CHAPTER 1

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1.0 Background

Entrepreneurs convert ideas into opportunities of producing tangible products and providing intangible services (Sharpe, 2009; Mani, 2008) and are treated as backbone of the economy, with enterprise being the barometer (UNCTAD, 2005). They immensely contribute to the Gross Domestic Product (GDP) of the country (Mani, 2009). Entrepreneurship is reflected by self-employment rate (Acs et al., 2005), number of small firms and market participants (Carree and Thurik 1998; p.16; OECD, 1998; pp.11-12). Higher degree of entrepreneurial activity leads to higher economic growth (Acs et al., 2005; Reynolds et al., 2002; pp.7-24). The growth chart of rural areas is not in tandem with growth chart of urban areas. Rural areas face structural weakness, limited income generating opportunities, neglect of agriculture research, poor economic and social infrastructure and high level of poverty (The Economist, 2005). Considering the ancient relationship between entrepreneurship and economic growth (Acs and Armington, 2005), economists emphasize that a proper way of alleviating poverty and improving human well being in poor nations is routed through increasing economic growth (Strong, 2008). The growth of Small and Medium Enterprises (SMEs) and Small Scale Industries (SSIs) holds the key role to resolve the problems of poverty and unemployment and generate economic development of the nation (Vetrivel et al., 2010, p.29).

The role of imitating (Schmitz, 1989) and innovative entrepreneurship in boosting dynamic national growth and increase of employment is colossal (Schumpeter 1911; Schumpeter 1942; Dejardin 2000; Jääskeläinen 2000; Thurik and Wennekers 2001; Barreto 1989). There are several aspects which prove the rise of innovations in India with respect to service and knowledge based sectors (Mani, 2009, p.41). According to Economic Intelligence Unit’s report of 2009, India’s rank in its Global Innovation Index stands at 56 in 2004-08 (Mani, 2009, p.43). Policymakers never used the term innovation in explicit manner; it was recently titled in policy of 2003 as Science and Technology, given the increasing number of Indian innovations, when a draft on National Innovation Act is on the anvil (Mani, 2009). Of late, it was comprehended that entrepreneurial growth is driven on technological advance and knowledge accumulation through Research and Development (R&D) efforts (Peretto, 1999).
Technological innovations are necessary for making societies wealthy (Strong, 2008). The thesis provided by Zoltan Acs, research chair of the Global Entrepreneurship Model (GEM) project described that higher the ratio of “opportunity entrepreneurs” (who create real businesses that grow based on identified entrepreneurial niche) to “necessity entrepreneurs” (self-employed poor people struggling to survive), will lower the incidence of poverty in various countries (Strong, 2008).

Primary reason to advance rural entrepreneurship is to foster strategic rural development intervention for rural employment, supplementary income generation in rural areas, non-reliance on asymmetrical seasonal amount of income derived from agriculture, dependent on erratic monsoon and finally equitable development of the country (Sharma and Chhibber, 2007; Soundarapandian, 2001; Gladwin et al., 1990). Villagers strive to become rural entrepreneurs, start new businesses, generate economic activity and utilize the surplus labour (Gladwin et al., 1990). Illustrations of rural entrepreneurship are provided by diversification into non-agricultural activities and formal horizontal expansion of agriculture and allied activities (Sharma and Chhibber, 2007; Sinha, 2007; Soundarapandian, 2001; Gladwin et al., 1990). Considering the importance of knowledge based economy, Gupta et al., (2001) made a noteworthy comment that keeping the poor constantly engaged in low value-adding activity will only perpetuate their poverty; to break the shackle of poverty their skills and traditional knowledge will have to be acknowledged for, by developing a market for such innovations (Gupta, 2005). The role of innovations is being appreciated not only at urban level but also rural innovations are considered capable enough to reverse the model of globalization from grassroots to global markets (Abrar and Nair, 2011).

To give physical shape to ideas and commercialize the innovation, risk capital is required. Innovation and finance are inextricably linked (Sharpe, 2009). Conventional sources of finance like banks, financial institutions etc., provide finance to well established enterprises of urban areas. The sources of funds for rural development are diagrammatically represented as follows.
From the above figure it can be seen that domestic and foreign set of institutional and non-intuitional funds are used for rural development. Institutional funds are mostly targeted for rural infrastructure development whereas non-institutional funds are targeted for individual specific requirement for the purpose of self-employment. MF a well rooted source has been recognized as a popular tool for poverty alleviation which seeds the entrepreneurial spirit, and boosts rural enterprises (Strong, 2008; Mistry and Arora, 2007).

From 1990 onwards a new finance solution in the form of Venture Capital (VC) and Private Equity (PE) emerged to cater to the needs of technocrats and budding entrepreneurs (Chary, 2010). VC and PE play a role distinct from conventional stringent debt financers. They provide equity finance to innovative, high growth potential firms owned by sophisticated and well educated entrepreneur of urban areas. VC and PE bridges the equity and competency gap (Retrieved from http://www.hbs.edu/entrepreneurship/pdf/Puri_Zarutskie-summary.pdf, as on March, 2010).
Rural entrepreneurs face various problems like lack of finance, know-how etc., (Mistry and Arora, 2007; Nath and Singh, 2007). At rural level growth of Micro Small and Medium Enterprises (MSMEs) sector is stagnant either due to lack of access to capital or the available micro credit is too small to start a new business (Retrieved from http://www.aavishkaar.org/index.htm, as on March, 2011). Conventional Venture Capitalists (VCs) target big ticket investments. It is also observed that most venture funds failed to help innovation based entrepreneur who did not have much net-worth (Gupta et al., 2003). Business which specifically addresses the needs of remote rural areas does not find the risk capital (Retrieved from http://www.aavishkaar.org/index.htm, as on March, 2011). It is this point where the role of Micro Venture Capital Finance (MVCF) is imperative.

1.1 Micro Venture Capital: Concept and Characteristics

To understand the upcoming concept of Micro Venture Capital (MVC), one needs to know Micro Finance (MF) and VC. Micro credit (MC) is a subset of MF. MC and MF are used interchangeably. MF is provision of financial services to low income poor and self employed poor people, who are neglected by banks (Schreiner and Colombet, 2001). MC refers to small loans (Sinha, 1999; Roy, 2007) and micro finance supplements small loans (Schreiner and Colombet, 2001) with small deposits (Schreiner and Colombet, 2001; Roy, 2007), savings, insurance, pensions and payment services with the help of NGOs and MFIs (Sinha, 1999; Okiocredit, 2005; Ledgerwood, 1999; Robinson, 1999) for undertaking self-employment projects (Chavan, 2002).

The most comprehensive definition of MF is stated by Robinson (a research fellow) as, “MF refers to small scale financial services for both credits and deposits-that are provided to people who farm or fish or herd; operate small or micro enterprises where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries, in both rural and urban areas” (Retrieved from http://www.mssriram.in/sites/mssriram.in/files/microfinance-RT_0.pdf/, as on May, 2011).

VC, defined as independently managed, dedicated pools of capital that focus on equity, or equity-linked investments in privately held, high-growth companies (Kaplan and Lerner,
plays a role in translating R&D activities into commercial outcomes and is therefore credited with a catalytic role in innovation (Christofidis and Debande, 2001). VCs has evolved as providers of seed capital to start ups, as finance providers on flexible terms and providers of all types of operational and organizational assistance. VCs plug in the role as a mentor, decision maker and financer. VCs provide financial and managerial resources in the project and finally divest their equity holdings at market price when the project reaches profitability stage (Kumar, 1995). According to Mishra (1998) traditional bankers are ‘finished intermediary’ and VCs are ‘resource manager’ for high risk rapid growth ventures that promise faster returns.

Pandey (1996, 1996a) has given a comprehensive definition of VC in the Indian context. According to him, VC is an investment, in the form of equity, quasi-equity and sometimes debt-straight or conditional (i.e. interest and principal payable when the venture starts generating sales), made in new or untried technology, or high risk ventures, promoted by a technically or professionally qualified entrepreneur’s where the venture capitalists expects the enterprise to have a very high growth rate, provides management and business skills to enterprise, expects medium to long term gains and does not expect any collateral to cover the capital provided.

From the above definition of VC it is clear that VC financing promotes the growth of urban innovations undertaken by well educated and qualified entrepreneurs. VC has a wider scope of financing when compared to MVC. MVCs operate in a niche. According to definition of Wordiq, “MVC financing invests in projects too small to attract attention of more traditional VCs” (Retrieved from http://www.wordiq.com/definition/Micro_venture_capital, as on December, 2010). According to the definition of New Partners for Community Revitalization (NPCR), “MVC is an equity investment where investor takes partial ownership position. The investor’s role may be as either silent or active partner. A preferred return rate or amount may be specified in initial agreement, but the investor assumes an uncollateralized risk that if the business is not profitable, there will be no return. The exit strategy- how one gets the investment back with a return will vary” (Retrieved from http://www.cura.umn.edu/publications/NPCR–reports/npcr1104.pdf, as on May, 2011).
According to the definition of Aavishkaar India, a Micro Venture Company having MVC Fund, “micro capital is the support of businesses which need start up capital greater than those provided by Microfinance Institutions (MFIs) but smaller than those provided by VCs” (Retrieved from http://microcapitalmonitor.com/cblog/index.php/?archives/300-Another-Micro-Venture-Capital-Fund-Seeks-to-Fill-the-Gap-between-Microfinance-and-Venture-Capital-Agora-Partnerships-Funds-Entrepreneurs-in-Nicaragua.html, as on April, 2008).

The most comprehensive meaning of micro venture finance is explained by National Innovation Foundation (NIF) as, “The fund which is to provide means of finance for innovation and traditional knowledge-based micro ventures, which are generally not given any priority by other venture capital funds (VCFs) and financial institutions (FIs). It helps in extending risk capital to many ventures which otherwise are too risky for FIs to fund in the beginning” (Retrieved from http://www.nif.org.in/bd_mvif, as on October, 2007). Providers of MVC are now referred as growing breed of ‘social venture capital funds’, which look to invest in companies that deliver social benefits and generate decent financial returns (Retrieved from http://business.outlookindia.com/printarticle.aspx?264361, as on March, 2010).

From above definitions, certain features of MVC investments can be known. It bridges the financial gap by bringing in investments to innovations in order to create viable micro enterprises at grassroots. MVC like social venture capitalists are passionate about helping people, the commercial returns is usually secondary concern. They make money by serving the needs of the people at the bottom of the pyramid (Retrieved from http://business.outlookindia.com/printarticle.aspx?264361, as on March, 2010).

MVC investment builds a financial ecosystem that would nurture entrepreneurs by providing risk capital for scalable rural focused enterprises. Along with the provision of risk capital, it promotes participative business practices, introduces efficiency, empowers masses by creating widespread ownership and sets fair distribution of return (Retrieved from http://www.aavishkaar.in/, as on March, 2010). Micro venture finances small amount of resources for ideas, technologies, innovations and prototyping and economic activity at the bottom of the pyramid and boosting the entrepreneurial spirit.
1.2 Need for the Research

There exists no dearth of literature on MF in the context of Indian as well as global scenario from macro and micro perspectives. Researchers from management, finance, economics, entrepreneurship and cooperatives have studied the progress, prospects and problems of MF. Colossal, conceptual (Gulli and Berger, 1999; Singh, 2009; Lokhande, 2009; Patel, 2009; Sengupta, 2007; Roy, 2007; Tripathy and Tripathy, 2007), disbursement (Hema et al., 2009; Ravindranath, 2009; Saha, 2007) and experimental studies (Balkenhol, 2007; Karmakar, 1999; Chavan, 2002; Roy, 2007) have been conducted in the field of MF based on various geographical territories.

Scholars and researchers have appreciated the importance of MF (Von Pischke, 1991; Karalay, 2005) as it plays significant role in women empowerment (Saha, 2007; Namboodiri and Shiyani, 2001; Sreelakshmi and Shetty, 2008) by providing need based finance (Sheokand, 2000, Lokhande, 2009; Ravindranath, 2009; Karalay, 2005; Balkenhol, 2007). MF has been studied as a field of mainstream finance research (Brau and Woller, 2004) along with post disbursement study to identify the problems associated with MF (Sheokand, 2000; Kaur and Saini, 2007; Basu and Srivastava, 2005; Sundaresan, 2008). A comprehensive study on literature review by Brau and Woller (2004) have segregated the study on parameters of self sufficiency and sustainability of MFIs, MFI products and services, best practices in MFI management, client targeting, policy and MF, and impact of MFI. All the studies highlighted the contribution of MF for the purpose of self employment.

Researchers from diverse field have tried to explore the parameters, techniques, methodology of evaluation and mode used by VCs to provide finance to budding entrepreneurs. Empirical, exploratory and conclusive literature work is done by various researches in the field of VC. They have found that search for market attractiveness, product differentiation (Tyebjee and Burno, 1984; Pandey, 1996) preference for liquidity, essential location, cross section ownership preference (Kumar, 2002; Kumar and Kaura, 2003) and accurate business plan (Macmillan, Siegel and Subbanarasimha, 1985) were considered as the major funding criteria adopted by VCs.
Indian researchers either borrowed or extended the literary work of VCs of USA, Europe, Germany, UK or Japan, by applying the same parameters of research in Indian context. Studies made by (Kumar, 1996; Verma, 1997; Mitra, 2000; Pandey, 1996) scholars were directives to government for future course of action. Analytical research in India was merely based on the annual reports of VC industry. Case based research was carried out by domestic academicians to identify the problems faced by Indian VC firms (Pandey, 1998). Various studies on VC indicated the new architect of the new economy, where lot of money was going into funding of various new economies sophisticated, urban business models.

On the review of literature it was found that a good idea often slipped away due to unavailability of small sum of money. VCs are more fascinated to finance high-tech and dot com projects. VCs have overlooked innovations at the grassroots level (innovations which reduce drudgery through simple yet highly practical innovations). To attract capital for commercialization, what is needed is not just another VCs or angel investor. In order to tackle the inherent problem of low and stretched economic returns, an entirely new model of funding is required. A micro venture capital fund involves comparatively small amounts of money for grassroots innovation is required. The MVC is a novel concept and notable innovation in itself. It refers to the idea of barefoot venture capitalism. MVC is a cousin to MC and downsized approach to professional VC, which makes a trade off between low economic returns and high social returns (Retrieved from http://goodnewsindia.com/index.php/Magazine/story/aavishkar-innovators., as on June, 2008).

The empirical or exploratory research carried out in the field of VC is highly sophisticated. No cases were found where professional VCs have funded any grassroots, unlettered innovators. Professional VCs have never gone beyond their conventional methods of due diligence, business models, business plans and attractive positive rate of return. Thus the study is an attempt to fill a research gap between MF (for self subsistence) and qualified VC (for urban innovations). One finds plenty of MF activities and institutions in the world. Especially in Gujarat, Self Employed Women Association (SEWA) is the most popular, MFI working for up-liftment of women. VCs are also found across the globe; in Gujarat Gujarat Venture Finance Limited (GVFL) is an active VCs which promotes ideas of
educated urban innovators. There is no VCF for small and scattered innovations any where
in the developing world (Gupta, 2000).

In Indian context, there are rarely any comprehensive studies done on finance provided to
grassroots innovations. There exists only one firm called Aavishkhaar India Micro Venture
Capital Fund (AIMVCF) which promotes development in rural and semi-urban India with
minimum funding of ₹10lakh and maximum of ₹2 crore to commercially viable companies.
This is beyond the scope of study for research as its portfolio size is quite huge and at the
same time it funds only commercially viable projects. The very spirit of incubating the
nascent stage idea by an illiterate rural folk is not served by AIMVCF. AIMVCF’s primitive
goal is to make commercial profit and not social profit.

The present study is conducted with special reference to Gujarat, only one institute,
Grassroots Innovations Augmentation Network (GIAN), Ahmedabad is found to be India’s
technology business incubator and a venture promotion fund, which is focused on incubating
and commercializing grassroots innovations. No evidence of GVFL financing grassroots
innovations were found in the literature study. A review of international, Indian and regional
studies reveal that there is a real and apparent need to fill the research gap at the new corner
where VCs play dual role of providing finance and providing a fair chance to people at the
bottom of the pyramid so that their valuable ideas can be commercialized for the social
benefit. This study is an attempt made to understand the concept of MVCF, its relevance,
and to check out the viability of the projects it funded.

1.3 Outline of the Study
The present study has been divided in two parts viz., innovators i.e. seekers of support and
micro venture capitalists (MVCs) i.e. providers of micro venture capital. Study of innovators
was done from demand side and study from the supply side of micro venture capitalists was
done. An attempt was made in the demand side to study how innovators came out with the
innovation, what was the novelty in the innovation, what kind of financial and mentoring
support was provided to them at various stages like idea generation, seed, start up, early
expansion and expansion stage. Various diffusion (technology transfer) strategies of
innovation for commercialization were also studied.
With respect to supply side, the role of MVCs was studied. It was explored that how such non conventional VCs promoted extra ordinary ideas as advocated by grassroots innovators, acknowledged their work, funded the innovators, provided mentoring support, support for commercialization of product etc. The effort was made to explore what exactly the VCs with social motive did for diffusion of innovation and how it brought assistance at the door step of the innovator. A detailed study of unsophisticated yet knowledgeable pastoral innovators was made in the form of seven exclusive cases which were funded and supported by such non conventional VCs.

1.4 Significance of the Study

Welfare economist Amartya Sen has stated that poverty can be curbed down only when the number of paupers reduces. Providing either employment, or self employment or grassroots based entrepreneurship is a route to remove poverty. Studies in venture capital sector focused more on stages of financing, successful financing, unsucseful financing and it is based upon archival data or single respondent surveys especially focusing upon the venture capitalist’s perspective. Exploratory works of research in the form of cases are found which are exclusively funded by VCs.

Abundant research is done in the field of MF also. It covers various dimensions of conceptual and analytical work. Various models of disbursing MF, origin of concept, its significance etc., has invited scholars for research. Analytical work in terms of effect study of test group i.e. the seekers of MF is examined on structures like financial, social and credibility empowerment is studied. However, there is a dearth of studies in the field of MVCF. The present study is an empirical study. It starts with the root level understanding of origin of concept of social entrepreneurship (SE), understanding its present need and significance. Subsequently, it deals with the understanding of the real importance of grassroots innovation made by rural people which has a capability of solving societal problems to a great extent.

Attempt is made to differentiate MVCs from conventional VCs. The MVCs also provide all conventional ancillary support which is provided by professional VCs. In this study the role
of such MVCs has been explored for Gujarat region. Researching the various perspectives and objectives from MVCs and innovators may have significant practical implications. The findings from innovators study (demand side) can be useful to existing MVIF (GIAN) to understand the roadblocks faced by grassroots innovators, facilities required to carry the innovation ahead, managerial inputs, procedure for getting quicker patent process done etc., and various help provided by the MVCs. The same can be treated as a roadmap for prospective conventional VCs to extend to the new areas of funding.

Findings from the MVCs side (supply side) can be useful to disseminate a discriminated working style of non conventional VCs. The study advocates and proposes the model of funding stage and type of funding provided by existing MVCs. The same can act as a guide for the prospective VCs for financing rural innovations. As the innovators funded or supported by GIAN have been studied in this research, these findings would be beneficial to GIAN as well as for generalization.

1.5 Organization of the Study
The present study apart from the introduction chapter is divided into six more chapters and the content of these chapters are organized as follows:

Chapter 2 Literature Review
The chapter provides a comprehensive and exhaustive research work done by former scholars and academicians in the field of entrepreneurship, rural entrepreneurship, SE, MF, inventions, innovations, incubation, funding to entrepreneurs and VC. It covered studies from the International, Indian and regional contexts. Research explains the importance and necessity of grassroots innovations. The chapter concludes by identifying the research gap and also provides the need of research in the field of MVCF.

Chapter 3 Research Design
The study looked into the aspects from demand side and supply side of micro venture finance. To study the demand side the factors influencing innovation, difficulties faced in innovation, support received, and status of innovations were studied from the perspective of grassroots innovators based in Gujarat. Primary data were collected through questionnaire.
While on the supply side as GIAN was the only agency in Gujarat, their perspective were taken to study the funding approach and funding mechanism for grassroots level innovation based in Gujarat. This chapter covers the research approach of all two types of study. More specifically, research objectives, research design framework, sample or data description methodology, sources of information, content of the questionnaire and data analysis methods for all primary study has been focused upon. Simultaneously, in the case based research the parameters of type of research, objectives of research, method of data collection, sources of information and content of major theme of the study in the case has been discussed in the chapter.

**Chapter 4 Micro Venture Capital Finance: Global, Indian and Regional Dimensions**

The upcoming concept of MVCF has been discussed in this chapter. Firstly the importance and need for innovation is linked with enterprise establishment and economic development. On the review of available literature it was found that this concept is in a very nascent stage, and thus there exists an ample scope for future research. The role of incubator was also discussed within the limelight of VCs. The genesis of MVCF concept in Gujarat is discussed with the origin of institutions like Society for Research and Initiatives for Sustainable Technologies and Institutions (SRISTI), GIAN and National Innovation Foundation (NIF). Crucial role of Honeybee Network is appreciated in the chapter. Various roadblocks for the development of the MVCF in the state have been investigated. The method of disbursement of MVIF as adopted by GIAN is described in this chapter.

**Chapter 5 Data Analysis and Interpretation**

Taking the demand side of the research, the responses of the innovator which were collected through questionnaire were analyzed and the results were duly interpreted. The quantitative information were analyzed using frequency distribution, descriptive statistics and various non-parametric tests like Fisher’s Exact Test, Chi Square Test and Binomial Test. Weighted Average Mean (WAM) and Rank Analysis were also applied in the analysis. Primary qualitative analysis on categorizing of innovators was done from the primary data collected from innovators through questionnaire.
Chapter 6 Comprehensive Case Studies
To cover the supply side from GIAN’s perspective, seven exhaustive cases have been written and analyzed on the parameters of genesis of idea, scouting of innovator, features of the product, cost of the product, GIAN’s study on the need gap analysis and market for innovation, decision of patenting the innovation and Prior Informed Consent (PIC), innovator’s robustness versus frailty, incubation support from GIAN, MVIF support or value added research development fund (VARD), GIAN’s supplementary support, GIAN’s imposition of golden triangle (Innovation, Investment, Enterprise) and the background of the innovator. Findings were compared and inferences were generated.

Chapter 7 Findings, Suggestions and Conclusion
Some broad findings, inferences and observations from the analysis as carried out in the previous chapter are presented in this chapter. Proposed suggestions are made in the study based on the environment scanning done at national level in general and micro environment at state level in particular. The entire work done and the implications of the study, various limitations and the scope for the future research are discussed in this chapter.