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Research Article

The Working Structure And Investment Analysis Of Selected Venture Capital Firms Operating In Delhi Ncr.

Ms. Manisha[1*], Dr. Matloob Ullah Khan[2]

[1*]Research Scholar, School of Management and Business Studies, Jamia Hamdard, New Delhi- 110062
[2]Assistant Professor (Finance), School of Management and Business Studies, Jamia Hamdard, New Delhi- 110062

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ABSTRACT

In this research paper, the researcher studies the working structure and investment analysis of venture capital firms operating in Delhi NCR. The researcher also studies the introduction and brief Literature review of the Venture Capital firms. It is hard to find investors such as Venture Capitalists for those entrepreneurs, who are looking forward to raising capital in their startup businesses. This paper studies that investment by venture capitalists and their keen interest in funding new start-ups has been increasing day by day. This paper also aims at the growing awareness of this concept specific to the Indian scenario gives a boost to our economy especially when entrepreneurship startups are being given such importance. The paper would contribute to help in formingapolicy related to the investment criteria and working structure of venture capitalists in Delhi.

Keywords: Venture Capital and Investment Analysis.

INTRODUCTION

The concept of 'Venture Capital' can be understood in multiple ways. In a more specific context, it pertains to the act of putting money into emerging and inventive companies that may not have a proven track record of stable growth but hold the promise of yielding substantial returns for the venture firms in the future. Startup enterprises often rely on venture capitalists as their primary external funding source.

Entrepreneurs seek financial support for their newly established businesses, and when they collaborate with venture capital firms, these VC entities help mitigate investment risks. Additionally, venture capitalists are granted liquidation preference, which means that in case the company fails, they have the first claim to all of its assets and technology. They also wield voting rights on pivotal decisions like initial public offerings (IPOs) or the company's sale.

The approach to venture capital financing involves entrepreneurs identifying innovative ideas with profit potential, followed by careful evaluation and well-considered financial backing from venture capitalists. Given the substantial risks related to factors such as management quality, market expansion, and the adoption of new technology, venture capitalists face considerable uncertainties in their investments. The COVID-19 pandemic and ensuing lockdowns adversely affected startup operations, survival, and venture capital investments, posing a threat to early-stage ventures. In comparison to growth-stage ventures, early-stage ventures carry a higher degree of risk, making them less attractive for venture capital funding.

To illustrate, let's take a scenario where a venture capital firm invests $1 billion across various companies, and over time, these companies grow in total value to $3 billion. In this case, the venture capital firm earns a profit of $200 million. Out of this profit, $160 million goes to the investors, while the venture firm retains 20%, which is equivalent to $40 million.

Unfortunately, the minimum investment requirement for these funds is prohibitively high, making it inaccessible to most individual investors. Individuals who invest in startup companies are commonly referred to as Angel investors, and they retain 100% of the profits. Angel investors typically possess substantial wealth, as they need to have a net worth of at least $1 million to qualify. Unlike angel investors, most venture capitalists do not invest during the initial stages of a startup but instead wait for the business to develop further.

In today's contemporary financial landscape, venture capital stands out as a dynamic sector. It involves the process of VC firms raising capital from sources like insurance companies, pension funds, and high net worth individuals, which they subsequently invest in promising startups. Venture capitalists are individuals who possess a keen interest in backing innovative startups capable of making substantial contributions to the

economy. Their fundamental goal is to merge their financial resources with the innovative ideas of entrepreneurs.
The availability of funds is pivotal in driving the success and expansion of startup ventures. Venture capital organizations meticulously select startups that exhibit the potential for profitability, along with the ability to manage risks effectively while offering promising future returns. Venture capitalists willingly embrace the risks associated with the potential failure of startup enterprises.
The venture capital (VC) sector comprises four primary participants:

1. Entrepreneurs who seek financial backing for their ventures.
2. Investors who aspire to attain exceptionally high returns on their investments.
3. Investment bankers who facilitate the acquisition and sale of companies.
4. Venture capitalists who aim to generate profits by creating a market for the three aforementioned players within the industry.

OBJECTIVES OF THE STUDY

1. The main objective of this paper is about aware of venture capital firms,
2. The working structure and investment analysis of selected venture capital firms operating in Delhi NCR.

REVIEW OF LITERATURE

Pankaj Patel and Rodney D'Souza (2008): a study titled "Uncovering Knowledge Structures of Venture Capital Investment Decision Making" was conducted by Pankaj Patel and Rodney D'Souza. This research delved into the decision-making process within the realm of venture capital (VC) investments. It utilized various criteria and methods for aggregating utility, yielding diverse outcomes. In order to reduce both random and systematic biases in VC decision-making, the study employed an approach rooted in latent decision structures, drawing from the field of psychological scaling literature. The analysis involved the assessment of 143 business plans, encompassing both those that received funding and those that did not.
Additionally, the study highlighted that VC firms tend to display a greater inclination toward investing in business plans that exhibit higher potential for ventures, are positioned in favorable competitive landscapes, and hold substantial market potential. Such investments are often associated with the prospect of increasing returns. Conversely, VC firms are less inclined to invest in businesses with lower venture potential, even if they possess a strong team, as this tends to result in diminishing returns.
Douglas Cumming, Grant Fleming, Armin Schwienbacher (2006): The researcher explored the topic of "Legality and venture capital exists" within their paper. This study offers an analysis that investigates how the legal framework impacts the prevalence of venture capital investments. The research team examined a sample comprising 468 venture companies operating across 12 Asia Pacific nations, with a particular emphasis on venture capitalists' investments in entrepreneurial firms based in the United States. The study's results reveal a positive connection between a higher legality index in countries and the probability of initial public offerings (IPOs) occurring.
George Foster (2000): researcher addressed "*Venture Capital financing and the growth of startup firms*" in his research. This research paper explores the relationship between the existence of venture capital and the growth of startups. It delves into the question of whether venture capital drives growth or if growth itself indicates the necessity for venture capital. Additionally, the study investigates the potential impact of venture capital financing events on the growth trajectory of these firms.
David H. Hsu (2007): In the study titled "Experienced Entrepreneurship Founders, Organizational Capital, and Venture Capital Funding," the research paper investigates the acquisition and assessment of venture capital funding among entrepreneurs with varying degrees of prior startup founding experience, academic background, and social capital. The study's outcomes yield two significant findings. Firstly, an escalation in prior startup founding experience has a positive impact on both securing venture capital funding and determining the value of entrepreneurial ventures. Secondly, the capacity to attract executives with their own social networks is positively linked to the valuation of these ventures.
Sabrinathan G. – This research paper focuses on the topic of "Angel investment in India - Trends, Prospects, and Issues." The paper commences by describing the investment activities of individual angel investors and angel networks. It highlights the distinctions between angel networks and individual or independent angel investors in terms of organizational structure and investment practices. Additionally, the paper presents an overview of top-level data concerning angel investment trends in India over the past fifteen years.
Jean –Etienne De Bettignies, James A Brander (2007): researcher addressed "*Financing Entrepreneurship: Bank finance versus venture capital*" in his paper. In this research paper, the researcher delve into the decision-making process that entrepreneurs go through when making choices between bank finance and venture capital. Opting for bank finance allows entrepreneurs to maintain full control over their business and provides them with strong motivations to allocate their efforts efficiently. Conversely, venture capital financing introduces a two-fold moral hazard challenge, as it hinges on efforts that are difficult to verify from both the entrepreneur and the venture capitalist (VC). Consequently, venture capital financing becomes a more attractive option compared to bank finance when the effectiveness of venture capital is high, and the entrepreneur's effectiveness is relatively lower.

Dr. Jaya Manglani (2014): conducted a study on the topic titled "VENTURE CAPITAL FINANCING & INNOVATIVE SKILLS OF INDIAN ENTREPRENEURS". In this paper, the researcher conducted an analysis of the developments within the venture capital (VC) financing industry, particularly in terms of investment participation, deal volume, and its positive influence on the economy and its future prospects. The study unveiled that during periods of rapid economic growth, VC firms tend to achieve heightened profitability, which subsequently translates into increased gains for the companies within their portfolio. Additionally, VC financing proves advantageous for extended-duration projects such as BOT (Build, Own, and Transfer) and Public-Private Partnerships.

The researcher's conclusion underscores that the present era signifies an evolution that opens up fresh opportunities for venture capital investors, corporate investors, and innovative entrepreneurs. This evolution allows the industry to continue making substantial contributions to fostering innovation and generating employment opportunities on a global scale.

Tarek Miloud, Arild Aspelund, and Mathieu Cabrol (2012): explained "Startup valuation by venture capitalists: an empirical study" in their paper. This research paper aims to analyze the valuation process carried out by venture capitalists when assessing a new venture. The valuation is believed to be influenced by strategic factors that are crucial for the firm's performance. The study involved an examination of 102 investee firms from 18 different countries. The researchers emphasize the importance of venture capitalists considering these performance-related factors when valuing new ventures. To conduct their analysis, they utilized data from Thomson Financial Securities Data (TFSD), which is the official data collector for the National Association of Venture Capitalists and a highly reputable source for venture capital investment data. The Shapiro-Wilk W Test was employed for statistical analysis. The authors highlight that these empirical findings bridge the gap between well-established theories in strategic operations and the relatively under-researched practice of venture capital valuation.

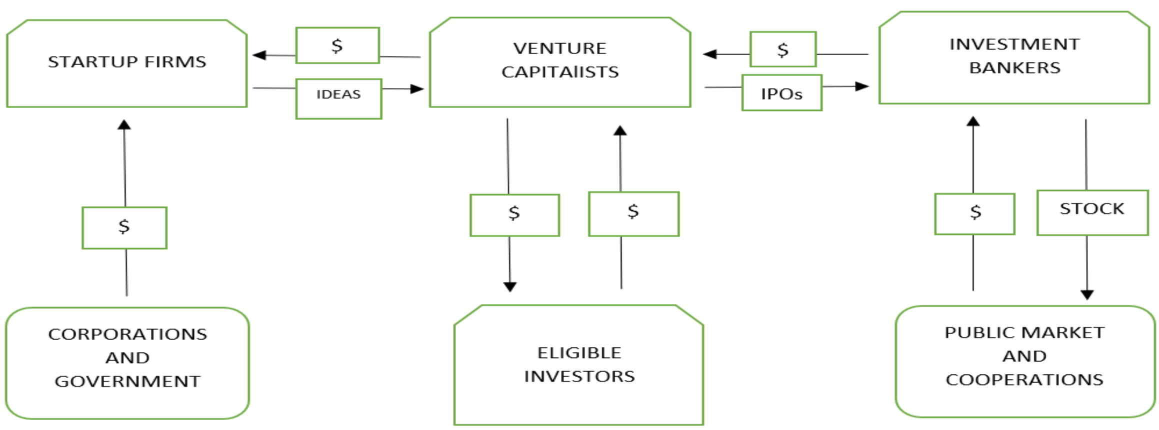
Gompers Paul, Gornall Will, Kaplan Steven N. and Ilya A. Strebulaev (2016): did a study on the topic titled "How do venture capitalists make decisions?" A survey was conducted on 885 institutional venture capitalists (VCs) representing 681 enterprises to gain insights into their decision-making processes across eight key areas: deal sourcing, investment selection, valuation, deal structure, post-investment value-added, exits, internal firm associations, and connections with limited partners. The findings indicate that venture capitalists place greater importance on the management team compared to other business-related characteristics such as the product or technology. Furthermore, the survey reveals variations in practices based on factors such as industry, stage of investment, geographical location, and past success.

Sonia (2017): did a study on the topic titled "Investment decisions of venture capital providers in India". In this study, the researcher discusses the diverse investment criteria utilized by venture capital providers in India, which exhibit substantial variations. These investment criteria encompass various aspects such as management, finance, and growth prospects of the target company. The decision-making process employed by venture capital providers involves considering factors including the business plan, management team, financials, market dynamics, competition, product or service offering, customer base, and industry dynamics. The study indicates that the investment criteria and variables demonstrate a certain level of success, as they exhibit a significant relationship with the success parameters under investigation, with the exception of one parameter.

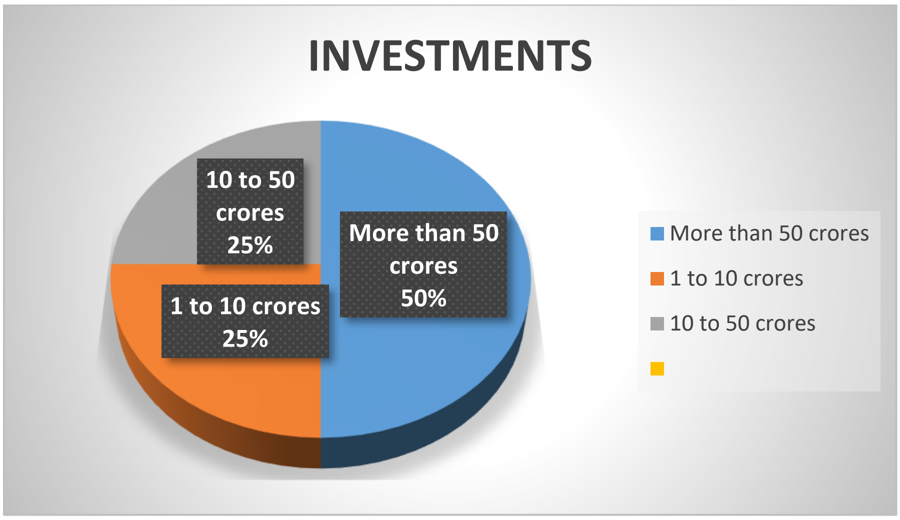
HOW VENTURE CAPITAL FIRM WORKS

ere are four main players in the venture capital industry i.e. startup firms that need funding for their projects, investors who want to earn high returns from their investments, investment bankers who need companies to sell, and venture capitalists who make money for themselves by creating a market for the rest three.

SECTOR-WISE APPROACH OF PARTICULAR COMPANIES.



The extent of investment made by venture capitalists in a particular company can vary based on multiple factors. These factors include the company's stage of development, funding requirements, growth potential, profitability prospects, and market competition.
During the early stages of a startup, venture capitalists often make smaller investments, typically ranging from a few hundred thousand dollars to a few million dollars. This approach allows them to acquire a smaller ownership stake in the company, minimizing their risk while the company is still in its initial phase.
As the company progresses and demonstrates potential for success, venture capitalists may increase their investment through subsequent funding rounds, known as follow-on funding. This can lead to a larger ownership stake in the company and a higher potential return on -investment.
The extent of investment by venture capitalists can also be influenced by the terms of the investment agreement. For instance, venture capitalists may negotiate for preferred stock, which grants them certain privileges and preferences over other shareholders. These privileges can include receiving dividends before common shareholders or participating in future funding rounds.
Overall, the extent of investment by venture capitalists in a specific company can vary significantly based on various factors, including the unique circumstances of the investment and the objectives of both the venture capitalist and the company seeking funding. In India, investments in early-stage startups typically range from a few hundred thousand rupees to several crore rupees. On the other hand, later-stage startups or those in more established industries may attract larger investments ranging from tens of crores to hundreds of crores.
The actual amount of investment made by venture capitalists in a startup can also be influenced by the specific terms negotiated in the investment agreement. For instance, venture capitalists may seek a certain percentage of equity in the company in exchange for their investment.



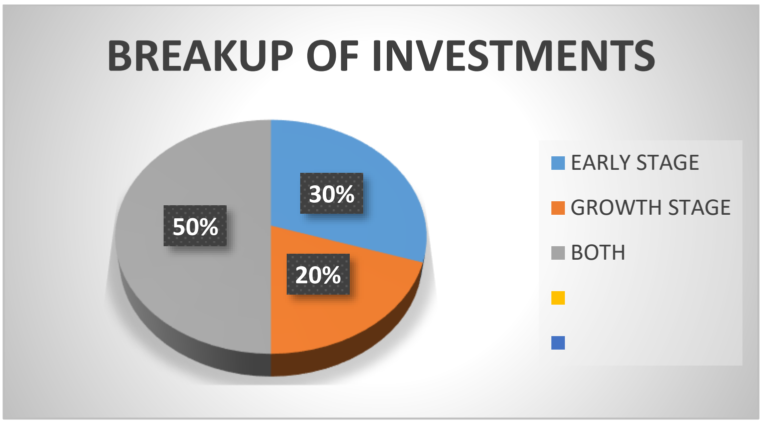
It's worth noting that venture capitalists typically invest in a company in exchange for equity or ownership shares. Therefore, the actual investment amount is determined based on the company's valuation and the desired percentage of ownership sought by the venture capitalist. A higher valuation allows the startup to raise more capital while maintaining a specific equity percentage, and vice versa.
The precise amount of investment made by venture capitalists is established through negotiations between the startup and the venture capitalist, taking into account the startup's requirements, the available capital of the venture capitalist, and the potential return on investment. As the company progresses and demonstrates its potential for success, venture capitalists may provide additional rounds of funding. These subsequent rounds can range from a few crores to several hundred crores, serving to fuel the company's growth and expansion.
Overall, the investment amount contributed by venture capitalists in a startup can vary significantly based on the specific circumstances of the investment and the needs and objectives of both the venture capitalist and the company seeking funding.
Venture capitalists (VCs) assess their investments based on a range of criteria, which include the following:

1. Team: VCs seek a capable and experienced team with diverse skills and a proven track record. They look for evidence that the team can execute the startup's business plan effectively.
2. Market: VCs target startups that address sizable and expanding market opportunities. They expect the startup to have a clear understanding of its target market, encompassing its size, demographics, and consumer behavior.
3. Product/Service: VCs evaluate the startup's product or service to determine its ability to solve a genuine market problem. They seek uniqueness and differentiation from competitors, along with a compelling value proposition.
4. Traction: VCs prefer startups that have demonstrated early market traction, such as customer adoption or revenue growth. They expect the startup to have a clear path to scale its business further.

5. Financials: VCs scrutinize the startup's financial projections to assess the viability and sustainability of its business model. They expect a realistic plan for revenue generation and profitability.
6. Exit Strategy: VCs inquire about the startup's strategy for achieving a return on their investment. They evaluate the proposed exit strategy, whether it involves an IPO or acquisition, to ensure alignment with their investment goals.
7. Risk: VCs evaluate the risks associated with the startup and its target market. They seek an understanding of potential challenges and obstacles the startup may encounter, as well as the team's mitigation plans.

VCs employ a combination of qualitative and quantitative factors to assess their investments. They aim to identify startups with the potential for significant returns while minimizing risks. The specific criteria used by VCs may vary depending on the startup's stage, market conditions, and the preferences of the VC firm.

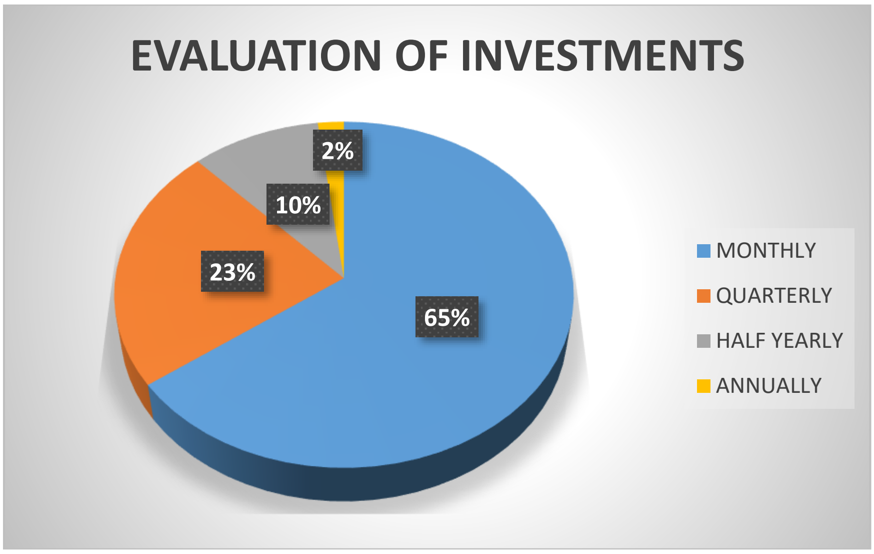
4.1.2. STAGE-WISE BREAKUP OF INVESTMENTS



Here is a breakdown of venture capital investments according to different stages:
1. Seed Stage: At this initial phase, startups seek funding to develop and test their product or service. Venture capital firms may invest in seed-stage startups to help them establish themselves. In 2021, approximately $11.7 billion, constituting about 16% of total venture capital investments, was invested in seed-stage startups, according to the National Venture Capital Association.
2. Early Stage: Startups in this stage have typically developed their product or service and aim to secure funding for business expansion. Funds at the early stage are often allocated for hiring additional staff, expanding marketing efforts, and developing new products or services. In 2021, venture capital firms invested approximately $43.4 billion, accounting for about 60% of total venture capital investments, in early-stage startups.
3. Later Stage: Startups in the later stage have validated their product-market fit and require funding to further scale their business. This funding is commonly used for market expansion, acquisitions, or preparing for an initial public offering (IPO). In 2021, venture capital firms invested around $13.8 billion, constituting about 19% of total venture capital investments, in late-stage startups.
4. Growth Stage: Startups in the growth stage have gained substantial traction in their market and seek funding to accelerate their growth. Funding at this stage is often directed towards hiring additional staff, expanding marketing efforts, and developing new products or services. In 2021, venture capital firms invested approximately $5.5 billion, accounting for about 7% of total venture capital investments, in growth-stage startups.
5. Other Stages: Venture capital firms may also invest in startups at various other stages, such as bridge financing or mezzanine financing. Bridge financing provides short-term funding while a startup raises a larger funding round, while mezzanine financing offers funding between debt and equity financing. In 2021, venture capital firms invested roughly $1.5 billion, representing about 2% of total venture capital investments, in startups at other stages.

It's important to recognize that the proportion of investments in each stage can vary based on market conditions, investor preferences, and funding availability. Additionally, the definitions of each stage may differ among different sources and investors.

4.1.3. EVALUATION OF THEIR INVESTMENTS



Venture capitalists (VCs) continuously assess their investments rather than following a fixed schedule, such as weekly, semi-annual, or annual evaluations. The frequency and timing of evaluations depend on the investment stage, portfolio company requirements, and VC firm preferences. Before making an investment, VCs perform due diligence, conducting a comprehensive analysis of the startup's team, market, product/service, financials, and exit strategy. This evaluation process may take several weeks or months, depending on the investment's complexity.

Once an investment is made, VCs closely monitor the startup's progress, providing guidance and support as necessary. This involves regular meetings with the management team, reviewing financial statements and reports, and tracking key performance indicators (KPIs) like revenue, customer acquisition, and user engagement.

Periodic reviews of portfolio companies may also be conducted to assess performance and determine if additional resources or support are required. These reviews may occur quarterly or annually, depending on the VC firm's preferences and the portfolio company's needs.

Apart from ongoing monitoring, VCs may periodically conduct valuations to determine the current value of their investments. The frequency of these valuations can range from annual to more frequent intervals, depending on regulatory requirements and the VC firm's needs.

The evaluation frequency varies widely based on the investment stage and individual VC firm preferences.

1. Early-stage investments: For early-stage investments, VCs typically have regular check-ins with the management team, ranging from weekly to monthly, to track progress and address challenges.
2. Mid- to late-stage investments: For more mature startups, check-ins may be less frequent, such as quarterly or semi-annual reviews, which involve a deeper analysis of financials and market performance.
3. Annual reviews: Most VC firms conduct an annual review of their portfolio companies, regardless of the investment stage. This comprehensive analysis includes assessing the startup's performance over the past year and evaluating future prospects.

It's important to note that the evaluation frequency depends on the VC firm's investment strategy, investor preferences, and the unique characteristics of each portfolio company. Some VCs may engage in more frequent check-ins for closer involvement, while others adopt a more hands-off approach. Ultimately, the evaluation frequency should be tailored to the specific investment and aligned with the goals and objectives of both the VC firm and the startup.

INVESTMENT DECISIONS MADE BY VENTURE CAPITALISTS

Venture capital firms follow a structured process when making investment decisions in individual companies, which encompasses several pivotal stages. Initially, they scrutinize the company's business plan, which serves as the starting point for their evaluation. Subsequently, they arrange an initial meeting, facilitating face-to-face interactions between the venture capitalists and the entrepreneurs. These initial phases can be likened to the investigative phase of the company assessment. Through these steps, venture capitalists form judgments regarding the feasibility of investing in the company. This methodical approach allows venture capitalists to mitigate uncertainties and evaluate the risks associated with investing in a particular business.

Venture capitalists are particularly interested in understanding the level of competition in the market they intend to invest in. They recognize that higher competition can pose challenges to the growth of the venture. Previous studies have shown that venture capitalists deliberately examine the extent of competitive threats in the market before making investment decisions.

Moreover, venture capitalists have a preference for directing their investments toward sectors that exhibit substantial growth potential. Given that they might not possess an in-depth understanding of particular sectors or entrepreneurial ventures, they concentrate on pinpointing industries that genuinely pique their interest. To make well-informed investment choices, it is imperative for venture capital firms to acquire a comprehensive comprehension of specific sectors and then channel their efforts towards those sectors.
On the flip side, angel investors, who predominantly invest in high-growth entrepreneurial domains, bridge the financing gaps in the market that other investors may hesitate to address. These investors, frequently high-net-worth or affluent individuals, inject early-stage capital into companies during their nascent startup phase. Angel investors can encompass entrepreneurs, family members, and friends, or they may participate individually or through crowdfunding platforms or engage in angel investor networks to pool resources. They enter the picture at a very early stage, typically when revenue visibility is absent, and risk levels are high. Beyond financial resources, they also bring their valuable business expertise to the table.
Additionally, the nature of the product also plays a crucial role in the investment decision-making process for both venture capitalists and angel investors. They seek products that are unique, innovative, and capable of creating demand in the global market. Therefore, venture capitalists and angel investors are particularly interested in investing in innovative products because they recognize that such products, which have the potential to generate substantial demand, are more likely to deliver better returns in the future.

WHAT DO VENTURE CAPITALISTS LOOK FOR IN A STARTUP?

- Clear vision and strong conviction are essential.
- The team should consist of top-notch talent, even if it's a lean team.
- Traction and scalability are crucial factors to consider.
- The target market size should be substantial.
- Avoid small market sizes.
- Valuation of the company should be reasonable.
- An exit strategy should be in place.

RESEARCH METHODOLOGY

The research is based on descriptive sources, primarily collecting data from online sources, as well as multiple published articles and journals that offer insights into funding criteria in various startup firms. The literature review reveals an extensive body of work dedicated to the topic of venture capital, highlighting the significant role it plays in the growth and development of startup firms.

CONCLUSION

In summary, venture capitalists face a multitude of obstacles when evaluating potential investments in specific businesses. The world of venture capital has been extensively explored, with comprehensive research delving into the decision-making processes of these firms. These entities are required to comply with a range of both local and global regulations and investment criteria. The realm of venture capital investment, especially in the context of supporting startups, is a dynamic and captivating financing avenue that has been subjected to thorough examination. The primary aim of this paper is to provide a thematic overview of the existing body of literature, forging connections among pertinent research findings, and laying the groundwork for future investigations in this vibrant field.

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