# HSNC UNIVERSITY, MUMBAI

“VENTURE CAPITAL IN INDIA: A DETAILED OVERVIEW”

# MASTERS IN COMMERCE (Advanced

**Accountancy) (SEMESTER III) ACADEMIC YEAR: 2024-2025**

# SUBMITTED BY PREM PANCHAL

**ROLL NO- HSPMCAA032**

## H.R. COLLEGE OF COMMERCE AND ECONOMICS VIDYASAGAR PRINCIPAL K.M. KUNDNANI CHOWK 123, D.W. ROAD, CHURCHGATE,

**MUMBAI – 400 020**

## EXECUTIVE SUMMARY

Venture Capital is a private or institutional investment made into early-stage / start-up companies (new ventures). As defined, such ventures involve risk (having uncertain outcome) in the expectation of a sizeable gain. Venture Capital is money invested in businesses that are small; or exist only as an initiative, but have huge potential to grow. The people who invest this money are called venture capitalists (VCs).

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. It 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.

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. Though it can be risky for the investors who puts up the funds, the potential for above-average returns is an attractive payoff. For new companies or ventures that have a limited operating history (under two years), venture capital funding is increasingly becoming a popular – even essential – source for raising capital. The major downside is that the investors usually get equity in the company, and thus a say in company.

Venture Capital in India is provided as risk capital in form of shares, seed capital and other similar means. Financial institutes like ICICI have stepped into this and have their own venture subsidiaries. Apart from Indian investors, international companies too have settled in India financing large business This sector is replete with success stories of entrepreneurs creating disruption in areas as diverse as retail, technology, finance, education, classifieds, online tour agents, among several others. It gives valuable insights on how ― “unicorns” have been built within the space of five to ten years by people who have exhibited a knack for coming up with good ideas and the determination to follow through on them.

**OBJECTIVES OF THE STUDY**

* To understand the concept of venture capital:
1. Meaning and brief history of VCs
2. Its objective and vision
3. Its industry lifecycle in India
* To study the evaluation & need of venture capital industry in India.
* To understand the Venture Capital Spectrum
* To comprehend the process of Venture Capital investing and methods of venture capital financing
* To study exit routes for venture capitalists
* To understand the legal framework formulated by SEBI to encourage venture capital activity in Indian economy.
* To find out opportunities that encourage & threats that hinder the venture capital industry in India.

# SCOPE OF THE PROJECT

The scope of the research includes all type of venture capital firms whether setup as a company or a trust fund.

The research reviews the growing body of academic research on venture capital

Venture Capital basically means the professional asset management activity that invests funds raised from institutional investors, or wealthy individuals, into promising new ventures with a high growth potential. Therefore other forms of investments in companies by non-professional investors like business angels, other forms of financial intermediation that are targeted at different types of private companies, like buyouts, turnarounds, or mezzanine finance are excluded

This study mainly provides a comprehensive review of this academic literature, highlighting the main findings and pointing to some of the open issues.

It basically focuses on the following:

* + Understanding the working of venture capital funding.
	+ Studying about the evolution of the venture capital.
	+ Learning about the future of venture capital firms.
	+ Comprehending the role of legal regulations and frameworks to have a stable growth and development of this method of financing.
	+ Knowing about the probable opportunities and threats for this industry.

# PROBLEMS ANALYSED IN THE STUDY (HYPOTHESIS)

Hypothesis is the principal instrument in research. Its main function is to suggest new experiments and observations. There are two types of hypothesis. They are null hypothesis and alternative hypothesis stating two contradictory propositions. A detailed study is then carried out to prove one of the two hypotheses right.

**HYPOTHESIS 1:**

H0: Economic and Social factors like GDP, Inflation, Age, etc. have an impact on the Venture Capital Industry

H1: Economic and Social factors like GDP, Inflation, Age, etc. have no impact on the Venture Capital Industry

**HYPOTHESIS 2:**

H0: The total value of Venture Capital Investments has grown more than double in the past 10 yrs. H1: The total value of Venture Capital Investments has not grown more than double in the past 10 yrs.

**HYPOTHESIS 3:**

H0: The Venture Capital Industry is attractive H1: The Venture Capital Industry is not attractive

**HYPOTHESIS 4:**

H0: Various opportunities and threats have a positive and/or negative impact on the existing business of a Venture Capital firm

H1: Opportunities and threats have no impact on the existing business of a Venture Capital firm.

# LIMITATIONS

* A study of this type cannot be without limitations. It has been observed that venture capitals are very secretive about their investments. This attitude is a major hindrance for data collection.
* Problems regarding infrastructure details of production, plant location, accessibility, relationship with the suppliers and creditors, transportation facilities, labor availability etc. are present
* Availability of funds is very low in the market due to Limited infrastructure, low foreign investment and other transitional problems,
* Uncertainty regarding the success of the product in the market.
* As there is requirement of an experienced management team, Due to unavailability of experienced and skilled people it is difficult to analyze the future growth of the product in the market.
* Government has taken all the Initiatives in formulating policies to encourage investors and entrepreneurs. A government policy has many rules and regulation that can create problems in allocating the fund to the Organizations.
* Initiatives of the SEBI to develop a strong and vibrant capital market has led to several stringent rules. Due to the many rules and regulations from SEBI organizations face difficulties at the time of entering in the market.
* Problem regarding requirement of an above average rate of return on investment and also longer payback period. The returns on investment are high but the probability of fund return is dependent on the product success in the future.

# LITERATURE REVIEW

**Groh, A. P. and Von Liechtenstein, H. (2011),** contributed to the knowledge of the capital flow from institutional investors via venture capital (VC) funds as intermediaries to their final destination, entrepreneurial ventures. They found the top criteria to be the expected deal flow and access to transactions, a VC fund's historic track record, entrepreneur local market experience, the match of the experience of team members with the proposed investment strategy, the team's reputation, and the mechanisms proposed to align interest between the investors and the VC funds.

**Selvakumar and Ketharaj, (2009)** has given the inherent strength by way of its human capital, technical skills, cost-competitive workforce, research and entrepreneurship. India can unleash a revolution of wealth creation and rapid economic growth in a sustainable manner. There is a need for risk finance and venture capital environment which can leverage innovation, promote high-fi technology and harness knowledge based ideas.

**Subbulakshami (2014)** has published an edited volume on venture capital industry in India. The book compiles various research articles in relation to the role of venture capital in fostering entrepreneurship leading to overall economic growth. The origin and the regulatory framework of Indian venture capital industry as well as the development of venture capital in US, Taiwan and China.

**Kumar and Kaura (2003)** this study found out that a sustained effort was continuously required in the target market which was highly meticulous. This research concluded that Indian venture capitalists do not seemed to be biased in favour of high technology ventures and also the numbers of successful ventures were not hi-tech.

**Mason and Harrison; (1999), Mishra et al.; (2005)** venture capital plays a key role in the entrepreneurial process by providing equity capital and managerial support for young, rapidly growing, high risk and high tech private companies with the potential to develop into significant global businesses.

# RESEARCH METHODOLOGY

Research Methodology is a way to systematically solve research problems. In it, step- by-step methods are followed to solve a particular problem. It refers to a search for knowledge. It can also be defined as a scientific and systematic search for pertinent information on a specific topic.

The study is carried out around different sources of data regarding Venture Capital Finance in India. The data is analysed using different functions of Microsoft Office Excel 2007 and Microsoft Office Word 2007. It is a descriptive diagnostic type of research. Both qualitative and quantitative research is done. It is based on primary data and secondary data collected from the published material.

Primary Research is the first hand research that the researcher collects, by interacting with the sample population and finding the conclusions and analysis he/she draws from the data that has been obtained.

Secondary Research the background research done by the researcher regarding the topic on information that is already existing. Secondary research in this project involved reading and examining various research papers, journals and books

Data was collected by following method:

Primary data: Primary data was collected through interview and discussions with the Vice President of a leading firm majorly financed by a renowned Venture Capital firm and seeking an understanding towards the growth and overall development of the firm

Secondary data: Books, research paper, Internet etc. were used for collecting secondary data which helps to know more about the research topic at hand and basically get a gist of the existing information on that topic.

Secondary data: Books, research paper, Internet etc. were used for collecting secondary data which helps to know more about the research topic at hand and basically get a gist of the existing information on that topic.

**Farmako Survey**

Farmako founded by Aman Bhandula, Keshu Sahu and Nikhil Kumar is India’s first centralized E-healthcare system that connects patients directly to specialized doctors both online and offline based on their needs and uses an automated software engine to simultaneously store the customers health related data which is easily accessible to their patients and can also be shown as a record of the patient. This start up is currently being funded by Y combinator which is one of India’s best venture capitalists.

### Interview Questions: Farmako

**Question: What are the opportunities where Farmako can augment its services based on the customer’s consumption pattern?**

Augmentation will be done using services like door-to-door medicine delivery provided by our delivery team, prescription recommendations for the patients and also pre-set as well as customizable reminders for medicine intake and prescheduled doctor appointments and internationalisation of medicine database continuously analysing and studying customer patterns in different sectors and age groups to provide best possible recommendations and services.

### Question: What was your company’s journey prior to being funded by investors through Y combinator?

Prior to Y Combinator, Farmako was majorly run with the support of IIT Roorkee professors, administration and the director (Dr. Ajay Bajaj) of Fortis Mumbai.

### Question: What can we expect from you and your company in the next few years in terms of advertising, public relations and other marketing strategies?

You can expect a whole lot of things like Brand ambassadors, blitzscale expansion and hiring, and we are currently working on social media outreach, growth and HR team recruitment panel, possible partnership with government and a health and fitness team that provides daily exercise and diet routines for our customer for better overall health. We expect to be through with most of these strategies in the next few years.

### Question: Since your company requires more investments to be made, What kind of preparation do you put in before pitching your start up to investors? Does this pitch vary from investor to investor?

We review pitch from various startups to understand and maintain a level of professionalism for the pitch. We are also helped in this by other founders who take interview practices from us and help us portray our company to its full potential to the investors. Discussions and communications with customers about our product also helps in this matter. Other than that Business analysis of our idea, monetization and scalability of Farmako. Our pitches to investors are personalized pitch based on their previous areas of work, investments, idealogy to make them understand why the idea is important and has great potential on both national as well as global level.

### Question: How has the ongoing pandemic of Covid-19 affected your work, targets and goals in the last year? What changes did you make to adapt to this unforeseen satiation?

Our team got completely scattered in the work from paradigm. We also faced a lot of difficulties in setting up our new office in Delhi due to the strict rules and regulations posed by the government, moving nationally as well as internationally for business meets became near to impossible for almost the whole year. Recruiting and managing new recruits and interns was also a difficult job again due to work from home. Pitching our company to investors was much less effective when done online.

ADAPTATIONS

After dealing with a lot of trouble first hand we managed to setup our work-office in Noida. Used online servers and hosted services side by side with more PaaS solutions to counter the physical presence demand. Using trending platforms like Clubhouse helped us with social media outreach

### Question: What about revenues? How do you see Farmako contributing to a regular flow of income?

Revenue will be generated through sale of medicine and listing-partnering-softwareselling with labs, hospitals and clinics. Since medicine is a fix demand product the income flow will always see a steady growth provided our service influence more and more people to become our valuable customers and a part of the farmako family.

### Question: To what extent do you plan to impact the expenses related to healthcare in particular?

1. Reduce expenses by storing records in one place thereby reducing the repitiveness of similar tests which are usually quite expensive and hold a major part when it comes to the total expense for any disease
2. Medicine at discounted rates
3. B2B with doctors to help setup software management and medicine inventory helps them start with low investment so they can charge patients lesser and beat competition which will in turn start a chain reaction to decrease the overall cost of consultation and prescription

## CONCEPT OF VENTURE CAPITAL

The term venture capital comprises of two words that is, ‘Venture‖’ and ‘capital‖’.

* Venture is a course of processing the outcome of which is uncertain but to which is attended the risk or danger of Loss.
* Capital‖ means recourses to start an enterprise. To connote the risk and adventure of such a fund, the generic name Venture Capital was coined.

Venture capital is considered as financing of high and new technology based enterprises. It is said that Venture capital involves investment in new or relatively untried technology, initiated by relatively new and professionally or technically qualified entrepreneurs with inadequate funds. The conventional financiers, unlike Venture capitals mainly finance proven technologies and established markets.

However, high technology need not be prerequisite for venture capital.

Venture capital has also been described as ‗unsecured risk financing‘. The relatively high risk of venture capital is compensated by the possibility of high return usually through substantial capital gains in term. Venture capital in broader sense is not solely an injection of funds into a new firm, it is also an input of skills needed to set up the firm, design its marketing strategy, organize and manage it. Thus it is a long term association with successive stages of company‘s development under highly risky investment condition with distinctive type of financing appropriate to each stage of development. Investors join the entrepreneurs as co-partners and support the project with finance and business skill to exploit the market opportunities.

Venture capital is not a passive finance. It may be at any stage of business/ production cycle, that is start- up, expansion or to improve a product or process, which are associated with both risk and reward. The Venture capital gains through appreciation in the value of such investment when the new technology succeeds. Thus the primary return sought by the investor is essentially capital gain rather than steady interest income or dividend yield.

The most flexible Definition of Venture Capital is:-

“The support by investors of entrepreneurial talent with finance and business skills to exploit market opportunities and thus obtain capital gains.”

Venture capital commonly describes not only the provision of start-up finance or ‘seed corn’ capital but also development capital for later stages of business. A long term commitment of funds is involved in the form of equity investments, with the aim of eventual capital gains rather than income and active involvement in the management of customer‘s business.

### FEATURES OF VENTURE CAPITAL

* **High-risk investment:** It is highly risky and the chances of failure are much higher as it provides long-term startup capital to high risk-high reward ventures.
* **High Tech projects**: Generally, venture capital investments are made in high tech projects or areas using new technologies as they have higher returns.
* **Participation in Management**: Venture Capitalists act complementary to the entrepreneurs, for better or worse, in making decisions for the direction of the company.
* **Length of Investment**: The investors eventually seek to exit in three to seven years. The process takes several years for having significant returns and also need the talent of venture capitalist and entrepreneurs to reach completion.
* **Illiquid Investment**: It is an investment that is not subject to repayment on demand or a repayment schedule.

## NEED AND RELEVANCE OF VENTURE CAPITAL IN INDIA

In India, a revolution is ushering in a new economy, wherein entrepreneurs mind set is taking a shift from risk averse business to investment in new ideas which involve high risk. The conventional industrial finance in India is not of much help to these new emerging enterprises. Therefore there is a need of financing mechanism that will fit with the requirement of entrepreneurs and thus it needs venture capital industry to grow in India. It is normal for an entrepreneur or inventor of a new product /process to set up company to produce and market the product by obtaining finance through the sale of company shares to Venture Capital Funds which are readily willing to share the risk in return for future gains.

* Promotes Entrepreneurs: Just as a scientist brings out his laboratory findings to reality and makes it commercially successful, similarly, an entrepreneur converts his technical know-how to a commercially viable project with the assistance of venture capital institutions.
* As Catalyst: A venture capital institution acts as more as a catalyst in improving the financial and managerial talents of the borrowing concern. The borrowing concerns will be keener to become self- dependent and will take necessary measures to repay the loan.
* Creates more employment opportunities: By promoting entrepreneurship, venture capital institutions are encouraging self-employment and this will motivate more educated unemployed to take up new ventures which have not been attempted so far.
* Helps technological growth: Modern technology will be put to use in the country when financial institutions encourage business ventures with new technology.
* Helps development of backward areas: By promoting industries in backward areas, venture capital institutions are responsible for the development of the backward regions and human resources.
* Helps growth of economy: By promoting new entrepreneurs and by reviving sick units, a fillip

is given to the economic growth. There will be increase in the production of consumer goods which improves the standard of living of the people.

## THE VENTURE CAPITAL SPECTRUM/STAGES

The growth of an enterprise follows a life cycle as shown in the diagram below. The requirements of funds vary with the life cycle stage of the enterprise. Even before a business plan is prepared the entrepreneur invests his time and resources in surveying the market, finding and understanding the target customers and their needs. At the seed stage the entrepreneur continue to fund the venture with his own fund or family funds. At this stage the fund are needed to solicit the consultant‘s services in formulation of business plans, meeting potential customers and technology partners. Next the funds would be required for development of the product/process and producing prototypes, hiring key people and building up the managerial team. This is followed by funds for assembling the manufacturing and marketing facilities in that order. Finally the funds are needed to expand the business and attaint the critical mass for profit generation. Venture capitalists cater to the needs of the entrepreneurs at different stages of their enterprises. Depending upon the stage they finance, venture capitalists are called angel investors, venture capitalist or private equity supplier/investor.

Venture capital was started as early stage financing of relatively small but rapidly growing companies. However various reasons forced venture capitalists to be more and more involved in expansion financing to support the development of existing portfolio companies. With increasing demand of capital from newer business, venture capitalists began to operate across a broader spectrum of investment interest. This diversity of opportunities enabled venture capitalists to balance their activities in term of time involvement, risk acceptance and reward potential, while providing ongoing assistance to developing business.

### How Venture Capital industry works

**Figure 1. Start-up Financing Cycle**

Different Venture capital firms have different attributes and aptitudes for different types of Venture capital investments. Hence there are different stages of entry for different venture capitalists and they can identify and differentiate between types of venture capital investments, each appropriate for the given stage of the investee company, these are:-

### Early stage Finance

* 1. Seed capital
	2. Start-up Capital
	3. Early/First Stage Capital
	4. Later/Third Stage capital

### Later Stage Finance

1. Expansion/Development Stage Capital
2. Replacement Finance
3. Management Buy Out and Buy Ins
4. Turnarounds
5. Mezzanine/Bridge Finance

Not all business firms pass through each of these stages in sequential manner. For instance seed capital is normally not required by service based ventures. It applies largely to manufacturing or research based activities. Similarly second round finance does not always follow early stage finance. If the business grows successfully it is likely to develop sufficient cash to fund its own growth, so does not require venture capital for growth.

The table below shows risk perception and time orientation for different stages of venture capital financing.

|  |  |  |  |
| --- | --- | --- | --- |
| F**inancing Stage** | **Period** | **Risk perception** | **Activity to be financed** |
| Early stage finance | 7-10 | Extreme | For supporting a concept or idea or R & D for product development |
| Start up | 5-9 | Very high | Initializing operations or developing prototypes |
| First stage | 3-7 | High | Start commercial production and marketing |
| Second stage | 3-5 | Sufficiently high | Expand market & growing working capital need |
| Later stage finance | 1-3 | Medium | Market expansion, acquisition & product development for profit making company |
| Buy out-in | 1-3 | Medium | Acquisition financing |
| Turnaround | 1-3 | Medium to high | Turning around a sick company |
| Mezzanine | 1-3 | Low | Facilitating public issue |

### Table 1: Risk Perception and Time Orientation for Different Stages of VC Financing

1. **Seed Capital**

It is an idea or concept as opposed to a business. European venture capital association defines seed capital as ―The financing of the initial product development or capital provided to an entrepreneur to prove the feasibility of a project and to qualify for start-up capital.

The characteristics of the seed capital may be enumerated as follows:

* Absence of ready product market
* Absence of complete management team
* Product/process still in R & D stage
* Initial period/licensing stage of technology transfer

Broadly speaking seed capital investment may take 7 to 10 year to achieve realization. It is the earliest and therefore riskiest stage of Venture capital investment. The new technology and innovations being attempted have equal chance of success and failure. Such projects, particularly hi-tech, projects sink a lot of cash and need a strong financial support for their adaptation, commencement and eventual success. However, while the earliest stage of financing is fraught with risk, it also provides greater potential for realizing significant gains in long term. Typically seed enterprises lack asset base or track record to obtain finance from conventional sources and are largely dependent upon entrepreneur‘s personal resources. Seed capital is provided after being satisfied that the entrepreneur has used up his own resources and carried out his idea to a stage of acceptance and has initiated research. The asset underlying the seed capital is often technology or an idea as opposed to human assets (a good management taem0 so often sought by venture capitalists.

### Volume of Investment Activity

It has been observed that Venture capitalist seldom make seed capital investment and these are relatively small by comparison to other forms of Venture finance. The absence of interest in providing a significant amount of seed capital can be attributed to the following three factors:-

* Seed capital projects by their very nature require a relatively small amount of capital. The success or failure of an individual seed capital investment will have little impact on the performance of all but the smallest venture capital investments. This is because the small investments are seen to be cost inefficient in terms of time required to analyze structure manage them.
* The time horizon to realization for most seed capital investment is typically 7-10 years which is longer than all but most long-term oriented investors will desire.
* The risk of product and technology obsolescence increases as the time to realization I extended. These types of obsolescence are particularly likely to occur with high technology investments particularly in the fields related to Information Technology.

### Start Up Capital

It is stage second in the venture capital cycle and is distinguishable from seed capital investments. An entrepreneur often needs finance when the business is just starting. The start-up stage involves starting a new business. Here in the entrepreneur has moved closer towards establishment of a going concern.

Here in the business concept has been fully investigated and the business risk now becomes that of turning the concept into product.

Start-up capital is defined as; ―Capital needed to finance the product development, initial marketing and establishment of product facility.

The characteristics of start-up capital are:-

* **Establishment of company or business:** the company is either being organized or is established recently. New business activity could be based on experts, experience or a spin-off from R & D.
* **Establishment of most but not all the members of the team:** the skills and fitness to the job and situation of the entrepreneur‘s team is an important factor for startup finance.
* **Development of business plan or idea:** the business plan should be fully developed yet the acceptability of the product by the market is uncertain. The company has not yet started trading..

In the start-up preposition Venture capitalists ‘investment criteria shifts from idea to people involved in the venture and the market opportunity. Before committing any finance at this stage, venture capitalist however, assesses the managerial ability and the capacity of the entrepreneur, besides the skills, suitability and competence of the managerial team are also evaluated. If required they supply managerial skill and supervision for implementation. The time horizon for start-up capital will be typically 6 or 8 years. Failure rate for start-up is 2 out of 3. Start-up needs funds by way of both first round investment and subsequent follow-up investments. The risk tends to be lower relative to seed capital situation. The risk is controlled by initially investing a smaller amount of capital in start-ups. The decision on additional financing is based upon the successful performance of the company. However, the term to realization of a start-up investment remains longer than the term of finance normally provided by the majority of financial institutions. Longer time scale for using exit route demands continued watch on start-up projects.

### Volume of Investment Activity

Despite potential for secular returns most venture firms avoid investing in start-ups. One reason for the paucity of start up financing may be high discount rate that venture capitalist applies to venture proposals at this level of risk and maturity. They often prefer to spread their risk by sharing the financing. Thus syndicates of investor‘s often participate in start-up finance.

### Early Stage Finance

It is also called first stage capital is provided to entrepreneur who has a proven product, to start commercial production and marketing, not covering market expansion, de-risking and acquisition costs. At this stage the company passed into early success stage of its life cycle. A proven management team is put into this stage, a product is established and an identifiable market is being targeted.

British Venture capital Association has vividly defined early stage finance as: ―Finance provided to companies that have completed the product development stage and require further funds to initiate commercial manufacturing and sales but may not be generating profits.

The characteristics of early stage finance may be:-

* Little or no sales revenue.
* Cash flow and profit still negative.
* A small but enthusiastic management team which consists of people with technical and specialist background and with little experience in the management of growing business.
* Short term prospective for dramatic growth in revenue and profits.

The early stage finance usually takes 4 to 6 years’ time horizon to realization. Early stage finance is the earliest in which two of the fundamentals of business are in place i.e. fully assembled management team and a marketable product. A company needs this round of finance because of any of the following reasons:-

* Project overruns on product development.
* Initial loss after startup phase.

The firm needs additional equity funds, which are not available from other sources thus prompting venture capitalist that, have financed the start-up stage to provide further financing. The management risk is shifted from factors internal to the firm (lack of management, lack of product etc.) to factor external to the firm (competitive pressures, in sufficient will of financial institutions to provide adequate capital, risk of product obsolescence etc.)

At this stage, capital needs, both fixed and working capital needs are greatest. Further, since firms do not have foundation of a trading record, finance will be difficult to obtain and so venture capital particularly equity investment without associated debt burden is key to survival of the business

### Second stage Finance

It is the capital provided for marketing and meeting the growing working capital needs of an enterprise that has commenced the production but does not have positive cash flows sufficient to take care of its growing needs. Second stage finance, the second trench of Early Stage Finance is also referred to as follow on finance and can be defined as the provision of capital to the firm which has previously been in receipt of external capital but whose financial needs have subsequently exploded. This may be second or even third injection of capital.

The characteristics of a second stage finance are:

* A developed product on the market
* A full management team in place
* Sales revenue being generated from one or more products
* There are losses in the firm or at best there may be a breakeven but the surplus generated is insufficient to meet the firm‘s needs.

Second round financing typically comes in after start up and early stage funding and so have shorter time to maturity, generally ranging from 3 to 7 years. This stage of financing has both positive and negative reasons.

Negative reasons include:

* Cost overruns in market development
* Failure of new product to live up to sales forecast.
* Need to re-position products through a new marketing campaign
* Need to re-define the product in the market place once the product deficiency is revealed.

Positive reasons include:

* Sales appear to be exceeding forecasts and the enterprise needs to acquire assets to gear up for production volumes greater than forecasts.
* High growth enterprises expand faster than their working capital permit, thus needing additional finance. Aim is to provide working capital for initial expansion of an enterprise to meet needs of increasing stocks and receivables

It is additional injection of funds and is an acceptable part of venture capital. Often provision for such additional finance can be included in the original financing packages as an option, subject to certain management performance targets.

### Later Stage Finance

It is called third stage capital is provided to an enterprise that has established commercial production and basic marketing set-up, typically for market expansion, acquisition product development etc. it is provided for market expansion of the enterprise.

The enterprises eligible for this round of finance have following characteristics:

* Established business, having already passed the risky early stage.
* Expanding high yield, capital growth and good profitability.
* Reputed market position and an established formal organization structure.

“Funds are utilized for further plant expansion, marketing, working capital or development of improved products.” Third stage financing is a mix of equity with debt or subordinate debt. As it is half way between equity and debt in US it is called ―mezzanine‖ finance. It is also called last round of finance in run up to the trade sale or public offer.

Venture capitalists prefer later stage investment Vis a Vis early stage investments, as the rate of failure in later stage financing is low. It is because firms at this stage have a past performance data, track record of management, established procedures of financial control. The time horizon for realization is shorter, ranging from 3 to 5 years. This helps the venture capitalists to balance their own portfolio of investment as it a running yield to venture capitalists. Further the loan component in third stage finance provides tax advantage and superior return to the investors.

There are four sub divisions of later stage finance:

### Expansion/ Development finance

An enterprise established in a given market increases its profit exponentially by achieving the economies of scale. This expansion can be achieved either through an organic growth, that is by expanding production capacity and setting up proper distribution system or by way of acquisitions. Anyhow, expansion needs finance and venture capitalists support both organic growth as well as acquisitions for expansion.

At this stage the real market feedback is used to analyse competition. It may be found that the entrepreneur needs to develop his managerial team for handling growth and managing a larger business.

Realization horizon for expansion/development investment is one to three years. It is favoured by venture capitalist as it offers higher rewards in shorter period with lower risk. Funds are needed for new or larger factories and warehouses, production capacities, developing improved or new products, developing new markets or entering exports by enterprise with established business that has already achieved break even and has started making profits.

### Replacement Finance

It means substituting one shareholder for another, rather than raising new capital resulting in the change of ownership pattern. Venture capitalist purchase share from the entrepreneurs and their associates enabling them to reduce their shareholding in unlisted companies. They also buy dividend coupon. Later, on sale of the company or its listing on stock exchange, these are re-converted to ordinary shares. Thus Venture capitalist makes a capital gain in a period of 1 to 5 years.

### Buy-out / Buy-in Financing

It is a resent development and a new form of investment by venture capitalist. The funds provided to the current operating management to acquire or purchase a significant shareholding in the business they manage are called management buyout. Management Buy-in refers to the funds provided to enable a manager or a group of managers from outside the company to buy into it.

It is the most popular form of venture capital amongst stage financing. It is less risky as venture capitalist in invests in solid, ongoing and more mature business. The funds are provided for acquiring and revitalizing an existing product line or division of a major business. MBO (Management buyout) has low risk as enterprise to be bought have existed for some time besides having positive cash flow to provide regular returns to the venture capitalist, who structure their investment by judicious combination of debt and equity. Of late there has been a gradual shift away from start-up and early finance towards MBO opportunities. This shift is because of lower risk than start up investments.

### Turnaround Finance

It is rare form later stage finance which most of the venture capitalist avoid because of higher degree of risk. When an established enterprise becomes sick, it needs finance as well as management assistance for a major restructuring to revitalize growth of profits. Unquoted company at an early stage of development often has higher debt than equity; its cash flows are slowing down due to lack of managerial skill and inability to exploit the market potential. The sick companies at the later stages of development do not normally have high debt burden but lack competent staff at various levels. Such enterprises are compelled to relinquish control to new management. The venture capitalist has to carry out the recovery process using hands on management in 2 to 5 years. The risk profile and anticipated rewards are akin to early stage investment.

### Bridge Finance

It is the pre-public offering or pre-merger/acquisition finance to a company. It is the last round of financing before the planned exit. Venture capitalist help in building a stable and experienced management team that will help the company in its initial public offer. Most of the time bridge finance helps improves the valuation of the company. Bridge finance often has a realization period of 6 months to one year and hence the risk involved is low.

## CONCLUSION

Venture capital plays a transformative role in fostering entrepreneurship, driving technological advancement, and enhancing economic growth. In India, it has become an essential mechanism for supporting innovative startups and high-growth ventures that traditional financing methods often overlook. The study highlighted the diverse spectrum of venture capital financing stages, from seed funding to later-stage investments, emphasizing its role in enabling businesses to scale sustainably.

Despite challenges such as regulatory hurdles and limited infrastructure, the venture capital ecosystem in India has shown remarkable resilience and growth, catalyzing the creation of successful enterprises. By bridging the gap between innovative ideas and financial resources, venture capitalists contribute significantly to the development of industries and the economy at large.

Future growth in the sector depends on collaborative efforts from regulatory authorities, investors, and entrepreneurs to overcome existing challenges and leverage emerging opportunities. With continued support, venture capital can act as a cornerstone for innovation, employment generation, and sustainable economic progress in India.

## REFERENCES

 Books:

 - Taneja Satish, ―Venture Capital In India‖, Galgotia Publishing Company, 2002, pg 1 – 44.

 - Chary T Satyanarayana, ―Venture Capital – Concepts & Applications‖, Macmillian India Ltd,

2005, pg 19 – 22. - Thompson Arthur, Strickland A J, Gamble John E, Jain Arun K, ―Crafting & Executing

Strategy – The Quest for Competitive Advantage‖, Tata McGraw Hill, 2006, pg 44 – 80. - Click – The Amazing Story of India‘s E- commerce Boom and Where It‘s Headed.

Magazines:

 - Sharma Kapil, An Analysis of Venture Capital Industry in India, ICFAI Reader, April 2007, pg

37 – 43.

Reports:

 - Trends of Venture Capital in India, survey Report by Deloitte, 2007.

 - Global Trends of Venture Capital, survey report by Deloitte, 2007.

Websites:

 - https://www.phocuswire.com/History-and-evolution-of-venture-capital

 - http://shodhganga.inflibnet.ac.in/bitstream/10603/150193/12/10\_chapter%201.pdf

 - https://www.edupristine.com/blog/venture-capital