

Venture Capital

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ABSTRACT: Venture capital can offer 10 to 1000 times return. However often the return is rather modest and only slightly higher than Stock Market. Venture Capital however leads to creation of innovation of path breaking goods and services.

During the dot com boom days at the turn of millennium, I have explored trying to start a company and get venture capital. Needless to say I was among the 99% of entrepreneurs rejected by Venture capital firms. But that short experience of 6 months, taught me enough about Venture Capital. Venture Capital is the funding of startups in exchange for equity. Venture Capital is called so because it is very risky. But on the flip side Venture Capital gives manifold returns - 100X or so - meaning 100 times the capital in 10 years or around that.

Of course, there can be confusion in terminology like seed funding, angel investing, and venture capital. Suffice it to know that all of these are extremely early stage investments in an innovative idea.

The whole thing begins with an idea - such as say Facebook or Google. And then the entrepreneur starts with some funds of his own which may be called seed funding, to be followed by angel investment which comes a little later and when the idea has taken off, and then comes full blown venture capital.

For all these early state investments the payoff comes when investors exit through an Initial Public Offer or Private Placement of stake.

Venture Capital took off in a big way after the advent of the Internet. For instance, in 1990, total Venture Capital funding was around 1.5 billion dollars and that grew to 90 billion dollars by 2000.

Of course, after the dot com boom and dot com crash a little after 2001, the venture capital craze has shrunk considerably.

As a share of the GDP, Venture Capital is just 0.2% of GDP. So despite all the brouhaha, venture capital is almost nonexistent. And any person can invest in venture capital firms just as any person can invest in mutual funds. Alternatively, an individual can invest in startups on venture capital. Sometimes venture capital does give great returns. For example:

1. Whatsapp: Sequoia Capital converted its 60 million dollars into 3 billion dollars
2. Facebook: When Accel Partners & Breyer Capital invested Facebook had a valuation of 100 million dollars and it sold at 16 billion dollars when it went for IPO.
3. Alibaba: Softbank's investment in Alibaba increased from 20 million dollars to 60 billion dollars.
4. Google: Kleiner Perkins, Sequoia Capital, Caufield and Bayers got a 300X return in 5 years for their investment in Google.
5. Twitter: Union Square Ventures converted its 5 Mn dollar investment into 800 Mn dollar investments in 5 years getting 160 X return.

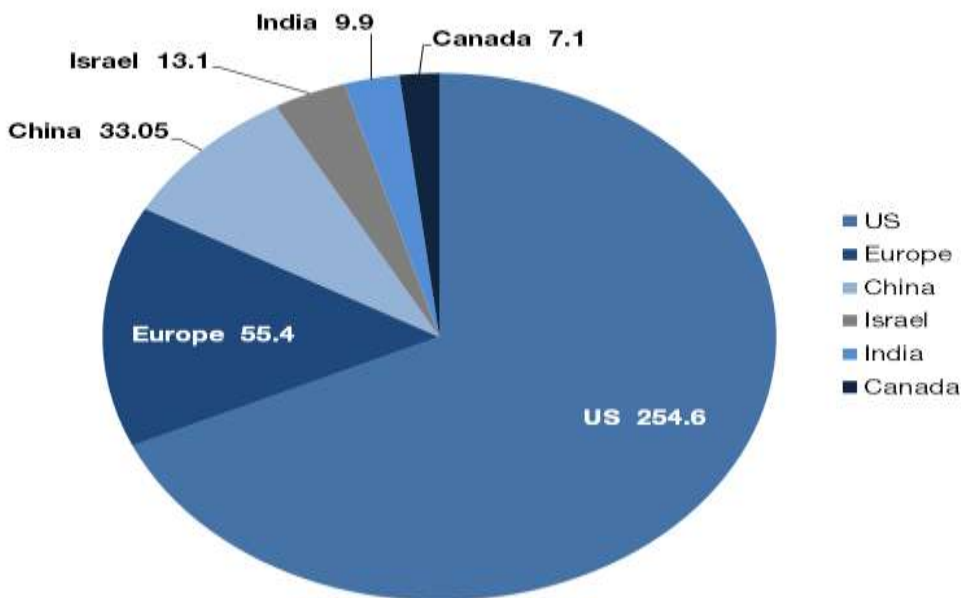
However, most of the time venture capital funds on average get returns of 15% to 30%. That is rather good and better than stock market returns. However, if that excites you here is a reality check. A study by Shikhar Ghosh, faculty at Harvard Business School says that 75% of startups fail as in don't return capital at all. And almost 35% fail completely. And if you go as per projections submitted to venture capital companies then 95% fail. Yet venture capital does give a good return than the stock market with also huge risk potential. After all, if 35% of companies fail, the risk is far higher than the stock market. Very interestingly Venture Capital is still a rather American phenomenon, though Asia seems to have been catching. Europe, despite its economic activity compared to the United States, is a laggard when it comes to venture capital.

Table 1. Venture Capital Investment Billion Dollars in 2020- Region Wise

Region	Venture Capital Investment Billion Dollars in 2020
North America	132 billion dollars
Europe	34 billion dollars
Asia	87 billion dollars
Rest	6 billion dollars

Top countries for total venture capital invested

Share of total venture capital invested 2006-2013, \$ billions



Source: Ernst & Young

Figure 1. Venture Capital Investment Billion Dollars in 2006-2013

Source: Ernst and Young

The Global GDP is 80 trillion dollars and annual investment may be around 20 trillion dollars. Thus annual venture capital investment of around 200 billion dollars represents just 0.2% of Global GDP and 1% of total investment. Hence it could be argued that Venture Capital is not important. However consider the kinds of organizations that Venture Capital has created - Facebook, Google, Twitter, Amazon, Alibaba and then you realize the tremendous contribution to innovation and human well being that is unleashed by very small venture capital investment.