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Competition in the Product Market, Venture Capital and the Success of Entrepreneurial Businesses

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Abstract

A sort of private equity fund known as venture capital (VC) is given by venture capital firms or funds to start-ups, early-stage, and rising businesses that have demonstrated rapid growth (in terms of number of workers, yearly revenue, and scope of operations). In exchange for equity, or a stake in the business, venture capital firms or funds invest in these start-ups. In the hopes of seeing some of their investments succeed, venture capitalists assume the dangers of investing in high-risk start-ups. Due to the significant level of risk that start-ups confront, VC investments frequently fail. The start-ups primarily come from the high-tech sectors of information technology (IT), clean technology, or biotechnology, and they are typically built on cutting-edge business models or technological advancements.

Keywords: Product market • Venture capital • Entrepreneurial businesses

Introduction

Entrepreneurial businesses are crucial drivers of economic expansion. They account for 99.9% of all businesses in the United States, employ half of all workers in the private sector, and issue 16 times as many patents per employee as major patenting companies. These private businesses frequently require various types of assistance for their development, particularly from venture capitalists (VCs). VCs are investors who, as highlighted not only contribute capital to entrepreneurial enterprises but also closely supervise them and are typically knowledgeable about their prospects and investment opportunities. The literature extensively discusses the role that venture capitalists (VCs) play in the success of entrepreneurial enterprises [1].

Long-term money is not Venture Capital (VC). The objective is to invest in a company's balance sheet and infrastructure until it achieves a size and credibility that allows it to be sold to a corporation or provided liquidity *via* institutional public-equity markets. In essence, a venture capitalist invests in an entrepreneur's concept, develops it for a certain time, and then exits with the aid of an investment banker. Venture Capital (VC) is a type of private equity in technical terms. The basic difference is that, whereas private equity investors seek solid businesses, venture capitalists typically invest in startups. Small businesses with tremendous growth potential typically receive venture financing [2].

Types of venture capital (VC) funding

The many forms of venture capital are broken down based on how they are utilized at various stages of a company's life cycle. The three primary types of venture capital include finance for the early stages of a business, growth financing, and acquisition/buyout financing. Six steps make up the venture capital financing process, each of which corresponds to a particular stage in the growth of a company [3].

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- Seed capital is low-level finance used to test and develop innovative ideas.
- Beginning: New firms need funding to pay for the costs of product development and marketing.
- Manufacturing and early sales financing in the first round.
- Second round: Early-stage companies who are selling items but are not turning a profit are given operational funding.
- Third-round capital, also referred to as mezzanine financing, is utilized to expand a company that has recently turned a profit.

Features of venture capital (VC) investments

Investing in Venture Capital (VC) has certain characteristics:

- High Risk
- Lack of liquidity
- Long-term perspective
- Equity participation and capital gains
- Venture capitalists are involved in the management of the firm

Advantages of venture capital (VC)

- They contribute to the organization a wealth of knowledge and experience.
- A large amount of equity capital can be offered.
- No repayment of funds.
- It gives essential knowledge, resources and technical expertise in addition to funding to help a firm succeed.

Disadvantages of venture capital (VC)

- The founder's autonomy and authority are lost when the investors become part owners.
- It's a time-consuming and complex process.
- It is a risky method of funding, and the benefits from it can only be recognized over time.

Description

Investments are made in order to serve business visionaries and effectively

generate returns for limited partners. Investment is frequently utilized to support start-up businesses and individual projects. These organizations frequently struggle to obtain funding through conventional channels, so they turn to investors as a backup plan. Venture capital is funding invested in start-up businesses and private initiatives that are typically high risk but also have the potential for rapid growth. An exceptionally extraordinary income for the investment firm is the goal of a financing speculation, which is typically used to secure a startup or an IPO (Initial Public Offering) [4].

In light of these circumstances, conventional lenders like banks are hesitant to provide credit to innovative businesses operating in cutthroat industries. As a result, these businesses must look to VCs for funding and guidance. By breaking up the investment into several stages, VCs may apply more monitoring efforts in response to the rising business risk brought on by PMC. Before deciding to refinance, VCs can track company success thanks to staged financing. The knowledge gained through such monitoring aids VCs in minimizing losses due to ineffective continuance and in developing an exit strategy [5].

On the other side, PMC may lower predicted profitability, performance, and the possibility that entrepreneurial enterprises would successfully depart the market. In fact, PMC decreases a company's market share and diminishes the number of available customers, which raises concerns about future performance and the riskiness of their industry. VCs may be able to mitigate this negative impact of PMC by offering their networks, managerial, and financial resources to startup companies find that the presence of VCs boosts entrepreneurial enterprises' exit likelihood and long-term performance when comparing the performance of VC-backed and non-VC-backed firms. Therefore, when entrepreneurial enterprises encounter more challenges, we anticipate a larger reliance on VC monitoring.

We create a sizable sample of entrepreneurial companies that received first-round investments from lead VCs between 1990 and 2012 in order to analyses the effect of PMC on VC staging. The Herfindahl-Hirschman Index (HHI) is employed as an inverse PMC indicator. The majority of empirical data point to a beneficial impact of PMC on VC staging, which is in line with the hypothesis that entrepreneurial enterprises rely more on VC monitoring under more intense competitive pressure. Additionally, we discover that when the product market is competitive, VCs dedicate a lesser fraction of their contributions to the first funding round. We also take into account VC syndication as a different monitoring method and provide consistent proof that PMC has a favorable impact on the likelihood of syndicated investments. Our findings are still reliable when using different PMC measures.

Conclusion

We also discover that when entrepreneurial enterprises operate in more competitive markets with higher levels of business uncertainty, the chance of VC-staged financing rises. Younger companies or those that receive funding from unreliable and inexperienced VCs are those who meet our definition of entrepreneurial firms with increased business uncertainty. Our definition aligns with the body of research For instance, report that newer companies need greater VC engagement to thrive in a cutthroat market since they lack a track record or reputation in their primary business, trustworthy and seasoned VCs frequently invest in quality start-up businesses, creating a certification effect that lessens communication friction with outside investors.

Acknowledgement

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Conflict of Interest

None.

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