital firms, region wise.*

**Keywords:** *Venture Capital, Emerging Economics, VC Investment, Stock Markets, Private equity, Investment Banking, etc.*

**Introduction**

It is a private or institutional investment made into early-stage / start-up companies (new ventures). As defined, ventures involve risk (having uncertain outcome) in the expectation of a sizeable gain. The people who invest this money are called venture capitalists (VCs). The venture capital investment is made when a venture capitalist buys shares of such a company and becomes a financial partner in the business.

Venture Capital investment is also referred to risk capital or patient risk capital, as it includes the risk of losing the money if the venture doesn't succeed and takes medium to long term period for the investments to fructify.

Venture Capital typically comes from institutional investors and high net worth individuals and is pooled together by dedicated investment firms.

It is the money provided by an outside investor to finance a new, growing, or troubled business. The venture capitalist provides the funding knowing that there's a significant risk associated with the company's future profits and cash flow. Capital is invested in exchange for an equity stake in the business rather than given as a loan.

Venture Capital is the most suitable option for funding a costly capital source for companies and most for businesses having large up-front capital requirements which have no other cheap alternatives. *Software and other intellectual property* are generally the most common cases whose value is unproven. That is why; Venture capital funding is most widespread in the fast-growing technology and biotechnology fields.

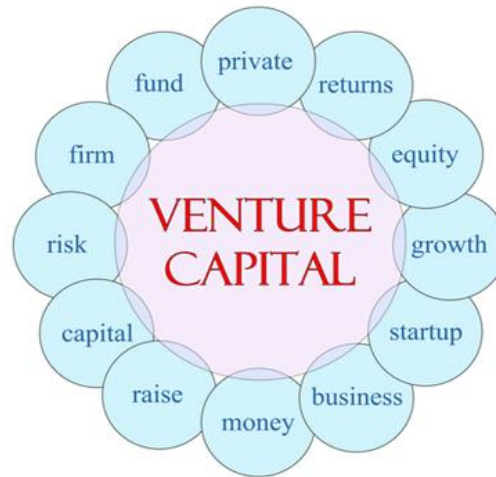


Figure: Venture Capital (source: <https://www.edupristine.com/blog/venture-capital>)

Venture capital has played an important role in the development of many sectors of different economies. It is the key driver in innovation, new firm creation, rapid growth of businesses, in promoting entrepreneurship, enhancing competition and job creation. Currently, venture capital industry of India is in its infancy and facing issues such as risk adverse attitude of entrepreneurs, family owned business mindset, and limited support from the government and listing regulations for SMEs.

Present article is study the framework to understand the role of venture capital practices in the emerging market. At the time of starting a new company, entrepreneurs turn to several financing options, one of them is venture capital, where the borrowed funds provide support to build a new firm, which possesses the expertise, qualities and characteristics to make something provable and those considered to demonstrate high risk potential and high-growth. Unlike banks and other financial institutions, where the borrowing entrepreneurs are required to pay only the loan amount with interest, in the case of venture capital financing, funds come as a part of ownership in the form of company shares in exchange, to ensure that the shareholders have the limited control, can express their opinions, judgment and have say in the company affairs to direct them in the future.

#### **Networks and Institutional changes of Emerging Economics:**

In this global scenario, the emerging economies have turned more mature with all kinds of revolutionary transformations, characterized by comprehensive technological innovations and the fundamental design of subtlety and refinement. The venture capitalists envisage maximum potential for growth in such functions of institutional transformations, as they prefer such environments that primarily differ from other mature markets. In India, when the global fastest growing economy is in transition, entrepreneurial firms expect and try to implement dramatic and rapid shifts in business and institutional environments. Such drastic shifts encounter various challenges that entrepreneurial firms have to face, because, they do not seek only the way to survive, but they have the drive to prosper in this rapidly evolving environment with successful institutional changes. Several research studies have been made to focus on certain institutional changes and witnessed their impact on economic development. But the evolutionary rate of institutions in this transition economy normally has the tendency to be less predictable, while bringing faster changes. The high technological machinery of entrepreneurial firms in India needs to deploy grounded methodology, and applicable theory to comprehend the effective ways the entrepreneurial ventures must work together and integrate to cope with speedy institutional changes, yet manage to be successful and prosper (Nahata, Hazarika & Tandon, 2014).

The fast emerging economies normally lack enforcement, the regulations, and business rule of laws that venture capitalists normally observe in establishing traditional economies. Here we explore the ways venture capitalists develop and utilize networking relationship with entrepreneurs, with other venture capitalists, various enterprises, and many informal institutions to apply and administer different ways and means of investments to replace weaker formal institutions, which are unstable lacking complete business knowledge in the emerging markets. Networking and Institutional Change theory adds cultural and social elements, that provide better socialized clarification regarding the effect and strength of networking, which affects every function of venture capitalist. The grounded theory and methodology is to gather data concerning institutional consequences on venture capital. Four fundamental venture capital functioning categories are; selection of companies with due diligence; monitoring and structuring; value added activities, and exit procedures. Evaluating the company activities and expertise is specifically vital considering inadequately enforced legal system, hence brings several obstacles. Therefore, developing relationship through networking is an adequately stable way to influence the direction of the company. Also, exiting the venture is constrained because listing the company has a limited scope, while the corporate market control remains weak, enforcing the bankruptcy code also does not exist. Therefore, in the emerging economic conditions, the networking method is applied to obtain precise information, effective monitoring, to follow rules of law, for contract enforcement. Analyzing the overall system, The overall analysis indicates the networking impact, with respect to changing institutional systems in case of transitional progression in the emerging economy (Ahlstrom & Bruton, 2006).

**Venture Capital as global model:**

Many large global firms also have internal investment groups that make corporate venture investments in early-stage and growing companies. These corporate VC firms may actually be the exit strategy and eventually acquire the young company if it fits their business objectives. This type of corporate VC is often called a strategic investor because they are more likely to place a higher priority on the strategic value of the investment rather than just the pure financial return on investment. For example, US-based Intel Corporation, one of the world’s largest technology companies, has an internal group called Intel Capital. The vision of Intel Capital is “to be the preeminent global investing organization in the world” and its mission “to make and manage financially attractive investments in support of Intel’s strategic objectives.”

Intel Capital makes investments in companies around the world to encourage the development and deployment of new technologies, enter into or expand in new markets, and generate returns on their investments. “Since 1991, Intel Capital has invested more than USD 9.5 billion in over 1,050 companies in 47 countries. In that timeframe, 175 portfolio companies have gone public on various exchanges around the world and 241 were acquired or participated in a merger. In 2009, Intel Capital invested USD 327 million in 107 investments with approximately 50 percent of funds invested outside the U.S. and Canada.”

Company	Country	Business
Althea Systems	India	Makes a cloud-based video platform to find and share online videos across devices (Shufflr is its social video browser)
Anobit	Israel	Memory signal processing technology
Boo-box	Brazil	Software-based ad system for social media
De Novo	Ukraine	Provides enterprise-class data centers and services in Ukraine
Iptego	Berlin	Makes software to optimize Next Generation Networks
Layar	Netherlands	Reality platform available on Android, iPhone, and Bada mobile devices
Rock Flow Dynamics	Russia	Makes modeling software that simulates fluid and gas filtration
Select-TV	Malaysia	Makes set-top boxes for IP TVs
Taifatech	Taiwan	Fabless semiconductor company that makes wireless system on a chip
WinChannel	Beijing	Makes software that manages replenishment orders, sales, inventory, and other activities in near-real time



Table: Intel Capital Investments Announced in November 2010 (Source: Copyright Intel Capital, 2010.)

As a result, the expanded global markets offer VCs access to (1) new potential investors in their venture funds; (2) a wider selection of firms in which to invest; (3) more exit strategies, including IPOs in other countries outside their home country; and (4) the opportunity for their portfolio companies to merge or be acquired by foreign firms. Tech-savvy American and European VCs have traced the source of the high-tech talent pool and increased their investments in growing companies in many countries, including Israel, China, India, Brazil, and Russia.

We can evaluate the performance related to decision strategy, linked to the outcome of decision quality that can change drastically between the environmental factors holding various statistical relationships between business plans data contains and related financial success. The similar circumstances arise in case of more complex and competitive strategic investment decisions, while its performance remains robust in the entire environment. It is the best way to learn those business plans, which simulate and guide VC investments. The overall results clarify the difference in decision strategies differ to that of the impact generated due to additional information about decision outcome. Finally, there is a need to evaluate the real-world implication VC practices, study and research on precise VC surety in decision making (Anjos, Fernando & Drexler, 2015)

#### **Public Policy on Venture Capital Investment:**

Governments justify intervention in the VC market along two basic arguments: first, market failures are responsible for unsatisfactory low levels of funding and second, VC markets produce positive spill-over effects for the economy as a whole due to their positive impact on employment and innovation. This section assesses two major instruments of government intervention:

(1) many governments choose to intervene directly in the VC market through public VC funds launched and managed by national promotional institutions (NPIs);

(2) governments use targeted tax incentives to lower the riskiness of VC investments, for example by lowering taxation on corporate income or capital gains taxes. At the same time, tax systems can provide a significant barrier for cross-border investment because they impose transaction and information costs on non-resident investors. Public policies to promote VC investments have an important multi-level governance component. In the EU, industrial policy (such as public VC funds) as well as taxation are, to a large extent, competences of the member states. Nevertheless, the limited integration of the European VC industry calls for coordination and even a pooling of these activities at European level. This section analyses the policy mix of national governments and EU institutions and makes recommendations on how to align activities at the two levels.

#### **The government as VC investor:**

In Europe, government agencies are the most significant investor group in the VC market. Over the last decade they provided about 18 % of funding. In their role as investors, public agents enjoy a substantial degree of discretion as they are directly involved in the allocation of financial resources. This can help to promote strategic sectors that are not yet competitive but it also carries the risk of inefficient favouritism. Despite mixed evidence of the efficiency of government VC funding and the theoretical question as to whether public actors are as suitable as private investors to select the most promising portfolio companies, public money is undoubtedly an important stabiliser in times of crisis.

The key goal of public investments is the development of a profitable and self-sustaining private market. To achieve this, public agents have to be careful not to replace or discourage private VC funding (crowding-out) but to leverage additional private investment (crowding-in). Furthermore, public agents may become so dominant that private actors start to rely on their 'seal of approval' with

regard to filtration and due diligence of portfolio companies rather than building up these capacities themselves.

In Europe, the major public actor in VC markets is the European Investment Fund (EIF), acting on behalf of the European Investment Bank, the European Commission and in some cases on behalf of member states. On the national level, national promotional institutions (NPIs) also play an important role. Examples are the Banque Publique d'Investissement (Bpifrance) in France, the British Business Bank (BBB) in the UK or the Kreditanstalt für Wiederaufbau (KfW) in Germany. Today, all these players deploy a diverse toolbox of equity instruments through which they try to compensate for the deficiencies in the VC market.

#### **Recent developments of government VC instruments:**

In recent years, policy-makers have adjusted the funding instruments to the specific problems of European VC markets. Three broad trends are observable:

First, public funds increasingly invest 'indirectly' to detach government agencies from the investment decision, either through FoF structures or by passing the management of public funds to private fund managers (like for example, the German fund Coparion). The Pan-European FoF programme does both.

Second, British, French and German governments as well as the EU have all launched funds that specifically target the growth phase. These funds are equipped with more capital and can sign larger deals.

Third, national governments and their NPIs increasingly cooperate with each other and with the EIF. Such cooperations can take the form of a long-term delegation or of ad hoc cooperation. The German government, for example, has handed over the management of large portions of its multi-billion VC support to the EIF in 2004. In 2015, the EIF, Bpifrance and KfW pioneered a joint VC investment of EUR 75 million in a large transatlantic growth fund.

In autumn 2016, the EIF together with European NPIs launched the EIF-NPI Equity Platform to enhance cooperation between the EIF and NPIs as well as between NPIs. The Equity Platform, still in a formative phase, aims to build up soft cooperation such as sharing of information and best practice as well as operational cooperation to facilitate joint investments through public equity instruments.

#### **Structure of Banks against Stock Markets:**

The Capital Market is perhaps the highly preferred and widely hunted markets. Both markets of bonds and stocks are always closely studied; their daily movements are rigorously analyzed and followed as they remain proxies for the overall economic affairs of the entire global markets. Hence, those operational capital market institutions like commercial banks, stock exchanges, and similar kind of corporations, non-banking institutions like mortgage banks and insurance companies are cautiously scrutinized (Da Rin, Nicodano & Sembenelli, 2006).

There are similarities and differences between money and capital markets. Viewing from the seller or issuer standpoint, these two markets generate required business functions, sustaining enough funding levels. The seller's market goal depends on their time based liquidity needs. While the buyers or investors pursue the market, investments with unique reasons. There is a higher risk in capital market investments, whereas, the money markets bring safe assets; the returns from money market are steady but low, and the capital market offers better and high returns. The capital market magnitude of returns has a clear connection to risk level, but this is not always (Da Rin, Nicodano & Sembenelli, 2006).

Even though all markets demonstrate long term efficiency, those exhibit short-term inefficiency provide investors to exploit on irregularity to gain higher rewards, which at times go out of control with respect to risk level. These exact anomalies all the capital market investors try to evaluate and study. Even though, money market is known to be safe, the investors encounter negative



returns. Unexpected risks, that may be unusual, always an inherent risk in investments, even in the case of short or long term, capital and money market can be very risky at times (Da Rin, Nicodano & Sembenelli, 2006).

The USA has several small banks in relation to large companies. They play a restricted role in terms of corporate governance, and well established stock market and associate markets to gain corporate control. In another way, Germany and Japan have less, but larger banks, those play a very dynamic role of central governance. But, they do not possess corporate control active market rules. Bank procedures and rules in relation to stock and capital market system have systematic differences between their systems, because the venture capital stock market systems possess greater vitality. To understand the connection between venture capital and stock market needs an awareness of contractual arrangements of entrepreneurs with venture capital providers; specifically while entering into an implied contract control, which permits successful entrepreneurs to reacquire the company share value from venture capital investors. It can be done using public offering initially, by which venture capitalists can exit from their portfolio investments. There is a need to study to understand venture capital procedures of contracting, the venture capital market, quick exit procedures by VC investors; and systematic exit process by preliminary public offering (Gilson & Black, 1997).

#### **Developing Environment of Venture capital:**

The VC- Venture Capital institution is too complex to commence because of policy intervention, specifically in this developing country like India, where an unstable macroeconomic environment persists, with the historical use of national funds and state capital involvement prevails in the industrial production composition. India carries several of such constraints. The year 1985 emerged with flourishing software industries, generating the best raw materials venture capitalists are looking to finance. Thus, the industry received the fundamental precondition for the growth of venture capital funds. This generated booming industry of venture capitalists. After different setbacks, little success was realized mainly because of slow molding processes of environmental regulations and rules, related to permit institutions. The overseas Indians assisted with their roles in the success of Silicon Valley entrepreneurs in the later part of the twentieth century. Yet, the combined work of practitioners and policymakers is to be processed to give a proper shape to the Venture Capital institution (Landstrom & Mason, 2014).

Venture Capital has turned out to be the driving force in every business sector for quick economic growth and industry developments. Its importance is growing faster in all sectors, as can be seen, there are many famous companies world over who have received VC or funding from business angels in their initial company development. Hence, it is necessary that business managers and entrepreneurs understand the precise tools, strategies, and techniques to secure financial support from the VC. India needs to explore and evaluate the importance and value of the globalization modules of the VC Institution (Lerner, Leamon & Hardyman 2012).

This modular framework is elaborate, extensive, intended to educate entrepreneurs to understand how in the initial stages of company starting, funding is generated and procured from venture capital companies, and further to access and evaluate the ways and strategies that help working alongside the industries and how to manage investments. This criteria stays in line with the Private Equity modules, Entrepreneurial Finance, which offers an elaborate information on the analysis and production of company financial status and information for the entrepreneurs to understand, and the extensive array of debt / equity financial schemes and methods available (Lerner, Leamon & Hardyman 2012).

This kind of modular framework provides an elaborate knowledge of the capital investment procedures, decision making and screening processes, business proposal, selecting and negotiating

techniques, structure to make the deal, following up on the amount of investments made and exiting formats (Landstrom & Mason, 2014).

**Venture Capital, Private equity and the financing of entrepreneurship:**

The venture capital or Risk Capital, private equity, investment banking develops the financial service system. However, the structure of their fund investment is unique. Private equity firms are the factions of private investors. They use their funds to buy assets or the complete businesses. Venture capitalists invest funds to new entrepreneurs in their startup businesses, as they can acquire more resources to develop the business. Investment banks have several other functions (Lerner, Leamon & Hardyman, 2012).

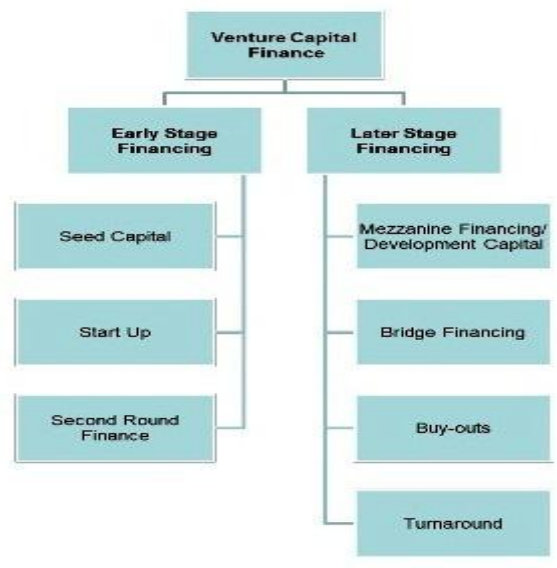


Figure: Venture Capital Financing Stages

(source: <https://www.slideshare.net/rksen/management-of-venture-capital-companies>)

**Private Equity**

Investors of Private equity merge multiple investor assets to implement transactions. They pool all resources, and purchase sections of any business or take control of the company in distress. However, they do not take business ownership permanently. Instead, they create an exit strategy. These Private equity companies try to improve the acquired business so as to sell with a substantial profit. Such equity measures are risky due to their large investments to clear debt and to complete the deal (Lerner, Leamon & Hardyman, 2012).

**Venture Capital**

The investment banking and private equity offer service facilities to various corporations having a good operating reputation and history. Venture capitalists invest in the early stages of business operations. They are prepared to take additional risks to fund new businesses, so as to help commence business operations and earn profits. This provides new businesses the requisite initial funds and turns an attractive proposal than to avail funds from those of private equity or investment banking (Lerner, Leamon & Hardyman, 2012).

**Investment Banking**

Venture capitalists, private equity investment firms and bankers generally offer support to secure funds from different other investors. While investment bankers utilize financial markets, that includes equity and debts to finance corporate transactions. Bankers also help finance different companies to form acquisitions, and mergers, sell debt shares and equity in capital markets, may be through restructuring corporation management. For example, in the year 2012, the investment banker pay structure changed as per the Bloomberg published article. At that time, very less bankers were

entitled to gain bonus during year end, and they were also earning bigger salaries (Lerner, Leamon & Hardymon, 2012).

**Regulation:**

Financial regulations have become very stringent due to the 2008 economic and financial crisis, that led to the formation of the Dodd-Frank law, which governs major parts of financial service industry. Due to this, investment banking rules have turned excessively large and cumbersome to deal with, as per The New York Times article of 2012. It states that all the Private equity companies were under inquiry and scrutiny, as they pocketed more profits than their share from every deal. This was published in an article on Bloomberg in September 2012. They claimed that the VC companies sidestepped the normal lawful, but expensive procedural needs of registering with government regulations stipulated by the Dodd-Frank rules, which mainly considers a break for such firms (Lerner, Leamon & Hardymon, 2012).

**Conclusion:**

It is being increasingly observed that irrespective of funding stage, Consumer Internet & Ecommerce have emerged as the most preferred industry segment across start-ups. Other popular industries Fintech, Logistics and Foodtech. What is encouraging is that in recent years, the Indian startup ecosystem has really put up a splendid performance and come into its own- driven by factors, like, substantial funding, consolidation activities, evolving technology and a mushrooming domestic market. The prognosis speaks about this fact, i.e. from 3,100 startups in 2014 to 11,500 by 2020. The Indian Government's Economic Survey Report of 2015 further highlights the emergence of substantial number of start-ups in India and has ranked India as the 4th biggest start-up hub in the globe. In terms of investment, over USD 1 billion has been invested in the last 3 years in the start-up space alone. These investments are not restricted to the poster boys of the Indian start-up ecosystem (Flipkart, Snapdeal and PayTM) but are widespread with global conglomerates investing into diverse start-ups in India. As such, India continues to hold high promise for the emergence of a start-up ecosystem.

The VC can provide a large amount of funds for businesses and for capital development that is not feasible through any bank loan or any other conventional means. Venture capitalists also provide relevant business expertise, connected with industrial progress and those guidance and mentoring processes is extremely valuable. Legal costs and accounting processes make the fund securing procedure through VC very difficult. In case a requisite deal is secured, the investors of VC will primarily get drawn in to decide on company affairs, strategies and directions.

However, Securing the capital from VC is very cumbersome, while the funds invested in any innovative venture may have a huge potential for profits as well as risks of losses are rigorously evaluated and considered. (Hellmann & Puri, 2000).

It is important to note that Asian economies needs to enhance the pace of industrialization, in order to cajole venture capital / private equity financing. Further, India being one of the emerging economies of the globe can play a pivotal role in inveigling private equity / venture capital. Moreover, India can leverage its Make-in-India campaign to entice venture capital investments, thereby strengthening its industrial base and increasing its National Income and Per Capita Income.

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