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# Venture Capital Financing And Its Impact On The Indian Economy

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## ABSTRACT

In India, the financial investing process has grown significantly over time. Previously, India had only financial institutions and a few financial institutes, but with the addition of venture capitalist institutes, the country has expanded significantly. Because they may acquire financial help from venture capital, businesses are now focusing on expansion. In India, the size and quality of business enterprises have increased. With increased international rivalry, a lot of growth-oriented businesses have turned to venture capital. Venture capital investment in India is available to all companies that deal with information technology, manufacture products, or provide modern services. As a result, venture capitalism involves money flows, job creation, and economic growth, both directly and indirectly.As a result, project finance involves money flows, job creation, and economic growth, both directly and indirectly. The influence of seed funding on the Indian economy is examined in this study, and the findings are substantial.

**Keywords:** Financial Investment, Financial Institutes, Venture Capital Investment, Capital Flows, Employment Generation, and Economic Growth.

## Venture Capital: Introduction

Due to the presence of large developing capacity and research laboratories, the world as a global village with improved technological advances and enriching brilliantly in all aspects provides huge opportunities for investors, growth, and development in sectors such as telecommunications, service providing (BPOs), information technology, drug companies, electronics, food processing, and health care. Different types of finance are accessible, such as equities, bank loans, bonds, personal debt, and so on, all of which aid in the optimal use of all available resources. However, each type has its own set of advantages and disadvantages. High-growth sectors using high technology frequently carry a high level of risk and have a lower chance of success.As a result, banks and other types of financial institutions are afraid to spend on such projects. Capital investment is a tool that not only gives funding to such businesses but also assists in their development by giving management and financial support.

In today's financial markets, angel investors are one of the most dynamic industries. Investors contribute venture capital financing to young, fast-growing businesses with the potential to become important economic contributors. Venture capital is an important source of equity for start-up enterprises.Venture capital uses the concept of "your ideas and our money" to establish businesses. High-risk, high-reward enterprises are rarely funded through traditional channels such as financial markets and banks. As a result, venture capitalists raise cash from a variety of sources, including high-net-worth people, insurance firms, corporations, pension funds, and so on, to invest in such businesses. Entrepreneurs receive assistance from venture capitalists as well as financial resources in developing their ideas into viable company ventures. Knowledge-based concepts and technology will drive the global economy in the next millennium.Similarly, India is pursuing rapid and sustainable economic growth by leveraging its inherent strengths in fields of human capital, technical skills, a cost-competitive workforce, research, and entrepreneurship. It is necessary to create a venture capital ecosystem that can meet all of these objectives to accelerate innovation, technology promotion, and the development of knowledge-based concepts.

Venture capitalists invest in quickly growing private enterprises in a limited number of sectors, such as infrastructure, telecommunications, clean technology, and health/life sciences. The goal of investment capital is to help private companies get listed on the stock exchange by assisting them in distributing their shares through an IPO or acquisition, and so providing investors with a return in cash or shares that is commensurate with the level of risk they are willing to assume. In contrast to finance, venture capitalists receive a piece of the company's equity. In the exchange for equity financing, there are no interest costs, which is one of its benefits.It is a type of long-term capital in which the benefits are in the case of regular capital gains rather than frequent interest payments, as with debt financing. The failure of a firm venture poses a risk to venture capital investors. As a result, venture capitalists should only invest in firms that have the chance to expand rapidly and provide returns that are sufficient to compensate for the risk incurred. Because they own the majority of the company's shares, venture capitalists are trustees of directors, but they normally do not interfere with the company's day-to-day operations.

### Venture Capital Boom and the Internet Bubble

Due to competition for fresh startups, an excess supply of IPOs, and the incompetence of many venture capitalist managers, venture capital profits were very modest towards the end of the 1980s, especially when compared to their rising leveraged buyout relatives. All through the 1980s and the early half of the 1990s, the venture capital business grew slowly, rising approximately $3 billion in 1983 to slightly over $4 billion in 1994, upwards of a decade later.Following a shakeout among venture capital firms, the most successful businesses retrenched, focusing more on continuous improvement at their investment managers than on making new investments. The results would start to become increasingly appealing and successful, resulting in the 1990s venture capital boom. Professor Andrew Metrick of Yale School of Management refers to the first 15 years of the contemporary venture capital sector, which began in 1980, as the "which was before period" in expectation of the boom which would begin in 1995 and run until the Internet bubble burst in 2000.

The late 1990s saw a surge in interest in the fledgling Internet and other computer technology, which benefited venture capital businesses on Sand Hill Road in Menlo Park and Silicon Valley. There were a lot of initial public offerings ( ipo of stock for computer and other development companies, and venture capital firms were making a lot of money.

### Growth of Venture Capital in India

Since the 1990s, India has had a venture capital industry. It has now effectively evolved for all business firms that undertake riskier ventures while also having significant growth chances. In India, venture capital was provided in the form of shares, seed capital, and other similar kinds of risk capital. With the unit trust of India, ICICI became a venture capital supplier in 1988. In India, there are presently a lot of venture capital firms. Financial institutions such as ICICI Bank have entered the market and established their venture capital units. Except for Indian investors, international organizations have set themselves in India as a financial institution that invests in huge corporations.Foreign investors are responsible for India's large-scale development of financial markets. Only foreign investors contributed to the introduction of European financial concepts, strict contracts, a focus on successful ventures, and direct participation in finance.

Over the previous decade, the Indian venture capital market has gone through four major phases. Throughout 2011 and 2015, the sector experienced a fast-changing commencement environment, with investors bullish about first-generation start-ups' expansion and scaling. Between 2016 and 2017, there was a period of maturity and moderation, with fewer although higher-quality investments. During 2018 and 2019, high-profile exits boosted investor confidence and ushered in new industries like fintech and SaaS. This fresh optimism was intended to last until 2020, but Covid-19 threw a wrench in the works. Despite Covid-19, transaction momentum continued in 2019, but with a considerable slowdown in the magnitude of agreements and the rate at which they were exited.

## REVIEW OF LITERATURE

Mukesh Kumar Mahajan (2014) looked at the challenges with venture capital in the United Kingdom, which began in the late 1800s when entrepreneurs sought affluent individuals to back their ventures on an ad hoc basis. Between 2007 and 2013, the total amount invested by venture capital in India more than doubled. Pallvi Rani and Hitesh Katyal (2015) investigated the state of venture capital in India and discovered that the BFSI sector accounted for almost two-thirds of overall impact investment, with microfinance accounting for the majority of it. Agriculture, healthcare, and non-financial business services are the primary sectors that receive significant investment.Shankar R. (2018) discovered in his research that private equity investment has a considerable impact on the SENSEX and NIFTY.

## Statement of the Problem

In industrialized countries, venture capital is however one vehicle that has had a lot of success. It has made important contributions to the development of new technologies and the expansion of a country's industrial base. Venture Capital activity grew in the United States and other industrialized countries as a result of the efforts of individuals or groups in the private sector, and changes in government fiscal policy that made funds available to small businesses accelerated the growth of Venture Capital activity. Governments in emerging countries such as India, on the other hand, have taken steps to promote Venture Capital.Venture capital can help countries like India boost entrepreneurship by helping to construct professional companies that can compete worldwide with a competitive advantage. Because entrepreneurship is the motor that will propel Indian society further by establishing enterprises that would provide innumerable jobs and long-term economic gain, venture capitalists assist in identifying new entrepreneurs with fresh ideas for untested but rising technology. As a result, it is necessary to investigate the influence of seed funding on India's economy.

## RESEARCH OBJECTIVE

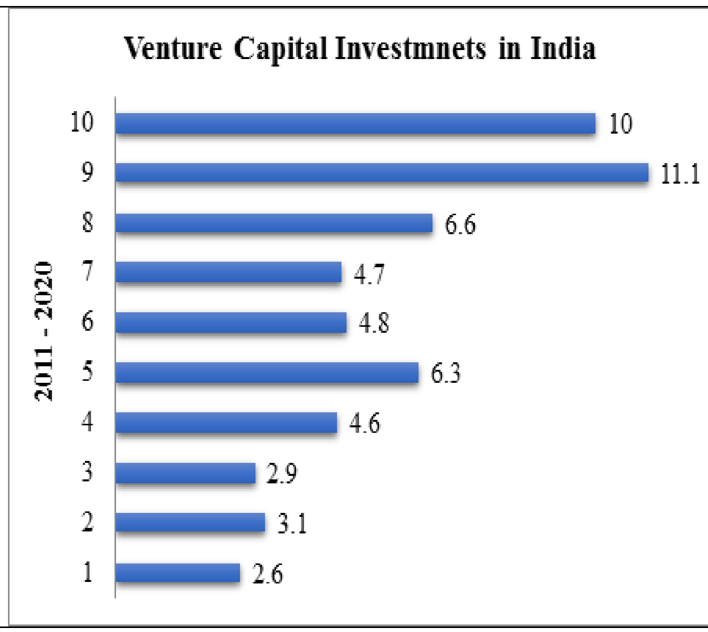
1. Determine the economic effects of venture capital in India.

## RESEARCH DESIGN

The study made use of secondary information. Statistics on venture capital and India's GDP are included in the secondary data. The study's data comes from the CMIE database, the Venture Intelligence and KPMG Database (VC-PE), and other relevant databases for the ten years between 2011-2012 and 2020-2021. Reliable data such as journals, publications, published and undiscovered research works, and websites were used to gather additional information for the study's analysis.

**Table 1:** Venture Capital financing in India

| Year | Investment (in $ billions) |
|---|---|
| 2011 | 2.6 |
| 2012 | 3.1 |
| 2013 | 2.9 |
| 2014 | 4.6 |
| 2015 | 6.3 |
| 2016 | 4.8 |
| 2017 | 4.7 |
| 2018 | 6.6 |
| 2019 | 11.1 |
| 2020 | 10 |




**ADF for Venture Capital Investments and GDP**

**$H_{01}$:** There is no unit root among the Venture Capital and GDP.

**Table 2:** ADF Test

| Variables | Level | |
|---|---|---|
| | ADF Test Statistic | Prob. |
| VC | .2513 | 0.0215 |
| GDP | 3.6521 | 0.0050 |

**Source:** Venture Intelligence

The table 2 concludes that the null hypothesis of having no stationary for all the given variables is rejected at their level since the ADF Probability value lesser than the critical values and have become stationary.

## Co-Integration Test of Private Equity Investment in India

The variables are integrated of I(0) and in this situation Auto Regressive Distributed Lag model can be used to extract both long run and short run relationship between the variables.

## Co-Integration Test

**$H_{02}$:** There is no co-integration between Venture Capital and GDP.

**Table 3:** ARDL Test

| Variable | Coefficient | Prob. |
|---|---|---|
| **VC** | 6.1250 | 0.0000 |
| **GDP** | .2351 | 0.0023 |
| **C** | 11.1772 | 0.0128 |

**Source:** Venture Intelligence

**Table 4:** Bound Testing for ARDL Co-Integration

| **Wald Test** | | | |
|---|---|---|---|
| **Null Hypothesis : PEI = SSM = NFY = 0** | | | |
| **F-statistic** | 11.1784 | **Probability** | 0.0001 |
| **Chi-square** | 487.1553 | **Probability** | 0.0004 |

**Source:** Venture Intelligence

The result indicated from the tables is that the probability values of the given variables are less than 0.05. Therefore the null hypothesis is rejected that means there is co-integration between the Venture Capital and GDP in India. In other words, Venture Capital affected GDP in the long run. Since there is long run relationship between the variables in India, so to determine the short term dynamic an Error Correction model is used and the result is displayed in table below.

**Table 5:** Error Correction Model Results

| Variable | Coefficient | Prob. |
|---|---|---|
| **DLVC** | 3.4410 | 0.0025 |
| **DLGDP** | -6.2170 | 0.0050 |
| **DLVC(-1)** | .8971 | 0.0410 |
| **DLGDP(-1)** | -2.7515 | 0.0038 |
| **ECT(-1)** | 0.1640 | 0.0041 |
| **C** | 1.8485 | 0.0020 |

**Source**: Venture Intelligence

Table 5 shows the Error correction results of region wise GDP in India. The coefficient of the error correction term in the model is statistically significant. The estimated coefficient value of 0.1640 of the error correction mechanism implies that the system corrects its previous period's disequilibrium from the long run estimates by 16 percent. The high significance of the coefficient of Error Correction Model term supports the existence of a long-run equilibrium relationship between the variables. From the table it can also be report that there had a short term relationship between variables too.

**Table 6:** Granger Causality Test

| Null Hypothesis | F- Statistic | p-value |
|---|---|---|
| VC does not Granger cause GDP | 15.1848 | 0.0233 |
| GDP does not Granger cause VC | 9.4859 | 0.0085 |

**Source**: Venture Intelligence

Table 6 reveals the results of granger causality test between the Venture Capital and GDP in India. It can be concluded that the null hypotheses are rejected since there is bidirectional impact between the variables.

## CONCLUSION

The year 2020 was genuinely remarkable for India, considering Covid-19's huge effect on the country's finances and healthcare institutions. GDP is predicted to fall by 8 percent in 2020, because more than 65 percent of the Indian economy had been at a standstill during the full closure, which concluded only in June 2020. However, new predictions even by International Monetary Fund (IMF) anticipate a robust rebound in 2021, with growth resuming to the long-term norm of 7 percent to 8 percent over 2022 to 2025. Within the year itself, Covid-19 had an essential role in dramatically advancing digital developments across sectors.It was mirrored in VC money flows and the creation of new, digitally based business models across industries. Overall, India's VC ecosystem has generated significant economic benefits for the country. Over the last eight years, a Large amount of capital has played a critical role in building India's start-up ecosystem, which has generated upwards of 3 million jobs direct or indirect, second only to the United States and China internationally.

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