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Venture Capital Financing : Helping Hand in Growth of Companies

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Abstract

The flourishing Venture capital is the most vibrant industry in the financial market. Venture capital can be visualized as "your ideas and our money" concept of developing business. It provide funds to early-stage, high-potential, high risk, growth startup companies. Venture capital firms are most interested in projects with remarkably high growth potential, which will possibly provide the financial returns within the required timeframe. The process of venture capital financing consist of different stages, it may be extended by the Venture Capital firm if it deems necessary and it ensue if the venture is not performing as per the expectation of venture capital firms. This paper studies the venture capital financing procedure at different stages by considering examples of beneficiary companies. The paper further studies the venture capital financing and their applicability at different stages in the growth of companies.

Keywords :- Venture Capital, Stages, Financing Procedure, Companies.

Introduction

The emergence of venture capital companies in India is a relatively new phenomenon. Until 1985, individual investors and Development Finance Institutions (DFIs) have played the role of venture capitalists in the absence of an organized venture capital industry. During that time entrepreneurs have largely depended on private placements, public offerings and lending by financial institutions. The venture capital phenomenon has arrived at a take-off stage in India with the easy availability of risk capital in all forms. In the earlier stage, it was easy to raise only growth capital but financing of ideas or seed capital is now available after the introduction of venture capital phenomenon. The number of players offering growth capital and the number of investors is rising rapidly. The concept of venture capital financing first time got statutory recognition in the fiscal budget for the year 1986 to 1987.

According to International Finance Corporation (IFC), venture capital is equity or equity featured capital seeking investment in new ideas, new companies, new production, new process or new services that offer the potential of high returns on investments.

Venture capitalists generally :

- Finance new and rapidly growing companies;
- Purchase equity securities;
- Assist in the development of new products or services;
- Add value to the company through active participation;
- Take higher risks with the expectation of higher rewards;

Venture capitalists are people who pool financial resources from high net worth individuals, corporate, pension funds, insurance companies, etc. to invest in high risk - high return ventures that are unable to source funds from regular channels like banks and capital markets. 'Venture Capital' is an important source of finance for those small and medium-sized firms, which have very few avenues for raising funds.

As the investments are not liquid and need at least 3-7 years to nurture, venture capitalists are extra cautious and carry out detailed due thoroughness before any investment. They are also expected to look after the companies in which they invest, so as to raise the likelihood of reaching an IPO (Initial Public Offering) stage under favorable valuations.

Companies such as Digital Equipment Corporation, Apple, Federal Express, Compaq, Sun Microsystems, Intel, Microsoft, Yahoo, Airtel and Genentech are famous examples of companies that received venture capital early in their development. Venture Capital is the business of establishing an investment fund in the form of equity financing via investments in the common stocks, preferred stocks and convertible debentures of various

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companies. These companies are seen to have a high growth potential and are able to be listed on the stock exchange in order to gain the highest returns in dividends and capital gain.

Objective

- To study the process of venture capital financing.
- To study the venture capital financing procedure at different stages by considering examples of beneficiary companies.

Process of Venture Capital Financing

Business stage plays an important part in how much money you can secure from venture capitalists. Many Venture Capital firms are very strict about providing only seed money to potentially big businesses. Others are only in the market to fund companies preparing to go public with an IPO (Initial Public Offering). Venture Capital may specialize in providing just one of these series of funding, or may offer funding for all stages of the business life cycle. It's important to know the preferences of the Venture Capital firm approaching for and to clearly articulate what type of funding company is seeking for its growth.

Early Stage

An early stage company is one that is not yet ready to position its product or service in the market. A company in this stage may need seed capital or start-up capital and the amount invested would probably be ranging from \$25,000 to \$250,000 by venture capital companies.

- **Seed Capital** :- Business is still in the idea stage and yet has to perform feasibility studies, market research, and product development, company probably is in need of seed money in order to continue getting business idea into fruition. Few Venture Capital fund at this stage invest capital and it may be used to create a sample product, fund market research, or cover administrative set-up costs.

- **Start-up Capital** :- Business which has performed studies and research into their chosen market and ready to take their product into the public is primed to receive start-up capital from venture capitalists. Start-up money can help with the initial marketing push, helping to distribute product in the market. It also tends to cover recruitment of other key management, additional market research, and finalizing of the product or service for introduction to the marketplace.

Expansion

Expansion capital is for businesses which are already in or ready to start production. There are usually four stages to expansion capital,

- **First Stage** :- In this stage financing is provided to companies that have expended their initial capital and now require funds to initiate commercial scale manufacturing and sales.
- **Second Stage** :- In this stage working capital is provided for the expansion of a company which is producing and shipping products and which needs to support growing accounts receivable and inventories. Although the company clearly has made progress, it may not yet be showing a profit at this stage.
- **Third Stage** :- Third stage, or "mezzanine" financing, helps businesses perform major expansion and perhaps even develop and introduce new products. Funds are provided for the major expansion of a company which has increasing sales volume and which is breaking even or which has achieved initial profitability. Funds are utilized for further plant expansion, marketing, and working capital or for development of an improved product, a new technology, or an expanded product line.
- **Fourth Stage** :- Also known as "Bridge Financing," the company is mature and profitable, and often still expanding. Financing is provided for a company expected to "go public" within six months to a year. Often bridge financing is structured so that it can be repaid from the proceeds of a public offering. Bridge financing also can involve restructuring of major stockholder positions through secondary transactions. This is done if there are early investors who want to reduce or liquidate their positions. This also might be done following a management change so that the ownership of former management (and relatives or associates) can be purchased prior to the company's going public.

Application of Funds by Beneficiary Companies Considering Different Stages

- **Seed Capital**

Rice Power : Cisco, DFJ Award Seed Money to Husk Power Systems

Husk Power Systems (HPS), founded in 2007 by University of Virginia business students Chip Ransler and Manoj Sinha, operates 35 kW to 100 kW mini power plants that convert rice husks into methane gas for energy.

The plants are used to deliver electricity to small villages of 2,000 to 4,000 inhabitants in India's Rice Belt, which usually has loads of leftover husks from rice milling.

Husk Power Systems designs, installs and operates biomass based power plants. Each plant uses proprietary gasification technology to convert abundant agricultural residue (procured from local farmers) into electricity, which is then distributed to rural households and micro-enterprises through a micro-grid system - providing a better quality, cheaper way to meet their need for energy. HPS creates an ecosystem around each plant by providing income generation opportunities to local farmers and entrepreneurs. Additionally, it creates employment through its livelihood programmes such as the incense stick manufacturing program which largely employs women. This enables sustainable development within the communities HPS.

In just four years HPS has installed 84 mini-power plants, providing electricity to over 200,000 people spread across 300 villages, and employing 350 people operating across the state of Bihar. Each plant serves around 400 households, saving approximately 42,000 litres of kerosene and 18,000 litres of diesel per year, significantly reducing indoor air pollution and improving health conditions in rural areas.

Launched in 2007, the startup has won \$250K in seed funding from DFJ and Cisco (as part of their Global business plan competition). The seed money, as Tim Draper points out enough to generate 10 new power plants -

"This is something that can help a whole society - and we think it will be a money-maker too."

- • *Start-up Capital*

- Freshdesk raises \$1 Million from Accel Partners*

Girish Mathrubhootam founder of Freshdesk Technologies with his friend Shan Krishnaswamy as co-founder. Freshdesk is a SaaS (software as a service)-based social customer service platform that enables small and medium sized businesses to roll out a professional and modern customer support system. In no time, the venture has attracted major venture capitalists in India. Freshdesk is the first investment Accel Partners made from its recently closed \$155 Mn fund aimed at startups in India. The investment will be used to expand the product team and step up marketing and business development efforts.

Freshdesk's features include multi product support, knowledge base, self service portal, community forums and tools to leverage mainstream social media for customer support. It allows organizations to support their customers through email, phone, website, Facebook and Twitter. Already integrated with Google Apps, the company plans to add more integration with other cloud services in future. Freshdesk now has customers in over 30 countries and is available in 6 languages.

"We were impressed by what Girish and the Freshdesk team have achieved in a relatively short span of time," said Shekhar Kirani Partner at Accel Partners "A solid team, a product that customers love, significant traction and a big global market opportunity - all the ingredients for success are in place. Started in a small space at home, Freshdesk has moved to one of the swankiest spaces on the IT Highway in Chennai. Freshdesk is one of the numerous start-up success stories India is witnessing ever since the economy opened.

- First Round*

- Fruition Partners Secures \$12 Million in Funding From Trident Capital*

Fruition Partners, the leading provider of technology-enabled services for the IT Service Management (ITSM) sector, announced that it has closed a \$12 million Series A financing round led by Trident Capital. The funds will be used to accelerate growth and aggressively expand sales, marketing and delivery resources to meet the increasing demands for cloud-based professional services and Platform-as-a-Service (PaaS) development offerings globally.

The financing follows a record-breaking year for Fruition Partners marked by more than 150 new customer engagements in 2012 and 125 percent revenue growth over 2011. This accelerated growth is in lock-step with the rapid expansion and market demand seen by ServiceNow, for whom Fruition Partners is a premier implementation partner. Companies are turning to cloud-based solutions to automate enterprise IT (Information Technology) operations and create a single system of record for enterprise IT that lowers operational costs and increases efficiencies. With a staff of nearly 150 cloud experts, highly trained in ITSM best practices, Fruition Partners provides superior integration, training and managed services that ensure customers get the most from their ITSM investment.

"The emergence of the cloud is not only redefining IT hardware and software, but it is creating new growth opportunities for technology-enabled services," said Michael Biggee, Trident Capital managing director. "With its deep IT service management background, highly trained staff and focus on supporting cloud solutions, Fruition Partners is optimally positioned to enable this paradigm shift and help drive the transformation of enterprise IT organizations to the cloud."

Trident Capital has an exceptional track-record of backing pioneering companies that leverage emerging technologies to redefine the next-generation of business services. Founded in 2003, Fruition Partners has quickly grown to become a trusted partner.

"Fruition Partners has invested heavily in expanding our ServiceNow capabilities in the past three years and this was the biggest advancement in ITSM automation," said Marc Talluto, CEO of Fruition Partners. "We continue to see clients migrating to cloud applications and requesting more advanced services to integrate and expand their usage. Our relationship with Trident Capital will allow us to continue on this growth trajectory and to extend our offerings to include advanced cloud integrations, platform development and managed services."

Second Round

AlienVault Lands \$8 Million Series B Funding Round Led By Trident Capital

AlienVault, creator of OSSIM, the de facto standard open source SIEM (Security Information and Event Management) solution, announced that it has closed an \$8 million Series B financing led by new investor Trident Capital with participation from existing investors Adara Venture Partners and Neotec. The funding will be used to accelerate research and development and aggressively expand sales and marketing to meet increasing demand for unified security management from around the world.

"The SIEM market is the fastest growing segment in information security and AlienVault's OSSIM is the leading open source SIEM," said Trident Capital managing director J. Alberto Yopez, AlienVault Board Chairman. "AlienVault is uniquely positioned to expand its leadership in a global market that wants proven, cost-effective solutions that provide a unified management approach to their security requirements. According to global investment banking and asset management firm William Blair & Co., the SIEM market is growing at 21.9% CAGR and on track to surpass \$2.3 Billion by 2014.

"Trident is one of the most prominent investors in cyber security, and we're proud to be partnering with them as we build our business and establish the first true platform for unified security management," said AlienVault President and CEO Barmak Meftah. "This funding comes amid significant momentum at AlienVault as the company has achieved 150% year over year revenue growth and is poised for even greater expansion in 2012."

• *Third Round*

Shop Clues raises third round of funding from Nexus Venture Partners and Helion Advisors

ShopClues.com, an Indian eCommerce marketplace has successfully completed its third round of funding. In a tough market, the company raised close to \$10 million (Rs. 54 crores) from Helion Venture Partners and Nexus Venture Partners. With this round, ShopClues.com has raised over \$15 million in capital so far. Anup Gupta from Nexus Venture Partners had joined the board which has now been expanded with Sanjeev Aggarwal from Helion.

The gross revenue transacted on the platform is up nearly 110 times from February 2012 to February 2013. ShopClues was started in Nov 2011 and is on of the fast growing eCommerce platforms. ShopClues.com had launched India's first managed marketplace, a model that proved disruptive for ShopClues helping it grow faster. Shop Clues works with thousand of merchants across India to sell online using ShopClues as a platform. It has a large catalog of products and brands in India with very low prices. According to Sandeep Aggarwal, founder & CEO of ShopClues.com, the site wants to help small and medium businesses in the country that struggle to garner a toe-hold in this growing marketplace.

• *Fourth Round*

Novariant adds \$40 Million in series D funding

Novariant was founded in 1994 under the name IntegriNautics, born from the prestigious Stanford University GPS Laboratory. The AutoFarm Agricultural Division was formed in 1999, launching the first commercially available automated steering system for farm equipment. Novariant is proud to have many industry "firsts" and award winning achievements through its continuing tradition of innovation. Novariant, a provider of industrial solutions for precision positioning and intelligent machine control systems, has received a \$40 million series D equity financing in a round led by Investor Growth Capital, with new investors Sierra Ventures and Ridgewood Capital, and existing investors Argonaut Private Equity, Clearstone Venture Partners, Pacifica Fund, Kirlan Venture Capital, and Yasuda Enterprise Development participating. The fund will be used to fuel the company's rapid growth.

In the year 2008, Novariant witnessed a 75 percent increase in the revenue over the last year. In the agricultural sector, as rising input costs lead farmers to look for new ways to increase efficiency and productivity, Novariant's Auto Farm Division, with its patented GPS automatic, hands-free steering systems, offers dramatic cost- and time-saving efficiencies along with increased yields.

Conclusion

Venture capital finance at different stages allows the companies to raise fund and utilize them for growth of the business. It provide fund to companies by considering various factors such as the product or service they offer or any other competitive advantage. Debt also support for an acquisition, a management buyout, a leveraged buyout or an IPO. It is important to understand at which stage business is in and how company propose to penetrate or expand into new markets and reach the next stage! Answer lies in, Helping hand of venture capital firms leads to growth of companies by utilizing the potentialities of business and application of funds raised by venture capital.

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