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An Study of Metamorphosis of Venture Capital Financing in Indian Financial Market

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Abstract

Venture capital funds (VCF) are investment funds that manage the money of investors who seek private equity stakes in startup and small- to medium-sized enterprises with strong growth potential. It is provided in the interest of generating a return on investment through an eventual realization event such as an IPO or trade sale of the company. To start a new startup company or to bring a new product to the market, the venture needs to attract funding. There are several categories of financing possibilities. Smaller ventures sometimes rely on family funding, loans from friends, personal bank loans or crowd funding. In July 2016, the Financial Post reported that according to a report by PricewaterhouseCoopers and the National Venture Capital Association, venture-capital funding in Silicon Valley fell 20% in the second quarter from a year earlier, there is turned out to be a mixed bag for India in term of private equity and venture capital investments. The volume and value of these investments in 2016 decreased by 25% and 39% respectively compared to the year before, said a KPMG India report. Therefore Venture Capitalists in India are biased toward technology companies with 68.0% of investments made in this sector. Other sectors include healthcare and education accounting for 9.0% and 7.0% of total investments respectively. The VC industry in India has had a somewhat frustrating run. With too much money chasing too few deals, Indian venture capital is struggling. Venture Capital firms invested over 206 deals in India during 2013, registering a fall of about 18 percent over the corresponding period a year ago. Of the 184 exits in the Industry, the technology sector accounted for about 137 of them. This manuscript is based on expository study of venture capital financing India and based on secondary source of data collection apart from this it is try to perusal the impact of venture capital investment in different sector and Venture Capital and Foreign Venture Capital invested in different sector and discuss the VCF financing in India. Finally the paper concludes with practical suggestion to promote VCF in India.

Keywords: *Venture Capital Financing (VCF), Foreign Venture Capital Investors (FVCI), Angel investors, Private Equity, Obstacles and Growth.*

Introduction:

Venture capital is financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. For startups without access to capital markets, venture capital is an essential source of money. Risk is typically high for investors, but the downside for the startup is that these venture capitalists usually get a say in company decisions. Venture capital is long-term risk capital to finance high technology projects which involve risk but at the same time has strong potential for growth. Venture capitalist pools their resources including managerial abilities to assist new entrepreneurs in the early years of the project. Once the project the stage of profitability, they sell their equity holding at a high premium. Therefore venture capital providing company is form of financing institution which joins as entrepreneur as a co-promoter in a project and share the risk and rewards of the enterprise.

Venture capital (VC) is a type of private equity a form of financing that is provided by firms or funds to small, early-stage, emerging firms that are deemed to have high growth potential, or which have demonstrated high growth (in terms of number of employees, annual revenue, or both). Venture capital firms or funds invest in these early-stage companies in exchange for equity an ownership stake–in the companies they invest in. Venture capitalists take on the risk of financing risky start-ups in the hopes that some of the firms they support will become successful. The start-ups are usually based on an innovative technology or business model and they are usually from the high technology industries, such as information technology (IT), social media or biotechnology.

“Venture capital is the provision of risk-bearing capital, usually in the form of a participation in equity, to companies with high growth potential. In addition, the venture capital company provides some value-added in the form of management advice and contribution to overall strategy. The relatively high risks for the venture capitalists are compensated by the possibility of high return, usually through substantial capital gains in the medium term”.

The Origin of Venture Capital:

In the 1920's & 30's, the wealthy families of and individuals investors provided the startup money for companies that would later become famous. Eastern Airlines and Xerox are the more famous ventures they financed. Among the early VC funds set up was the one by the Rockfeller Family which started a special fund called VENROCK in 1950, to finance new technology companies. General Doriot, a professor at Harvard Business School, in 1946 set up the American Research and Development Corporation (ARD), the first firm, as opposed to a private individuals, at MIT to finance the commercial promotion of advanced technology developed in the US Universities. ARD's approach was a classic VC in the sense that it used only equity, invested for long term, and was prepared to live with losers. ARD's investment in Digital Equipment Corporation (DEC) in 1957 was a watershed in the history of VC financing. While in its early years vc may have been associated with high technology, over the years the concept has undergone a change and as it stands today it implies pooled investment in unlisted companies.

Venture capital in India

The activity of venture capital is done by developmental financial institution like: IDBI, ICICI and state financial corporation. These institutions promoted entities in the private sector with debt as an instrument of funding. For a long time funds raised from public were used as a source of Venture Capital. This source however depended a lot on the market vagaries. And with the minimum paid up capital requirements being raised for listing at the stock exchanges, it became difficult for smaller firms with viable projects to raise funds from public. In India, the need for Venture Capital was recognized in the 7th five year plan and long term fiscal policy of GOI. In 1973 a committee on Development of small and medium enterprises highlighted the need to faster VC as a source of funding new entrepreneurs and technology. VC financing really 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 (CFC) and promoted by Bank of India, Asian Development Bank and the Commonwealth Development Corporation viz. Credit Capital Venture Fund. At the same time Gujarat Venture Finance Ltd. and APIDC Venture Capital Ltd. were started by state level financial institutions. Sources of these funds were the financial institutions, foreign institutional investors or pension funds and high net-worth individuals.

Regulatory Framework of Venture Capital Industry in India :

In the absence of an organised venture capital industry, individual investors and development financial institutions have hitherto played the role of venture capitalists in India. Entrepreneurs have largely depended upon private placements, public offerings and lending by the financial institutions. In 1973, a committee on Development of Small and Medium Enterprises highlighted the need to foster venture capital as a source of funding new entrepreneurs and technology. Thereafter some public sector funds were set-up, but the activity of venture capital did not gather momentum as the thrust was on high technology projects funded on a purely financial rather than a holistic basis. Later, a study was undertaken by the World Bank to examine the possibility of developing venture capital in the private sector, based on which Government of India took a policy initiative and announced guidelines for venture capital funds (VCFs) in 1988. However, these guidelines restricted setting up of VCFs by the banks or the financial institutions only. Internationally, the trend favoured venture capital being set up by professionals, successful entrepreneurs and sophisticated investors willing to take high risk in the expectation of high returns, a trend that has continued to this decade. Thereafter, Government of India issued guidelines in September 1995 for overseas venture capital investment in India. While, for tax exemption purposes, guidelines have been issued by the Central Board of Direct Taxes (CBDT), the investments and flow of foreign currency into and out of India are governed by the Reserve Bank of India (RBI). Further, as a part of its mandate to regulate and to develop the Indian securities markets, SEBI under Sec 12 of SEBI Act 1992 framed SEBI (Venture Capital Funds) Regulations, 1996. Thus, there were three sets of Regulations dealing with venture capital activity i.e. SEBI (Venture Capital Regulations) 1996, Guidelines for Overseas Venture Capital Investments issued by Department of Economic Affairs in the Ministry of Finance in the year 1995, and CBDT Guidelines for Venture Capital Companies issued in 1995, which were later modified in 1999. Therefore, there was a need to consolidate all these into one single set of regulations to provide for uniformity and hassle free single window clearance. Thereafter, based on recommendations of the K.B. Chandrasekhar Committee, which was set up by SEBI during the year 1999-2000, Guidelines for Overseas Venture Capital

Investment in India were withdrawn by the Government in September 2000, and SEBI was made the nodal regulator for VCFs to provide a uniform, hassle free, single window regulatory framework. SEBI also notified regulations for foreign venture capital investors. On the pattern of foreign institutional investors (FIIs), Foreign Venture Capital Investors (FVCIs) were also to be registered with SEBI.

Objective of the Study: In India the venture capital financing play the vital in the development and growth of innovative enterprises. Present study is undertaken to focus on the following issues related with VCF in India:

1. To give an overview of Venture Capital Financing and their role in Indian Financial market.
2. To study the impact of investment and current position of VCF in India.
3. An attempt is made to perusal the SEBI registered VCF and FVCI in India.
4. To discuss the obstacles in Venture Capital Financing in India.
5. Finally give the conclusion and suggestions concerning the study under review.

Research Methodology: It is an expository study and for the amenity of the study the data has been extracted from the secondary sources like journals, articles, various research based websites, and the published report of Indian Venture Capital Association (IVCA) etc.

The Stages in Venture Capital (VC) Investing

Angel investors are most often individuals (friends, relations or entrepreneurs) who want to help other entrepreneurs get their businesses off the ground - and earn a high return on their investment. The term "angel" comes from the practice in the early 1900s of wealthy businessmen investing in Broadway productions. Usually they are the bridge from the self-funded stage of the business to the point that the business needs true venture capital. Angel funding usually ranges from $150,000 to $1.5 million. They typically offer expertise, experience and contacts in addition to money.

Seed Finance: - The first stage of venture capital financing. Seed-stage financings are often comparatively modest amounts of capital provided to inventors or entrepreneurs to finance the early development of a new product or service. These early financings may be directed toward product development, market research, building a management team and developing a business plan.

A genuine seed-stage company has usually not yet established commercial operations - a cash infusion to fund continued research and product development is essential. These early companies are typically quite difficult business opportunities to finance, often requiring capital for pre-startup R&D, product development and testing, or designing specialized equipment. An initial seed investment round made by a professional VC firm typically ranges from $250,000 to $1 million.

Seed-stage VC funds will typically participate in later investment rounds with other equity players to finance business expansion costs such as sales and distribution, parts and inventory, hiring, training and marketing. The risk perception of investment at this stage is extremely high and the investment may be realized in 7 to 10 years.

Early Stage: - For companies that are able to begin operations but are not yet at the stage of commercial manufacturing and sales, early stage financing supports a step-up in capabilities. At this point, new business can consume vast amounts of cash, while VC firms with a large number of early-stage companies in their portfolios can see costs quickly escalate.

- **Start-up -** Supports product development and initial marketing. Start-up financing provides funds to companies for product development and initial marketing. This type of financing is usually provided to companies just organized or to those that have been in business just a short time but have not yet sold their product in the marketplace. Generally, such firms have already assembled key management, prepared a business plan and made market studies. At this stage, the business is seeing its first revenues but has yet to show a profit. This is often where the enterprise brings in its first "outside" investors.
- **First Stage -** Capital is provided to initiate commercial manufacturing and sales. Most first-stage companies have been in business less than three years and have a product or service in testing or pilot production. In some cases, the product may be commercially available.

Later Stage:- Capital provided after commercial manufacturing and sales but before any initial public offering. The product or service is in production and is commercially available. The company demonstrates significant revenue growth, but may or may not be showing a profit.

- **Expansion Finance:** Venture capitalists perceives low risk in venturesrequiring finance for expansion purpose either by growth implying bigger factory, large warehouse, new factories or new market or through purchase of existing business. The time frame of investment is usually from one to three years. It represent last round of financing before a planned exit.
- **Second Stage Financing:** Financing is done when the firm has the product or the service but it has yet to develop the marketing infrastructure to reach the consumer. During this period, additional finance is required because the project faces competition and the firm's own profits are normally meager to help it to penetrate the market. The entrepreneur has invested his own funds but further infusion of funds by the venture capital firm is necessary. The venture capital firms provide larger funds at this stage than at other early stage financing, because the time scale for the investment is obviously shorter than in the start-up case and the second round financing is partly in the form of debt instrument which will provide some income to the venture capital firm.
- **Third-Stage or Mezzanine Financing:** Funds provided for major expansion of company whose sales volume is increasing and has achieved break-even or profitable. Funds are used for plant expansion, marketing, working capital, penetration of new geographic region, or improved product development and so on . Venture finance provided at this stage has medium risk and can be realized in one to three years. It constitutes a significant part of the activities of many venture capital firms.
- **Bridge Finance:** Bridge finance may be provided when a company is expecting to go to the public shortly or any other sanctioned financial assistance from the commercial banks, financial institutions and the like. When the finance remains undisbursed due to some bureaucratic reasons, venture capital firms come forward to finance the projects of the ventures under such critical juncture. This is the last round of financing before going public, hence it involves low risk and the investment may be realized in one to three years. Often bridge financing is structured so that it canbe repaid from the proceeds of an initial public offering.

Turnaround/ Acquisition/Buy-out Financing

Ventures that seek finance for turning around or acquiring or buying out an existing company fall under this category.

- **Turnaround Financing** Finance may be given to a specialized group to bring about a turnaround of an ailing (sick) company. Two kinds of inputs are required in turn-around, namely money and management. The company may face mounting debt burden and slowing down of cash inflows and may need more funds from all sources. The enterprise may seek a moratorium from creditors for unpaid liabilities. The original entrepreneur may be compelled to relinquish the enterprise to a new management The venture capital firms play an active role in such a situation by providing more equity investments and deploying managerial experts. Risk here is medium to high and the investment can take three to five years to realize. It is gaining widespread acceptance and increasingly becoming the focus of attention of venture capital firms.
- **Acquisition Finance:** Funds may be given to one company to finance its acquisition of another company. Risk is medium to high and the investment may be realized in three to five years in this case.
- **Management / Leveraged Buy-out Financing** The funds provided to the current operating management to acquire or purchase a significant share holding in the business they manage are called management buy-out. 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. Buy-out financed by other venture capitalists is known as leveraged buy-out.

Each of these stages in the life cycle has an inherent risk and time scale for realization of the investment. However, the different stages of investment are analytically distinct and vary as regards the time-scale, risk perceptions and other related characteristics of the investment decision process. An overview of the venture capital spectrum is given in table

VENTURE CAPITAL SPECTRUM

Stages of Investment by Venture Capital Firm	**Time-Scale in years (From Investment to Public Offering)**	**Risk Perception**	**Finance for the Activity Involved**	**Expected Return (Indicative)**
1. Early Stage				
(i) Seed capital (usually prototype development)	7 – 10	Extremely High	Manufacturing and research based	60%
(ii) Start-up (to commence commercial)	5 – 10	Very High	Business Commitment	40 – 60%
(iii) Second round (not yet profitable enough for public offering)	3 – 7	High	Marginal Progress	30 – 40%
2. Later Stage				
(i) Mezzanine development	1 – 3	Medium	Expansion Finance	25 – 35%

capital (established, but needs, expansion finance)				
(ii) Bridge (last round before planned exit)	1 – 3	Low	Planned Exit	20 – 30%
(iii) Buy-out (MBOs and MBIs)	1 – 3	Low	New Management	20 – 30%
(iv) Turnaround	3 – 5	Medium to High	Rescue Finance	30 – 40%

Source: S. Ramesh and Arun Gupta, Venture Capital and the Indian Financial Sector", Oxford University Press, New Delhi, 1995, p.66.

Venture Capital Investment Process :- The venture capital investment activity is a sequential process involving five steps; Deal origination; Screening; Evaluation or due diligence; Deal structuring, and Post investment activities and exit.

Deal origination

Deals may be referred to the VCs through their parent organizations, trade partners, industry associations, friends etc. The venture capital industry in India has become quite proactive in its approach to generating the deal flow by encouraging individuals to come up with their business plans. Consultancy firms like Mckinsey and Arthur Anderson have come up with business plan competitions on an all India basis through the popular press as well as direct interaction with premier educational and research institutions to source new and innovative ideas. The short listed plans are provided with necessary expertise through people who have experience in the industry.

Screening

VCFs carry out initial screening of all projects on the basis of some broad criteria. For example the screening process may limit projects to areas in which the venture capitalist is familiar in terms of technology, or product, or market scope. The size of investment, geographical location and stage of financing could also be used as the broad screening criteria.

Evaluation or due diligence

Once a proposal has passed through initial screening, it is subjected to a detailed evaluation or due diligence process. Most ventures are new and the entrepreneurs may lack operating experience. Hence a sophisticated, formal evaluation is neither possible nor desirable. The VCs thus rely on a subjective but comprehensive, evaluation. VCFs evaluate the quality of the entrepreneur before appraising the characteristics of the product, market or technology. Most venture capitalists ask for a business plan to make an assessment of the possible risk and expected return on the venture.

Deal structuring

Once the venture has been evaluated as viable, the venture capitalist and the investment company negotiate the terms of the deal, i.e., the amount, form and price of the investment. This process is termed as deal structuring. The agreement also includes the protective

covenants and earn-out arrangements. Covenants include the venture capitalists right to control the investee company and to change its management if needed, buy back arrangements, acquisition, making initial public offerings (IPOs) etc., Earn out arrangements specify the entrepreneur's equity share and the objectives to be achieved. Venture capitalists generally negotiate deals to ensure protection of their interests. They would like a deal to provide for:

- A return commensurate with the risk.
- Influence over the firm through board membership.
- Minimizing taxes.
- Assuring investment liquidity.
- The right to replace management in case of consistent.poor managerial performance.

The investee companies would like the deal to be structured in such a way that their interests are protected. They would like to earn reasonable return, minimize taxes, have enough liquidity to operate their business and remain in commanding position of their business.

Post-investment activities and exit

Once the deal has been structured and agreement finalized, the venture capitalist generally assumes the role of a partner and collaborator. He also gets involved

in shaping of the direction of the venture. This may be done via a formal representation of the board of directors, or informal influence in improving the quality of marketing, finance and other managerial functions. The degree of the venture capitalists involvement depends on his policy. It may not, however, be desirable for a venture capitalist to get involved in the day-to-day operation of the venture. If a financial or managerial crisis occurs, the venture capitalist may intervene, and even install a new management team.

Impact of investments in India: An analysis

Investments by Industry

Investments were classified into eight categories based on the industry / sector. Table 2.1 shows the distribution of investments in different industry sectors. In terms of investment, close to two-thirds of the total investment has been in the BFSI segment, most of which can be attributed to the micro-finance segment. The other sectors that account for a reasonable amount of investment are Agriculture & Healthcare and Non-financial Consumer Services. These three industries account for 90% of the total investments. The trends are similar when the analysis is done based on the number of investments. Though the proportion of BFSI is the largest even when considered by the number of deals, it does not account for as large a proportion as it does when the analysis was based on investment value. In terms of the number of deals, the top three sectors account for 77% of the total. Of the total number of companies that have received investment, 72 (34%) are in the BFSI sector. It can be seen that this proportion is considerably lower as compared to the proportion accounted for by the BFSI sector when the analysis was in terms of investment amount or the number of deals. While the top three sectors accounted for 73% of the total companies that have received venture investments, the dominance of BFSI has considerably reduced. The ratio of number of deals to number of companies is the highest for BFSI sector (3.98) among all the sectors. An inference from this trend is that investors seem to be more upbeat about the prospects of companies in the BFSI sector, which is evidenced by the number of investors investing in companies in the BFSI sector as compared to other industries.

Impact of Investment in Different sector

Table: 1

Industry	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No of companies
Agriculture & Healthcare	156.69	12%	54	10%	3.48	35
BFSI	835.3	64%	287	55%	3.02	72
Engineering & Construction	29.08	2%	40	8%	1.04	16
IT & ITES	59.64	5%	34	7%	2.39	19
Manufacturing	1.39	0%	7	1%	0.28	5
Travel & Transport	1.2	0%	1	0%	1.20	1
Other services	39.07	3%	35	7%	1.56	17
Non-financial Consumer Services	180.91	14%	65	12%	3.23	47
Total	1303.28	100%	523	100%	2.82	212

Source:Report (2013) IIT madras on Venture Capital and Private Equity

The trends in impact investment differ markedly when compared to other segments of venture capital investing. For example, BFSI segment accounts for only 24% of the overall VCPE investment. In terms of number of investments, IT&ITES and Manufacturing sector were the top two sectors in the overall VCPE investments.[50] Analysis of incubation investments revealed that IT&ITES accounted for the highest proportion of incubatees, whereas BFSI contribution was just 1%. The trends in angel investments were similar to that seen in incubation support.[51] Impact investments are thus characterized by a high degree of concentration in the BFSI segment, because of the micro-finance sector. With investments gradually increasing in other industry categories, it can be expected that the dominance of BFSI segment will reduce in the coming years.

Average investment per deal presents an interesting picture. The average investment per deal in impact investments works out to be $2.82 million. This is much lower than the overall average deal size ($32million) seen in VCPE investments. This is also lower than the average deal size seen in early stage VCPE investments ($12.6 million). Two inferences can be made from this trend. First, impact investments are happening in comparatively the earlier stage in social enterprises as compared to the overall industry trends. This indicates the important role played by the investors in providing early stage capital to firms in the social sector. Second, social enterprise investing is still in a nascent phase. As the companies in this sector grow in size, they will attract larger and larger investments, which would then increase the average deal size.

Investment through Venture Capital and Foreign Venture capital investors

Table: 2

Industry wise Cumulative Investment Details of SEBI Registered Venture Capital Investors (VCI) and Foreign Venture Capital Investors (FVCI)					
Particulars	**as on December 31, 2016 (Rs. in Crore)**				
Sectors of Economy	**VCF**	**% of total VCF**	**FVCI**	**% of total FVCI**	**Total***
Information Technology	1224	19.34	5106	80.66	6330
Telecommunication	1016	15.66	5472	84.34	6488
Pharmaceuticals	345	63.30	200	36.70	545
Biotechnology	218	42.91	290	57.09	508
Media/Entertainment	399	34.79	748	65.21	1147
Services Sector	2712	51.17	2588	48.83	5300
Industrial Products	1023	54.33	860	45.67	1883
Real estate	8574	89.92	961	10.08	9535
Others	14977	33.96	29122	66.04	44099
Total	**30488**	40.20	45347	59.80	**75835**
	*excludes INR 9323 crore of FVCI investments through VCFs				

Source: SEBI website

Note: The above report is compiled on the basis of quarterly information submitted to SEBI by registered venture Capital Funds and Foreign Venture Capital Investors.

The above table depicts that the cumulative investment of Venture capital investors and Foreign Venture Capital Investors made by different industry which is registered with SEBI the pattern of investment is shown in absolute and in percentage of total investment, by perusal the aforesaid table it is found that the investment made in economy through Information technology by VCF is Rs.1224 crore and by FVCI is Rs.5106 crore and its percentage of total contribution is 19.34% & 80.66% respectively. And on the same way the telecommunication sector make investment Amount of Rs.1016

crore (15.66%) by VCF and Rs.5472 by FVCI. And through Pharmaceutical sector the VCF invested in Rs.345 (63.3%) crore and by FVCI is Rs.200 (36.7%) crore. In the Biotechnology sector Rs.218 (42.91%) crore through VCF and Rs.290 (57.09%) crore through FVCI. In the entertainment sector Rs. 399 (34.79%) crore and Rs.748 (65.21%) invested by VCF and FVCI respectively. The most prominent sector of economy is service sector they received funds through VCF Rs 2712 (51.17%) crore and through FVCI Rs.2588 (48.83%) crore. The industrial product sector received funds by VCF Rs.1023(54.33%) crore and Rs.860 (45.67%) crore through FVCI. At the last but not the lest the real and others different sector of economy received funds a sum of Rs.8574 (89.92%) Crore and Rs.14977 (33.96) by VCF respectively and on the another side Rs.961 (10.08%) and Rs. 29122 (66.04%) respectively. Apart from this highest investment made through VCF in real state sector i.e. Rs.8574 (89.92%) crore and lowest investment made in Bio-technology sector of Rs.218(42.91) crore and on the other side the highest investment made through FVCI in telecommunication sector i.e. Rs.5472 (84.34%) and lowest investment received by Pharmaceutical sector of Rs.200 (36.67%). Overall the FVCI is make more investment to promote new startup and entrepreneurship of Rs.45347 (59.8%) in comparison to VCF i.e. Rs.30488 (40.2%).

Distribution by city : Investments were analysed based on the type of city in which the enterprises were located. The cities were classified into two types - Metropolitan and Non-metropolitan cities. The six cities, viz., Bangalore, Chennai, Delhi, Hyderabad, Kolkata, and Mumbai were classified as metropolitan cities. All the other cities were classified as non-metropolitan cities.

Distribution Impact on Different Cities

Table: 3

City type	Total investment ($, million)	% of total investment	No. of deals	% of total deal	Average investment/deal ($, million)	No. of companies
Metro	1056.43	81%	389	74%	3.05	144
Non-metro	246.85	19%	134	26%	2.13	68
Total	1303.28	100%	523	100%	2.82	212

Source:Report (2013) IIT madras on Venture Capital and Private Equity

Despite the perception that the target customer segment for social enterprises would generally be in smaller cities, the enterprises themselves are located in the large metropolitan cities. This could be attributed to the poor quality of business support infrastructure in smaller cities. While the enterprises could have their operations in rural areas or smaller towns, their main offices are likely to be located in a metropolitan city. As it can be seen in above table metropolitan cities account for a large chunk of investments, deals, and companies. The average investment per deal in metropolitan city is higher by 43% as compared to the average investment per deal in a non-metropolitan city. The deals to companies ratio is also significantly higher in the case of metropolitan cities (2.70) as compared to that of non-metropolitan cities (1.97). In fact, the share of metro cities in impact investments is similar to the trends seen in overall VCPE investment and angel investments. A departure from this trend was

seen in the case of incubation support, where a large number of incubatees were from non-metropolitan cities. A possible explanation for this trend is that venture funds invest in highly capable entrepreneurs, and such entrepreneurs prefer to locate their enterprises in the metropolitan cities for a variety of reasons. As various entrepreneurship development programs such as incubation support programs bear fruit, impact investors would be able to find more entrepreneurs to fund even from smaller cities

Obstacles in Venture Capital Funding:

The PEVC industry is at a critical juncture today and facing significant challenges on multiple fronts. While phenomenal investments have happened over the past few years, overcoming these challenges will be crucial to the sustainability of this industry. Some of the typical challenges are:

Exits: Realizing the value of investments has been hampered by overdependence on IPOs for exits, very short IPO windows, and underdeveloped M&A exit mechanisms which need active cooperation of entrepreneurs and company promoters.

Valuation: In other comparable markets, such as China, there is an arbitrage in valuations between private markets and public markets. In India private valuations are on par or higher than their public peers. The primary reason is the paucity of good quality private companies of investible size. A majority of the 6,000 or so listed companies in India have the characteristics of private companies, are capital starved and available at lower valuations than their private peers. Unfortunately, they cannot be tapped by PEVC funds because of regulatory restrictions.

Scalability: Indian companies are finding it hard to scale beyond a certain critical size on account of infrastructure bottlenecks, regulatory delays and growing red tape.

Illiquidity: SMEs listed on the public markets are highly illiquid - companies with market cap less than 1,000 crores ($225 million) account for 11% of the total average daily traded value in public markets, while companies with market cap less than 500 crores ($113 million) account for 4%. PEVC investors who own significant stakes i.e. more than 10%) in portfolio companies have trouble exiting these companies on account of illiquidity in their scrips. Although the idea of a separate stock market for SMEs has been under discussion for some time, no significant progress has been made.

Returns: For various reasons, Indian PEVC has not been able to generate returns or exit multiples on par with competing markets, such asChina. If this continues then the allocation of new capital by investors (or limited partners, LPs) to India will recede.

Conclusion & Suggestions

Conclusion: From the study it is observed that two-thirds of the total impact investment has been in the BFSI segment, most of which can be attributed to the micro-finance segment. The other major sectors that account for considerable amount of investment are Agriculture & Healthcare and Non-financial Consumer Services. These three industries account for 90% of the total investments. The trends in impact investment differ markedly when compared to other segments of venture capital investing. For example, BFSI segment accounts for only 24% of the overall VCPE investment. In terms of number of investments, IT&ITES and Manufacturing sector were the top two sectors in the overall VCPE investments.

Average investment per deal presents an interesting picture. The average investment per deal in impact investments works out to be $2.82 million. This is much lower than the overall average deal size ($32 million) seen in VCPE investments. This is also lower than the average deal size seen in early stage VCPE investments ($12.6 million).Despite the perception that the target customer segment for social enterprises would generally be in smaller towns, the enterprises themselves are located in the large metropolitan cities. Enterprises in metropolitan cities account for a large chunk of investments, deals, and companies. The average investment per deal in metropolitan city is higher by 43% as compared to the average investment per deal in a non-metropolitan city.

Suggestions: The following elements are needed for the more success of venture capital in India:

- **R & D Activities** Public and private ltd. Venture capitalist companies should focus on the new technology.
- **Fiscal Incentive:** Government should give fiscal incentives to the entrepreneur as well as venture capitalist in form of tax cuts.
- **Promotion Efforts:** Promotional efforts, venture fairs, venture clubs and venture networks should be formed for the growth.
- **Better education and Training to the venture capital managers**: To prepare the manager competent and trained, they should be giving training with using new technology.
- **Industry–institute linkage:** Universities should be linked with universities so that new useful ideas can be transformed into realistic shape.
- **Motivation to the entrepreneurs:** Entrepreneur should be motivated so that they could become for the risk taker and Indian economy could flourish.

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