A study on Venture Capital Financing and Growth of Start-Ups"

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Abstract

Starting an enterprise and launching a new product or service in the market needs adequate financing. Depending on the nature of the venture, there are multiple variety of funding opportunities. If it is a small start up company, they may rely on friends or family funding, loans, or crowd funding. Venture capital financing is a type of private equity capital that can be provided at various stages or funding rounds. The funding can happen at an early stage known as seed funding in high-potential, growth companies (startup companies) and growth funding. Apart from providing finance to start-up companies, Venture capitalists (VCs) also add value and it is time consuming. The study aims to focus on the recent start-ups and the type of venture capital funding opted by them. The funding history and impact on growth of selected start-ups have been taken up for the study.

Keywords: Private equity, venture capital, start-up, bootstrapping, angel investors

Introduction:

Venture Capital is an Equity featured capital seeking investment in new ideas(Company/ Production/ project) that offer potential higher returns on Investments. A Capital that is invested in the project where there is substantial amount of Risk Involved relating to future creation of Profits and cash flows

Venture Capital typically comes from institutional investors and high net worth individuals and is pooled together by dedicated investment firms. It is the money provided by an outside investor to finance a new, growing, or troubled business. The venture capitalist provides the funding knowing that there's a significant risk associated with the company's future profits and cash flow. Capital is invested in exchange for an equity stake in the business rather than given as a loan

In 1983, the first analysis was reported on risk capital in India. It indicated that new companies often face barriers while entering into the capital market and also for raising equity finance which weakens their future expansion and growth. It also indicated that on the whole, there is a need to assess the equity cult by ensuring competitive return on equity investment. This all came out as institutional inadequacies and resulted in the evolution of Venture Capital.

In India, IFCO was the first institution to initiate the idea of Venture Capital when it established the Risk Capital Foundation in 1975. It provided the seed capital to all small and risky projects. However, the concept of Venture Capital got its recognition for the first time in the budget for the year 1986-87.

The venture capital funding process typically involves four phases in the company's development:

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- **Idea generation**
- **Start-up**
- **Ramp up**
- **Exit**

Step 1: Idea generation and submission of the Business Plan

The initial step in approaching a Venture Capital is to submit a business plan. The plan should include the below points:

There should be an executive summary of the business proposal

Description of the opportunity and the market potential and size

Review on the existing and expected competitive scenario

Detailed financial projections

Details of the management of the company

There is detailed analysis done of the submitted plan, by the Venture Capital to decide whether to take up the project or no.

Step 2: Introductory Meeting

Once the preliminary study is done by the VC and they find the project as per their preferences, there is a one-to-one meeting that is called for discussing the project in detail. After the meeting the VC finally decides whether or not to move forward to the due diligence stage of the process.

Step 3: Due Diligence

The due diligence phase varies depending upon the nature of the business proposal. This process involves solving of queries related to customer references, product and business strategy evaluations, management interviews, and other such exchanges of information during this time period.

Step 4: Term Sheets and Funding

If the due diligence phase is satisfactory, the VC offers a term sheet, which is a non-binding document explaining the basic terms and conditions of the investment agreement. The term sheet is generally negotiable and must be agreed upon by all parties, after which on completion of legal documents and legal due diligence, funds are made available.

Stages of Funding:

The various types of venture capital are classified as per their applications at various stages of a business. The three principal types of venture capital are early stage financing, expansion financing and acquisition/buyout financing.

The venture capital funding procedure gets complete in six stages of financing corresponding to the periods of a company's development

Seed money: Low level financing for proving and fructifying a new idea

Start-up: New firms needing funds for expenses related with marketing and product development

First-Round: Manufacturing and early sales funding

Second-Round: Operational capital given for early stage companies which are selling products, but not returning a profit

Third-Round: Also known as Mezzanine financing, this is the money for expanding a newly beneficial company

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Fourth-Round: Also called bridge financing, 4th round is proposed for financing the "going public" process

Early Stage Financing:

Early stage financing has three sub divisions seed financing, start up financing and first stage financing.

Seed financing is defined as a small amount that an entrepreneur receives for the purpose of being eligible for a start up loan.

Start up financing is given to companies for the purpose of finishing the development of products and services.

First Stage financing: Companies that have spent all their starting capital and need finance for beginning business activities at the full-scale are the major beneficiaries of the First Stage Financing.

Expansion Financing:

Expansion financing may be categorized into second-stage financing, bridge financing and third stage financing or mezzanine financing.

Second-stage financing is provided to companies for the purpose of beginning their expansion. It is also known as mezzanine financing. It is provided for the purpose of assisting a particular company to expand in a major way. Bridge financing may be provided as a short term interest only finance option as well as a form of monetary assistance to companies that employ the Initial Public Offers as a major business strategy.

Acquisition or Buyout Financing:

Acquisition or buyout financing is categorized into acquisition finance and management or leveraged buyout financing. Acquisition financing assists a company to acquire certain parts or an entire company. Management or leveraged buyout financing helps a particular management group to obtain a particular product of another company

Review of Literature

Nahata (2008) has proposed a new way to calculate venture capital firm reputation and to analyze its performance implications on private companies. The main finding of the study was that start-ups which are backed by reputable VCs have better access to capital markets and have higher asset productivity at IPOs.

Bertoni et al (2011), have studied the impact of venture capital funding on new technology-based firms. The main objective of the study was to test whether VC investments have a positive treatment effect on the growth of employment and sales of new technology-based firms. The outcome of the study was that venture capital funding had a major impact on growth of employment.

Guo et al (2013) have examined the contributions of venture capital investment entrepreneurial firms in China. The outcome of the study was that VC-backed firms

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outperform non-VC-backed firms in terms of profitability, labor productivity, sales growth, and R&D investment.

Achleitner (2013) focused on the impact of demand-related factors, e.g. entrepreneurial activity, as well as supply-related factors, i.e. money provided by VC investors, on the return of individual VC investments.

Success stories of start-ups

Swiggy

Like any other startup, Swiggy had its own journey, filled with many ups and downs, highs and lows but what contributed to its triumphant position today is the consistent efforts to adapt the everyday changing factors, obsession to serve the customers, foreseeable sight into the logistics operations and the never back down attitude of its three founding members. Bootstrapped till January 2015, the foodtech startup has come a long way. Launched only 4 years ago, Swiggy today is one of India's fastest growing internet companies and has one of the greatest success stories to boast about. Among the 18 Indian unicorns, out of which 8 including Swiggy joined the club in 2018, the food ordering and delivery platform's vision and business strategy have impressed the investors the most.

"Swiggy has the winning formula and will continue to build a leading business in the country," claimed Larry Illg, CEO Food and Ventures, Naspers after the VC firm led the startup turned unicorn's latest mega round of investment. With the staggering $1 billion, the firm plans to strengthen its technology backbone and focus on building the next-generation AI-driven platform for hyperlocal discovery and on-demand delivery.Let's have a look at Swiggy's arduous journey from a late entrant of India's e-commerce wave to India's largest food delivery platform:

2014: Coming from diverse backgrounds, Sriharsha Majety, Nandan Reddy and Rahul Jaimini had faced their share of failures before trying their luck with Swiggy. The first two are BITS-Pilani graduates who have together built a technology product called Bundl in 2013 to connect courier companies across India. owever, they soon had to shut shop and decided to explore the food-delivery space.

They had the vision to build a sustainable and sound business model along with a strong product mindset but lacked the technical chops required to build an internet company. Then entered Jaimini, a former Myntra software engineer and IIT alumni. As the three co-founders put their respective skills on a table, a distinctive online food ordering startup, Swiggy was born on August 2014.

2015: Within a year of launch, Swiggy had convinced many restaurants who were earlier vary of the online channel of delivery to join forces with the platform. What differentiated it from other players is their investment in building a proper logistics network with a vast fleet of their own delivery boys. It especially focused on customer experience due to which their clientele didn't mind when they started charging for deliveries.

Seeing their business model working seamlessly, many investors got interested in funding the venture and Swiggy received its first cheque of $2 million from Accel and SAIF Partners. In the same year, the two VCs again funded the startup along with Norwest. By then, the startup already had over 100 restaurants on board and was delivering over 70,000 orders on a monthly basis.

2016: The funding boom of 2014-2015 soon died down but Swiggy was yet to come down from the high. Once a major competitor in the food tech space, TinyOwl lost its presence, merged with Roadrunner to create Runner and got acquired by Zomato within a span of a few months. While that was happening, Swiggy's losses jumped 65 times for the year ended March 2016 and hence, the year was spent on cutting costs and strengthening its logistics network.

A bit of outsourcing by tying up with third-party logistics players had also started to further the efforts of building a sustainable network. Earlier in the year, the platform had caught the eyes of some global investors including Singapore-based RB investments and New York-based Harmony Partners. In September, another influential VC firm, Bessemer Venture got associated with the startup.

2017: With 6x growth in 3 years of its launch, Swiggy was leading the Indian food tech space, thanks to its customer understanding and adaptability. By 2017, the startup was introducing disruptive and highly differentiated service offerings. Understanding need of the hour, it increased investment across core engineering, automation, data sciences, machine learning and personalization.
In particular, cloud kitchens— a programme that allows its restaurant partners to set up kitchen spaces in areas where they don't operate, introduced back in 2015, had started creating a buzz among the millennials. The year witnessed Swiggy raising its biggest investment of $80 million in Series E round of funding led by Naspers, as other existing investors also participated.
2018: The year had brought along a rollercoaster of experiences for one of India's most sought-after consumer internet firms, marking one milestone after the other. With its focus on building real-time prediction and optimization systems to help customer choice and bring in personalization with speed of deliveries, Swiggy's goal was to change the way India eats.

Amid strengthening its leadership, introducing multiple initiatives including Swiggy Access and Capital Assist, all in all undergoing a revamp and the team claiming to have seen a 500 per cent increase in revenues from the last financial year, the top-rated app attained the unicorn status, becoming the fastest growing Indian startup.
Soon after receiving $100 million from Chinese investor Meituan-Dianping and Naspers in February, the Bengaluru-based firm raised $210 million, taking its valuation to $1.3 billion. The unicorn recently closed the funding of staggering $1 billion led by existing investor Naspers. New investors - Tencent, Hillhouse Capital and Wellington Management Company, also came on board. With this funding, Swiggy has left the competing Zomato and Food Panda way behind in the space.

Few other examples are summarized below

OLX

Sector- E-Commerce

Olx India Private Limited is an unlisted private company. It was incorporated on 22 May, 2009 and is located in Gurgaon, Haryana. It is classified as a private limited company

Rounds	Venture Capitalist	Amount of Seed capital	Financial as on March 2019-Operating Revenue	Competitors
A	Bessemer Venture Partners	$33.5 mn	100-500 crore	Quikr, Sulekha
B	Founders Fund			
C	General Catalyst			

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D	DN Capital			
E	Nexus Venture Partners			

Urban Ladder

Sector: Online and Offline Furniture

Urban Ladder is an omnichannel furniture and decor retailer based out of Bangalore, India. Urban Ladder currently has 3 stores in Bangalore and distribution across 75+ cities in India through its website.

Rounds	Venture Capitalist	Amount of Seed capital	Financial as on March 2019- Operating Revenue	Competitors
A	Kalaari Capital	\$1mn	434 crore	Pepperfry, HomeLane, CustomFurnish
B	SAIF Partners	\$5mn		
C	Steadview Capital	\$21mn		
D	Sequoia Capital	\$50mn		

Book my Show

Sector: Online entertainment ticketing

Book MyShow started out in 1999 as a software re-seller for movie theaters and converted into a platform catering to cloud-based events, movies, sports, and plays booking. BookMyShow was known by the name of its parent company, Bigtree Entertainment Pvt. Ltd. during inception.

Rounds	Venture Capitalist	Amount of Seed capital	Financial as on March 2019- Operating Revenue	Competitors
Seed	Network 18	undisclosed	\$850 million.	Explara, TicketGenie, Kyazoonga, IndianStage, BookMyEvent, MeraEvents, Asklaila, TicketCountes
A	Accel	\$18M		
B	Saif Partners	\$25M		
C	Accel, Saif partners, Stripes Group, Network18	\$81.5M		
D	TPG Growth	\$100M		
Venture	Jungle Ventures	undisclosed		

Big Basket

Sector: E-commerce, online grocery

Rounds	Venture Capitalist	Amount of Seed capital	Financial as on March 2019- Operating Revenue	Competitors
Seed	TR Capital	undisclosed	Rs. 1605 crore	Satvakart, Morning Cart
A	CDC Group	\$40m		
B	Mirae Asset	\$150m		
C	Alibaba Group	\$200m		
D	Paytm Mall	\$200m		
Venture	Trifecta Capital	100 crore		

Findings and Conclusion:

Considering the high risk involved in the venture capital investments complimenting the high returns expected, one should do a thorough study of the project being considered, weighing the risk return ratio expected. One needs to do the homework both on the Venture Capital being targeted and on the business requirements.

To promote and develop the Venture Capital business, the government should provide fiscal relief by exempting the dividend paid to Venture Capital fund investors from income tax.Venture Capital funds should be made easier by establishing Private Venture Capital funds. It allows funds independently rather than a Joint Venture with banks and financial institution.

Commercial banks should allow categorizing the investment in Venture Capital Funding as "priority sector lending". There must be a change in perception that Venture Capital is only for the high tech industry. The Venture Capitalist should seize the opportunities such as biotechnology, food processing, call centers, BPO's, etc.

Create profitable disinvestment opportunities as every Venture Capitalist identifies the exit route before it plans for investing in a company.

The role of Indian Venture Capital Association should be strengthened. It should build a database on the Venture Capital industry so as to enable, to disseminate information for those who are interested. It is essential to create coordinating bodies among technology institutes, as it can provide high-quality manpower which is essential to the success of the industry.

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