Venture Capital as A Catalyst for Entrepreneurial Development in India

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Abstract

Entrepreneurial development aims to enlarge the base of entrepreneurs by encouraging new ventures. It concentrates more on growth potential and innovation and offers benefits such as employment generation and economic development to the country. But the commercial exploitation of any business idea requires finance. Venture capital, as a form of financing, refers to equity or equity related investments in the projects involving high risk and high returns, besides providing managerial assistance and contributing to overall strategy for making long term gains for themselves. Commercially viable projects developed out of new technology and knowledge-based ideas by the new generation entrepreneurs have most of their assets in intangible form whereas conventional lending is done based on tangible assets and risk factors involved in the projects, which creates a gap in the financial intermediation.

The focus of this paper is on entrepreneurial development and the role played by venture capital in this process in India. It examines the growth of venture capital industry and the projects supported by them. It also examines the entrepreneurial needs and extent to which they have been fulfilled by the venture capital industry in India. The research is based on secondary data collected from books, journals and e-sources. The paper concludes that entrepreneurial talent is supported by venture capital through providing the required finance and business skills and makes recommendations for further enhancement.

Keywords: *Venture Capital, VCF, Entrepreneurial Development, Seed Capital, SME/MSME.*

Paper Type: *Theoretical*

Introduction

India, with decadal growth in population at the rate of 17.7%[1], with 65.6% in the age group of 15-64 years, with the rate of literacy of 72.986%, finds it challenging to provide decent economic opportunities to its citizens. To maintain the growth rate between 5.4% to 5.9%[2] (in the fiscal year 2014-15) a stimulus to private and public investments in the economy is required to be given to increase the industrial output, and maintain low inflation and conductive investment environment. A vibrant private entrepreneurial sector, particularly, micro, small and medium-sized enterprises (MSMEs) plays vital role in this respect. MSME is the second largest employer in the country with 3.6 crores of employers offering jobs to 8 crores of people[3].

A significant contribution of 45% of the total industrial production, 40% of the exports and 37.4% of GDP[4] explains the crucial role MSMEs can play in bringing economic stability and sustainability for the future.

In the words of Gottlieb[5] "An entrepreneur is someone who can take any idea, whether it be a product and/or service, and has the skill set, will and courage to take extreme risk to do whatever it takes to turn that concept into reality and not only bring it to market, but make it a viable product and/or service that people want or need."

High rewards attached to high risks motivate an individual to take initiative to become an entrepreneur, making him instrumental to economic change. The entrepreneurial endeavors give rise to economic activities, resulting in economic growth and development. By exploring and exploiting opportunities, entrepreneurs encourage effective resource mobilization of capital and skill, create new products/services and expand markets for growth of the economy besides creating large-scale employment opportunities, capital formation etc.

Thus, entrepreneurial efforts can be an important input in the process of economic growth and development to all nations. And to achieve it through the entrepreneurial development approach; enough opportunities for development of functional skills and entrepreneurial skills, financing and mentoring of entrepreneurial efforts must be provided for, especially for the first-generation entrepreneurs in the MSME sector.

India, as an emerging economy, is striving for development. It is rich in human capital- both technical and entrepreneurial. Through entrepreneurial development the talent and potential of unemployed young generation can be used productively. The projects of budding entrepreneurs with the new technologies developed by them and industries and services supporting these technologies need finance since the inception. With adequate finance, they can change the future of the economy for better. But their projects with domestically developed technologies are usually perceived to be uncertain by the conventional financial system. Besides, the DFIs which lend on long term basis are the debt providing organizations.

The new entrepreneurs find it difficult to raise equity/risk finance required as startup capital as they neither have physical assets nor low risk plan that conventional lenders want. There is a growing need for lending facilities complementary to existing ones which can provide risk finance to such projects and fill up the gap in financial intermediation. Private Equity and Venture Capital (VC) can be instrumental in helping small enterprises grow into medium-sized enterprises and semi-formal into formal businesses.

The present study is undertaken to assess the performance of venture capital in supporting entrepreneurial development in India.

Review of Literature

Efforts were taken to consult available literature on the topic of study. Research studies related to entrepreneurial development in India and abroad bring the following in light:

Large established companies are no doubt the backbone of most economies however, Beck et al., (2003)[6] observed a positive link between the SMEs' share of total economic activity and economic growth.

According to them the performance of SMEs is, however, greatly important for the long-term vitality of any economy. Davidsson et al., (1988)[7]; OECD, (2005a)[8]; Hijzen et al., (2007)[9] established that SMEs dominate net creation of new jobs. "For entrepreneurship to contribute to competitiveness, entrepreneurial activity based on innovation and opportunity needs to be cultivated" GEM, (2004)[10]. World Bank, (2004)[11] observed that environment needs to be business-friendly to foster more entrepreneurial activity. Andersson and Napier (2007)[12] opined that not lack of capital but the activation of the reservoirs of passive capital, raising the level of investment readiness among entrepreneurs has been the prime challenge.

For the policymakers, addressing the combined impact of the prevailing conditions on the willingness and ability of market players and increase their propensity to collaborate in generating new, high-risk business activities shall be challenging. Lal, and Clement (2005)[13] concludes that India can generate additional economic growth by fostering entrepreneurial activities as in case of a wide variety of nations have been found to yield significant economic benefits. According to Fernan (1989)[14], entrepreneurs need venture capital to develop ideas in the initial stage to product development stage and thus venture capital has encouraged an increasing number of potential entrepreneurs to develop their ideas in the marketplace.

The present research is undertaken to find out the extent of support by venture capital to entrepreneurial development in India.

Research Objectives

The research has following objectives:

i. To bring out the importance of entrepreneurial development

ii. To examine the role played by venture capital in the process of entrepreneurial development in India.

iii. To study the growth of venture capital industry and the projects supported by them.

Research Methodology

Data collected from annual reports of SIDBI along with other information pooled from books, journals and e-resources form the basis of study. Besides, informal interview of SVCL official was taken by the researcher personally. Thus, both primary and secondary data sources form the basis of research

Scope and Limitations

Before 1990, there were very few venture capital firms, now the number stands at 180[15]. There are small and big registered VC firms in India. With the best of efforts put in by the researcher, the relevant data and information could not be obtained from all the firms. Since SIDBI is a dominant player in MSME sector, it was decided to gather data from them for accomplishing the research objectives. A period of 15 years from 1999-2000 to 2013-2014 is covered in the study.

Venture Capital

Venture capital is a non-conventional risk finance provided to new ventures of innovative and technically or professionally qualified entrepreneurs to encourage innovative entrepreneurships - to turn innovative business ideas into a commercially viable project.

"Venture capital is a risk finance provided to enterprises which, for a variety of reasons are unable to raise such finance in the public or quoted capital market."[16]

Meaning

Venture Capital means

- a long-term investment held for capital appreciation,
- financing through mainly equity and quasi-equity securities and sometimes debt - straight or conditional,
- investment in the projects of new but qualified entrepreneurs with inadequate funds,
- taking higher risk for higher return - higher risk as the project involves new or relatively untried technology and higher capital gains through capital appreciation when the new technology succeeds (not through the dividend payout),
- a long-term association between investors and entrepreneurs as business partners. Investors support the project with finance and business skills to exploit the market opportunities for return.

It also involves actively working with the company's management to devise strategies pertaining to the overall functioning of the project and networking and marketing of the product /service being offered.

Origin of Venture Capital and Recent Trends

Venture Capital originated in the 20th century and now many countries of the world including India have adopted it to bring about development of SMEs and MSMEs by encouraging entrepreneurs in the country.

Origin

Post-World War II, the history recorded origin of venture capital in USA by setting up the American Research and Development Corporation (ARDC) as the first venture capital organization in 1946. However, the venture capital industry in India is of a recent origin and is still in its infancy. Venture Capital activity in the past was possibly done by the developmental financial institutions by using debt as an instrument of funding. The awareness for venture capital could be traced back to a committee on Development of small and medium enterprises (1973), set up by GOI in 1973, which recommended VC as a source of funding new entrepreneurs and technology. The need for venture capital was acknowledged in the 7th five-year plan. and long term fiscal policy.

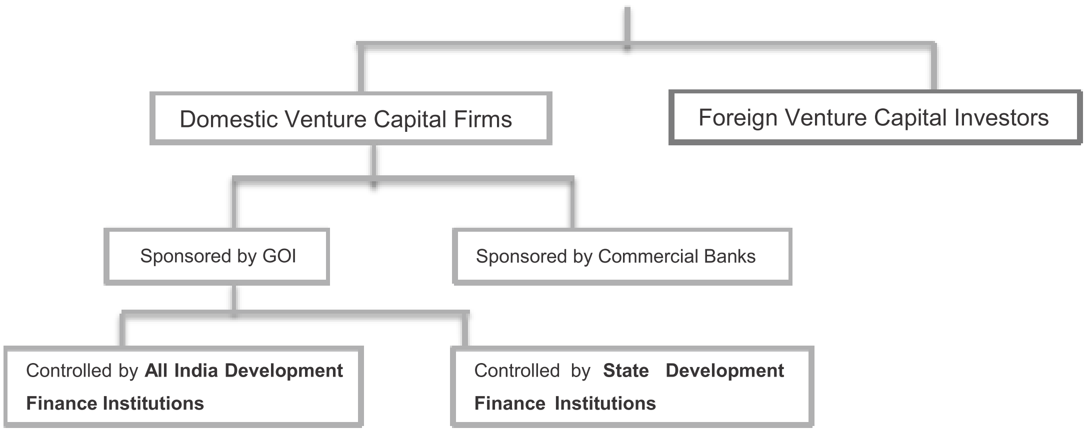
Recent Trends

VC financing started in India in 1988 with the formation of Technology Development and Information Company of India Ltd. (TDICI)- promoted by ICICI and UTI. The first private VC fund was sponsored by Credit Capital Finance Corporation and promoted by Bank of India, Asian Development Bank and the Commonwealth Development Corporation viz. Credit Capital Venture Fund. Besides, various state level financial institutions also started VC firms in the states. Sources of these funds were the financial institutions, foreign institutional investors or pension funds and high net-worth individuals. Venture Capital in India is governed by the SEBI Act, 1992 and SEBI (Venture Capital Fund) Regulations, 1996, which states that, any company or trust proposing to carry on activity of a Venture Capital Fund shall get a grant of certificate from SEBI. However, registration of Foreign Venture Capital Investors (FVCI) is not obligatory under the FVCI regulations. Venture Capital funds and Foreign Venture Capital Investors are also covered by Securities Contract (Regulation) Act, 1956, SEBI (Substantial Acquisition of Shares & Takeover) Regulations, 1997, SEBI (Disclosure of Investor Protection) Guidelines, 2000.

Institutional Set Up in India

The institutional set up of the Venture Capital firms is given in Figure 1.

Figure 1 : Institutional Set Up of Venture Capital Firms[17] in India



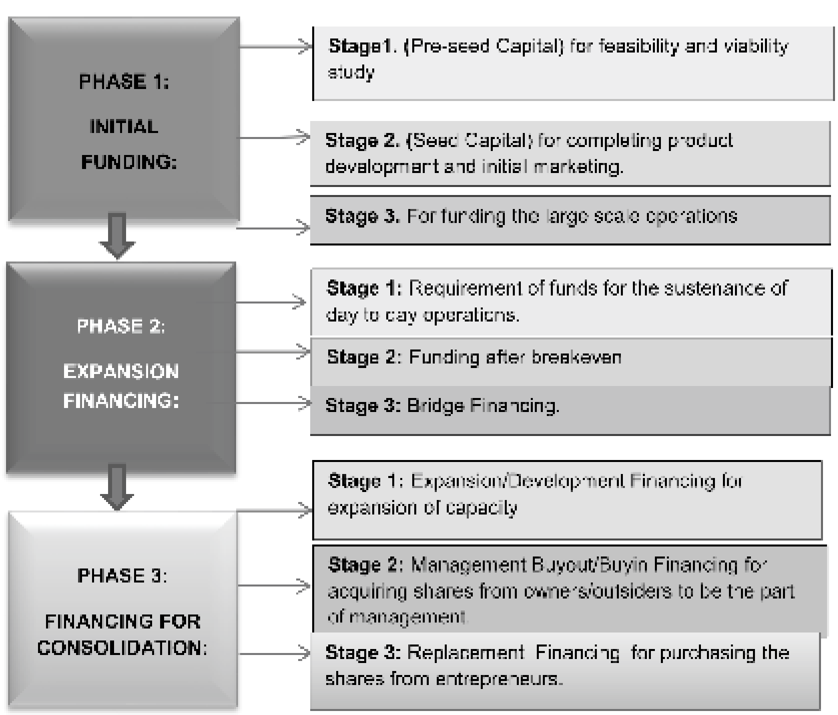
Source: Designed by Researchers

From figure 1, it can be inferred that the venture capital firms in India are diverse in nature and are in both public and private domain.

Role of Venture Capital

Initially VC firms were started with the investment interest of provision of start up capital to newer or small companies. A change is noticed in their aptitude as they now select the investees appropriate for different stages of entry to balance the time involved, acceptable level of risks and reward potential besides providing ongoing assistance. Figure 2 explains entrepreneurs 'need for VC at various stages:

Figure 2 : Entrepreneurial Needs and Venture Capital Financing



Source: Designed by the Researchers.

From the Figure 2, it can be inferred that from inception to consolidation phase, entrepreneurs require finance at every stage. The requirement may be different, e.g. amount of funds required for modernization is much larger than that for purchasing the materials. However, the risk element is much lower in phase 3 than in phase 1 and 2. Irrespective of degree of risk and quantum of finance, the entrepreneurs need support from venture capitalists until they stabilize themselves in the competitive environment. Many a times it is found that vulnerable ventures are given turnaround finance by the venture capitalists.

SIDBI and Venture Capital

SIDBI (Small Industries Development Bank of India) is a statutory company set up under an act of the Parliament in 1990 as the principal financial institution to meet the difficulties and increasing and varied needs of the growing MSME sector in India.

SIDBI, the main public financial institution involved in VC funding, operates through wholly owned subsidiary - SIDBI Venture Capital Ltd. (SVCL), set up to provide venture capital to emerging MSME sector[18]. SVCL, a venture capitalist for the entrepreneurs in the MSME sector, is selected for case study. A study of the operational aspect of this organization is dedicated for of SMEs and MSMEs may bring more visibility about the need for venture capital in supporting entrepreneurial activities in India.

SVCL - Venture Capital - Entrepreneurial Development

SVCL was incorporated in 1999 as a WOS of SIDBI with the following mission statement:

"*To catalyze entrepreneurship by providing capital and other strategic inputs for building businesses around growth opportunities and maximize returns on investment* "[19]

Currently (as on 31.3.2014) SVCL has four designated funds namely National Venture Fund for Software and Technology (NFSIT), SME Growth Fund (SGF), India Opportunities Fund (IOF) and Samridhi Fund (SF).

The functioning of SVCL entails a partnership with the entrepreneur. The working may be summarized as follows:

- Viability/ feasibility of the business idea is studied carefully. Project is selected based on promoters, management team, organization of the business, sector specific policies to ensure deployment of funds in promising projects.
- Risk analysis of the proposed projects which includes: Product risk, Market risk, Technological risk and Entrepreneurial risk. The final decision is taken in terms of the expected risk-return trade-off.
- A deal is structured to provide risk finance to the investees in the form of financial instruments –equity and quasi-equity instruments.
- Active role is played in the management of the company by appointing a nominee in the Board as well as provide the expertise and qualities of a good banker, technologist, planner and manager - a value addition to the company in terms of knowledge, experience and contact base.
- Regular follow up in the form of quarterly reports is kept to keep themselves updated.

Overview of Operations of SVCL:

The latest status of the funds set up by SVCL as on 2013-14 is presented in the following Table 1 gives a birds eye view of operational aspects of SVCL.

Table 1 : Operations of SVCL at a Glance

	Fund Name	NFSIT	SGF	IOF	SF
1.a	Established in	1999 - 2000	2004 - 2005	2011 - 2012	2013 - 2014
b	Closure on/Term	2016.	2012, but extended upto Sept.2014.	2021.	7 years
2.	Objectives	To support unlisted SME enterprises by way of equity and equity linked instruments.	To focus on the growth stage SMEs.	As sector agnostic fund, it focuses on meeting growth capital needs of growing and unlisted MSMEs.	To provide capital to social enterprises which can deliver both financial and social returns to 8 poorly developed states in India.
3.	Contributors	Contributed by Ministry of Communication and Information Technology, IDBI, SIDBI.	Contributed by SIDBI and 8 scheduled commercial banks.	Contributed by SIDBI, LIC, Technology Development Board, Canara Bank and other leading SCBs and insurance co.s	Major contributors: Department for International Development (DFID), UK along with SIDBI, LIC, United India Insurance.
4.	Number of Investee Co.s	31; Rs. 84.4 crs	25; Rs. 456.09 crs.	9; Rs. 58 crores, besides commitment in 15 Co.s for Rs182 crs.	5; Rs.39 crores. besides commitment in 7 Co.s for Rs.111 crores.
5.	Sectors	IT industries, IT training, IT enabled services, Internet related businesses geographically spread all over the country.	Diverse: auto components textiles, life sciences, clean technologies, light engineering, services etc 63% of the funds to MSMEs and SSIs.	Emerging sectors such as educational services, IT/ ITES, agro based industries, logistics, clean technologies, light engineering, infrastructure etc.	Water and Sanitation, affordable health care, agriculture and allied services, clean energy, financial inclusion, skill building, education.
6.	Stage/Phase	Divested	Investment phase completed. Exited from 14 co.s	NA	NA
7.	Returns to Contributors	Rs.219 crs.	Rs.282.09 crores.	NA	NA
8.	Portfolio IRR	16.79%	16.86% on exited portfolios.	NA	NA
9.	Significance	Instrumental to establishment of hi-tech enterprises, creating jobs for technology work force, earning foreign exchange, establishment of environment friendly processes. Investee companies attracted over Rs.600 crs of foreign investment through foreign venture capital fund and acquisition by overseas companies	Investee companies attracted over Rs.1000 crs of foreign investment through foreign venture capital fund and acquisition by overseas companies.	NA	NA

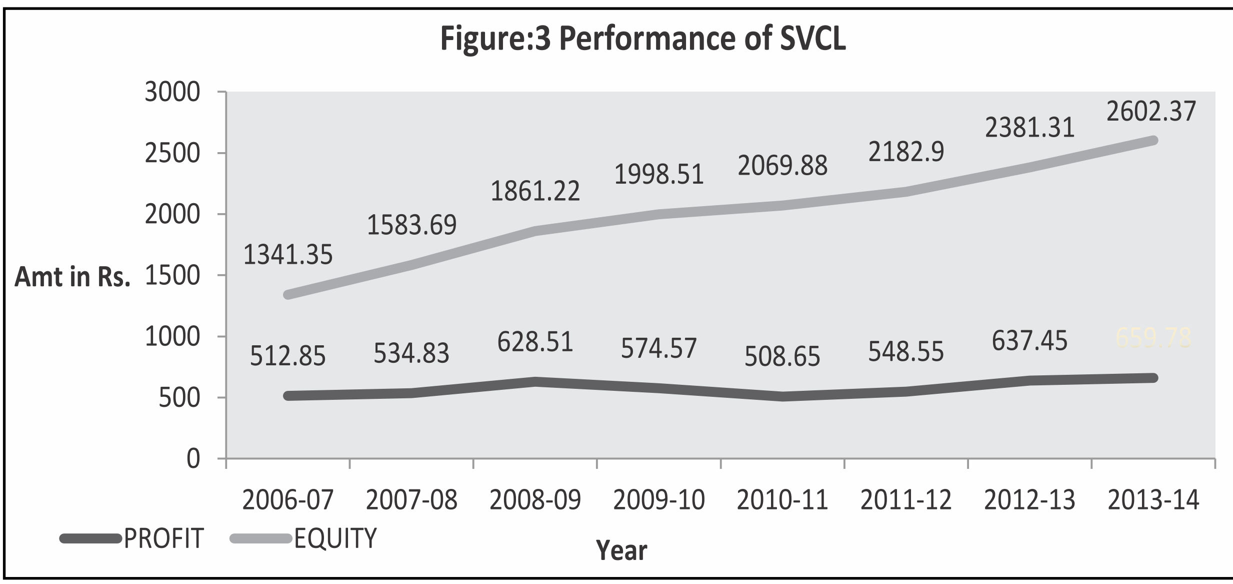
Note: NFSIT: National Venture Fund for Software and Technology, SGF: SME Growth Fund, IOF: India Opportunities Fund and SF: Samridhi Fund

Source: Adapted from the various Annual Reports of SIDBI, and website of SVCL

From the table, one can know that SVCL strives to achieve its goal of supporting the entrepreneurial initiatives during the period of study. A few names of entrepreneurs/enterprises who benefitted from their endeavor include Karrox Technologies Limited, Mumbai, Manthan Software Services Private Limited, Bangalore, Indus Teqsite Private Limited, Chennai from NFSIT, Basil Communications Private Limited, Bangalore, Champion Agro Limited, Rajkot, Direct Logistics India Private Limited, Mumbai by SGF, Autocal Solutions Private Limited, Mumbai, Avni Energy Solutions Private Limited, Bangalore, GEO Biotechnologies (India) Private Limited, MITCON Consultancy & Engineering Services Limited, Pune, Prasad NC Machine Systems Private Limited by IOF and Glocal Healthcare Systems Private Limited, Rite Water Solutions (India) Private Limited, Sahaj Inclusive Opportunities (India) Private Limited by SF.

Performance of SVCL:

A snapshot of performance of SVCL for the period 2006-07 to 2013-14 is presented below graphically.



Source: Developed by the researchers from the Annual Reports of SIDBI for the years from 2006-07 to 2013-14.

It is clear from the graph that there is a consistency in the performance, barring the period between the years 2009-10 to 2010-11. It also implies that SVCL is on a perfect roadmap and in the process of achieving mission.

Contribution

The research paper brings out the importance of venture capital as complementary source of funding for achieving the economic growth through the development of MSMEs and by improving the entrepreneurial skills.

Conclusion

The venture capital industry in India has really taken off. Promotion of venture capital activity can be effective in bringing the dream projects of the first-generation entrepreneurs into reality through the equity participation and participation in management. Due to its potential to promote innovation, enterprise and conversion of scientific technology and knowledge based ideas into commercial production, it can be also useful in other sectors such as bio-technology, pharmaceuticals and drugs, agriculture, food processing, telecommunications, services, etc. besides information technology.

Suggestions

To make a venture capital sector vibrant, the VC firms should be highly capitalized which means that a larger pool of funds from FVCI and all domestic institutional investors must be made. Due to the risk involved it should remain confined to sophisticated investors. There is a need to provide infrastructure and R&D facilities to VC firms and MSMEs.

Scope for Further Study

As developing entrepreneurial ability, the need of the hour, a systematic and well planned approach needs to followed. Research done in the following areas may be helpful:

- Problems and Needs of the Start Ups/ VC firms
- Performance of the Start Ups/ VC firms
- Performance of the public financial institution involved in VC funding
- Performance of the VC Funds in the private sector
- A comparative study of the performance of private sector and public financial institution involved in VC funding

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Institutions: They are promoted by the Central Government of the country. Examples: IFCI Venture Capital Funds, SIDBI Venture Capital Limited; State Development Finance Institutions: They are promoted by the state government/s. Examples: Hyderabad Information Technology Venture Enterprises Limited, Kerala Venture Capital Fund Private Limited, Gujarat Venture Finance Limited (GVFL); Commercial Banks: SBI Capital Markets Ltd and Canbank Venture Capital Fund are some of these kinds of VC funds; .Private Players: This category consists of Venture Capital funds promoted by Private Sector Companies. Examples: Infinity Venture India Fund, IL&FS Trust Company Limited (ITCL).II. Foreign Venture Capital Investors: Foreign venture capital investors can make direct investment in venture capital undertakings or through a domestic venture capital fund by taking FIPB / RBI approvals. This investment is long term and risk finance for start-up enterprises. Examples are Walden International Investment Group, SEAF India Investment and Growth Fund, BTS India Private Equity Fund Limited.

18. MSME is a sector beset with problems like non-availability of credit on suitable terms, poor response from the capital market/ banks, slow recovery of debts, weak bargaining power for obtaining raw materials, lack of/poor infrastructure facilities, old outdated machines, low level of technology, lack of skilled manpower etc. but has been a major contributor to the economic growth, entrepreneurial development, balanced regional growth and creation of employment opportunities.
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