Lesson Objectives

- To get an understanding of national and international scenario of venture capital financing.
- Governments efforts in the venture capital area.

Venture Capital in India

Venture capital was almost absent till 1975 when Industrial Finance Corporation of India (IFCI) set up Risk Capital Foundation (RCF). This was considered as the first step in the direction of venture capital.

In the year 1976, initiative had been taken by the Government of India to create Technical Development Fund (TDF) in the Ministry of Industry with the assistance of World Bank. The main intention was to ensure sufficient rupee resources to finance the modernisation programs.

In the year 1986, Government of India announced the setting up of venture capital fund (VCF) to encourage the enterprise based on indigenous technology and upgradation of existing technology.

Grindlays Bank of Australia set up Indian Technology Fund Ltd. (ITFL) with the objective of providing venture capital assistance to young and growing companies seeking funds at early stages.

State Bank of India and Canara Bank have entered in the business of venture capital. SBI Capital Markets (SBI Caps), a subsidiary of SBI’s merchant banking has set up a venture capital fund for “brought out deals”. Under this scheme SBI Caps invests in the equity- shares of new companies.

The Industrial Credit and Investment Corporation of India (ICICI) also entered in the field of venture capital by establishing a venture capital fund for assisting small and medium entrepreneurs with initial equity capital. This was provided for developing and commercialising the indigenous technology.

India has taken a unique step in introducing venture capital in the area of bio-technology. The Bangalore based Bangalore Genei Pvt. Ltd. will be India’s first ever venture capital bio-technology company engaged in the manufacture of enzymes used in genetic engineering manipulations in research and technology.

A significant feature of venture capital financing in India, which is little recognised, is the support the commercial banks provide to small scale industries. The small scale industries in India run both the risks inherent in a venture capital project-the failure of management and the high risks in the venture.

The venture capital providers in India (other than the commercial banks’ efforts as stated above) can be divided into following categories.

1. Specialised financial institutions and their financing schemes.
2. Funds promoted by state level institutions.
3. Funds promoted by public sector banks.
4. Private agencies.
5. Overseas venture capital funds.

I. Special/Sed Financial Institutions And Their Financing Schemes

In India, the Industrial Financial Corporations of India (IFCI), Industrial Development Bank of India (IDBI) and the Industrial Credit and Investment Corporation of India (ICICI) are the major three institutions, which are engaged in the financing of high tech new ventures. The difference and similarities between three schemes of IFCI, IDBI and ICICI are discernible from the objectives sought to be pursued under the broad characteristics of the schemes precisely explained below.

A. Risk Capital Scheme of IFCI

The IFCI began its equity financing through its Risk Capital Foundation (RCF) by providing risk capital assistance on soft terms to first generation entrepreneurs. The corporation envisages to provide assistance to technologists and the professionals who do not have adequate resources of their own for contributing to equity capital of the industrial projects undertaken by them with a view to enlarging entrepreneurial base for wider dispersal of ownership and control of industry in the national interest. The corporation is continuing its efforts through the newly formed Risk Capital and Technology Finance Corporation Ltd. (RCTFC) set up in 1988 as a wholly owned subsidiary of the IFCI. RCTFC was established with an objective of providing financial support to such activities in the area of innovative technology, energy conservation and environmental pollution. Some of the projects financed under the new scheme of IFCI include development of artificial intelligence software, three Dimensional Computer animation, educational robots, hybrid seeds etc.

In addition to operating its own schemes, the RCTC also manages a Venture Capital Unit Scheme VECASUS-III (started in mid-1991) with a resource base of Rs. 30 crores with participation from the UTI, IFCI and World Bank in equal proportions.

B. Technology Development & Information Company of India Ltd. (TDICI) of ICICI

Encouraged by the response to technology financing, ICICI floated a separate company-Technology Development and Information Company of India (TD ICI) in collaboration with UTI in 1988. Apart from Venture Capital financing TD ICI activity profile includes technology consultancy services and technology escort services such as marketing, business management, export marketing and guidance for individual venture capital projects etc. TD ICI makes investments in highly risky projects promising high return in future. It gives preference to
companies, which are unable to raise public share capital and would not be financed by anyone else.

In addition to equity participation (upto a maximum of 49%) undertaken by typical venture capital companies, TDICI offers the unique option of conditional loans. The entrepreneur neither pays interest on it nor does he have to repay the principal amount. If the venture succeeds, TDICI recovers back its investment in the form of royalty on sales which ranges between 2 % to 8 %. On the contrary, if venture fails to take off even after 5 years, TDICI will consider writing off the loan. TDICI usually has a nominee on the Boards of companies with whom it enters into long-term contracts. TDICI assists such venture projects in arranging working capital finance, recruiting senior executives. It also takes advise of the outside experts in taking various decisions. Some of the projects financed by TDICI includes:

1. Mastek a Bombay based software firm in which TDICI invested Rs. 42 lakh in equity in 1989 went public in 1992. It showed an annual growth of 70% to 80% in the turnover.
2. Temptation Foods which exports frozen vegetables and fruits, went public in November, 1992. The TDICI invested Rs. 50 lakhs in its equity.

C. SEED Capital Scheme or Venture Capital Fund of IDBI

IDBI's scheme is known as "Seed Capital Scheme" intended to help create a new generation of entrepreneurs who have the requisite traits of entrepreneurship but who lack financial resources to promote industrial ventures. The assistance is provided for meeting the risk capital requirements of entrepreneurs.

IDBI is doing well under the venture capital fund scheme by assisting the projects which are engaged in the promotion and development of indigenous technology, that is new and untested in India. The financial assistance is provided under this scheme in the areas of chemical, software electronics, biotechnology, food products and medical equipment.

The project cost varies between Rs. 5 lakh to Rs. 250 lakh. IDBI provides assistance both for financing the cost of fixed assets as well as for meeting the operating expenses in the form of unsecured loans carrying a concessional interest rate of 6% p.a. during the early stages of development.

II. Funds Promoted by State Level Institutions

Funds promoted by state level institutions include:

a. APIDC- Venture Capital Ltd. (A VCL)

This is wholly owned by the Andhra Pradesh Industrial Development Corporation Ltd. It aims at specialising venture fund management company. It has been entrusted with the management of a fund, namely APIDC - Venture Capital Fund. It is established with a capital of 13.5 crores contributed by APIDC, IDBI, Andhra Bank and IOB and few small organisations. The A VCL undertakes investments with the objective of bringing technological innovations in order to improve quality, reduce energy consumption, increase competition and enhanced exports.

b. Gujarat Venture Finance Ltd. (GVFL)

The GVFL has been promoted by Gujarat Industries Investment Corporation Ltd., (GIIC) in association with Gujarat Lease Finance Corporation Ltd., Gujarat Alkalis and Chemicals Ltd. and Gujarat State Fertilisers Corporation Ltd. GIIC holds 40% of the equity capital of the GVFL and the rest is contributed by other three organisations. The GVFL is a fund management company, and presently acts as a trustee manager of a venture fund, namely (GVCF) Gujarat Venture Capital Fund, started in 1990. GVFL provides finance for innovations in technology leading to an improvement - in product quality and energy conservation, for launching new products based on imported technology.

III. Funds Promoted by Public Sector Banks Such as Canara Bank Venture Capital Fund (CVCF)

This fund has been promoted by Canara Bank and its subsidiary Canbank Financial Services Ltd. (CANFINA). It was set up in 1989 as a trust. It provides finance in the form of equity, conditional loans, conventional loans or both. Its capital base is Rs. 24 crores. The Fund aims at providing financial support for commercial exploitation of new technologies, technology upgradation to improve quality etc.

IV. Private Agencies

Venture capital funds set up in the private sector include

1. Credit Capital Venture Fund (CCVF)
2. 20th Century Venture Capital Fund
3. India Investment Fund
4. Indus Venture Capital Fund (IVCF)
5. SBI Capital Venture Capital Fund

(1) Credit Capital Venture Fund (CCVF) - The Credit Capital Venture Fund (India) was established in 1986. It has a capital base of 10.8 crores. The principal shareholders are Credit Capital Finance Corporation, Bank of India, Asian Development Bank, Commonwealth Development Corporation. It finances ventures promising high returns with maximum assistance limited to Rs. 50 lakhs. It also provides value added services in an advisory role and actively participates in marketing, recruitment and management affairs. Thus it helps the entrepreneurs to realise maximum returns. It has recently launched 10 state funds of Rs. 10 crore each. It is now known as Lazard Credit Capital Fund (India) Ltd. (LCCVF).

(2) 20th Century Venture Capital Fund - It was promoted by 20th Century Finance Ltd. and has a resource base of Rs. 20 crores. The fund aims at reviving the sick industries and help first generation entrepreneurs.

(3) India Investment Fund - It is India's first private venture capital fund mainly subscribed by Non-Resident Indians (NRIs). The Fund is an offshore company owned predominantly by NRI investors incorporated in early 1987. The fund provides equity or equity linked finance to new projects or often young as well as established Indian companies which can demonstrate a potential for sustained growth. The maximum assistance made available to one venture is limited to Rs. one crore. The principal investment objectives of the fund is long term capital appreciation.
Merchant Banking Division of Grindlays Bank has been retained as the advisers for the Fund which evaluates and recommends specific investment proposals. The fund follows hands-off approach in making the investment.

(4) Indus Venture Capital Fund (IVCF) This fund was promoted by Shri T. Thomas, the former Director of Unilever. The Indus Venture Management Ltd. (IVML) has been entrusted with the management of (IVCF). IVCF has a capital resource of Rs. 21 crores contributed by IVML, the IDBI, IFCI, Deutsche Bank, International Finance Corporation (Washington) and a few other national/international organisations.

(5) SBI Capital Venture Capital Fund. This fund has been set up by the SBI Capital Markets Ltd. to finance ventures through its "bought out deals". The objective behind the fund is to promote new capital issues by purchasing them when capital market is sluggish and disposing them off at times when market picks-up. The fund has a capital base of Rs. 10 crore.

V. Overseas Venture Capital Funds
Overseas Venture Capital Funds look for investment in areas ensuring high and guaranteed returns such as tourism, hospitals, air transport, information technology, communication, pharmaceutical, consumer durables, food processing industry, machinery components and textiles etc. Following are some of the examples where foreign venture capitalists have undertaken investments:

1. The global insurance giant, AIG, has tied up with IL & SF to float a 150 million venture fund.
2. The IL & SF is also planning to launch a $ 100 million fund with the ADB.
3. George Sors has already floated the Indocean Fund.
4. NIKKO Securities has tied up with Walden and San Francis Company to float a venture capital fund with a minimum capital of $ 50 million.

Difficulties in India

1. The restrictive legal and financial framework is one of the main reason for the lack of development of venture capital industry in India.
2. Fundamentally, there are no private pools of capital of finance risk ventures in India. The financial institutions occupy a dominant position in providing long term finance to Indian industry. FIs and the state development agencies do provide limited amounts of equity finance to assist in the development of new business but there are no private, professionally managed investment capital sources.
3. There are no private sector insurance companies or pension funds gathering regular premium income and virtually no private banks willing to devote a small portion of their resources to the venture capital projects.
4. Small companies have no access to share capital or long term debenture capital. The absence of a proper system of financing such companies has been a major gap in the Indian capital market.

5. While the government institutions no doubt meet part of venture capital requirements, their procedural delays and bottlenecks, the rigidity of the government's announced parameters for priority lending and strict standards about security and collaterals and the like often create problems for new entrepreneurs wishing to set up enterprises in high technology areas.
6. Venture capital financing involves funding of relatively new projects with no proven record in market acceptability. This does not make the venture capital financing an attractive investment. There are other more attractive options available to an investor.
7. The venture capitalists have not been given tax incentives commensurate with the risks they carry. This has also been responsible for the slow growth of venture capital industry.

Need for Growth
India possesses a pool of young educated and technically qualified entrepreneurs with real innovative mind. Vast potentials of our country need to be properly tapped for continuous development, broadening of the industrial base of high-tech industries and to promote the growth of technology. Venture capital would provide the required initial funding facilities for the advancement of untried and untested technology. This new financing scheme would remove the constraints like inadequate funds, lack of encouragement to our young entrepreneurs etc. The changing economic scenario and the liberalisation of capital market would bring greater depth to the capital market as a whole, introducing more genuine investors of substance with long time horizons, provide avenues for the institutions to realise their equity portfolios more easily (freeing funds for new investment) and generally improve market liquidity. This would improve equity cult.

SEBI (Venture Capital Fund) Regulations, 1996
The existing set up of venture capital in India needs to be streamlined and strengthened. The entry of private sector should be encouraged. Tax exemptions and concessions should be given to the investors investing in risky ventures. Government should offer attractive opportunities to foreign investors to invest in venture capital firms.

SEBI has been a regulatory body for venture capital companies or funds with effect from Jan. 25, 1995. It issued certain guidelines on 4th December, 1996 which defines venture capital fund as "fund established in the form of a company or trust which raises moneys through loans, donations, issue of securities or units as the case may be, and makes or proposes to make investments in accordance with these regulations". The Guidelines are listed below:

I. Registration of Venture Capital Funds
Application for Grant of Certificate
1. Any company or trust proposing to carry on any activity as a venture capital fund on or after the commencement of these regulations shall make an application to the Board for grant of a certificate.
2. Any company or trust, who on the date of commencement of these regulations is carrying any activity as a venture
capital fund without a certificate shall make an application to the Board for grant of a certificate within a period of three months from the date of such commencement. Provided that the board, in special cases, may extend the said period up to a maximum of six months form the date of such commencement.

3. An application for grant of certificate under sub-regulation (1) or sub-regulation (2) shall be made to the Board in Form A and shall be accompanied by a non-refundable application fee of Rs. 25,000 by way of bank draft issued in favor of SEBI at Mumbai.

4. Any company or trust referred to in sub-regulation (2) who fails to make an application for grant of a certificate within the period specified therein shall cease to carry on any activity as a venture capital fund.

5. The Board may in the interest of the investors issue directions with regard to the transfer of records, documents or securities or disposal of investments relating to its activities as a venture capital fund.

6. The Board may in order to protect the interests of investors appoints any person to take charge of records, documents, securities and for this purpose also determine the terms and conditions of such an appointment.

Eligibility criteria: For the purpose of the grant of a certificate by the Board the applicant have to fulfil in particular the following conditions, namely

a. If the application is made by a company
   i. memorandum of association as has its main objective, the carrying on of the activity of a venture capital fund;
   ii. it is prohibited by its memorandum and articles of association from making an invitation to the public to subscribe to its securities;
   iii. its director or principal officer or employee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;
   iv. its director, principal officer or employee has not at any time been convicted of any offence involving moral turpitude or any economic offence;
   v. it is a fit and proper person;

b. if the application is made by a trust
   i. the instrument of trust is in the form of a deed and has been duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908);
   ii. the main object of the trust is to carry on the activity of a venture capital fund;
   iii. the directors of its trustee company, if any or any trustee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;
   iv. the directors of its trustee company, if any, or a trustee has not at any time, been convicted of any offence involving moral turpitude or any economic offence;
   v. the applicant is a fit and proper person;

c. the company or trust has not been refused a certificate by the Board or its certificate has been suspended or cancelled.

Furnishing of information, clarification: The Board may require the applicant to furnish such further information as it may consider necessary.

Consideration of application: An application which is not complete in all respects shall be rejected by the Board. Provided that, before rejecting any such application, the applicant shall be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by the Board. Provided further that the Board may, on being satisfied that it is necessary to extend the period specified in the first proviso, extend such period by such further time not exceeding ninety days.

Procedure for Grant of Certificate

1. If the Board is satisfied that the applicant is eligible for the grant of certificate, it shall send an intimation to the applicant.
2. On receipt of intimation, the applicant shall pay to the Board, the registration fee of Rs. 500,000 payable by way of bank draft in favor of SEBI at Mumbai.
3. The Board shall on receipt of the registration fee grant a certificate of registration in Form B.

Conditions of certificate: The certificate granted shall be interalia, subject to the following conditions, namely-

a. the venture capital fund shall abide by the provisions of the Act, the Government of India Guidelines and These regulations;

b. the venture capital fund shall not carry on any other activity other than that of a venture capital fund;

c. the venture capital fund shall forthwith inform the Board in writing if any information or particulars previously submitted to the Board are found to be false or misleading in any material particular or if there is any change in the information already submitted.

Procedure where Certificate is not Granted

1. After considering an application if the Board is of the opinion that a certificate should not be granted, it may reject the application after giving the applicant a reasonable opportunity of being heard.
2. The decision of the Board to reject the application shall be communicated to the applicant within thirty days.

Effect of Refusal to Grant Certificate

1. Any applicant whose application has been rejected shall not carry on any activity as a venture capital fund.
2. Any company or trust whose application for grant of certificate has been rejected by the Board shall, on and from the date of the receipt of the communication cease to carry on any activity as a venture capital fund.
3. The Board may in the interest of the investors issue directions with regard to the transfer of records, documents or securities or disposal of investments relating to its activities as a venture capital fund.
4. The Board may in order to protect the interests of the investors appoint any person to take charge of records, documents, securities and for this purpose also determine the terms and conditions of such an appointment.

II Investment Conditions and Restrictions
Minimum investment in a venture capital fund
1. A venture capital fund may raise monies from any investor whether Indian, foreign or non-resident Indian.
2. No venture capital fund set up as a company or any scheme of a venture capital fund set up as a trust shall accept any investment from any investor which is less than five lakh rupees: Provided that nothing contained in sub-regulation (2) shall apply to investors who are (a) employees or the principal officer or directors of the venture capital fund, or directors of the trustee company or trustees where the venture capital fund has been established as a trust; or (b) non-resident Indians; or (c) persons or institutions of foreign origin.

Restrictions on investment by a venture capital fund. All investments made or to be made by a venture capital fund shall be subject to the following restrictions:
a. the venture capital fund shall not invest in the equity shares of the company or institutions providing financial services;
b. at least 80 per cent of funds raised by a venture capital fund shall be invested in
   i. the equity shares or equity related securities issued by a company whose securities are not listed on any recognised stock exchange: Provided that a venture capital fund may invest in equity shares or equity related securities of a company whose securities are to be listed or are listed where the venture capital fund has made these investments through private placements prior to the listing of the securities;
   ii. the equity shares or equity related securities of a financially weak company or a sick industrial company, whose securities mayor not be listed on any recognised stock exchange.

Explanation - For the purposes of this regulation, a "financially weak company" means a company, which has at the end of the previous financial year accumulated losses, which has resulted in erosion of more than 50 % but less than 100 % of its networth as at the beginning of the previous financial year;

iii. providing financial assistance in any other manner to companies in whose equity shares the venture capital fund has invested under sub-clause (i) or sub-clause (ii), as the case may be.

Explanation - For the purposes of this regulation, "funds raised" means the actual monies raised from investors for subscribing to the securities of the venture capital fund and includes monies raised from the author of the trust in case the venture capital fund has been established as a trust but shall not include the paid up capital of the trustee company, if any.

Prohibition on listing - No venture capital fund shall be entitled to get its securities or units, as the case may be, listed on any recognised stock exchange till the expiry of three years from the date of the issuance of securities or units, as the case may be, by the venture capital fund.

III. General Obligations and Responsibilities
Prohibition on inviting subscription from the public No venture capital fund shall issue any document or advertisement inviting offers from the public for the subscription or purchase of any of its securities or units.

Private Placement A venture capital fund may receive monies for investment in the venture capital fund through private placement of its securities or units.

Placement Memorandum
1. The venture capital fund established as a trust shall, before issuing any units, file with the Board a placement memorandum which shall give details of the terms subject to which monies are proposed to be raised from investors.
2. A venture capital fund established as a company shall, before making an offer inviting any subscription to its securities, file with the Board a placement memorandum which shall give details of the terms subject to which monies are proposed to be raised from the investors.

Contents of Placement Memorandum
1. The placement memorandum referred to in sub-regulation (1) of regulation shall contain the following, namely:
   a. details of the trustees or trustee company of the venture capital fund;
   b. details of entitlement on the units of the trust for which subscription is being sought;
   c. details of investments that are proposed to be made;
   d. tax implications that are likely to apply to investors;
   e. manner of subscription to the units of the trust;
   f. the period of maturity, if any, of the scheme;
   g. the manner, if any, in which the scheme is to be wound up;
   h. manner in which the benefits accruing to investors in the units of the trust are to be distributed;
   i. details of the asset management company, if any, and of fees to be paid to such a company.

2. The placement memorandum referred to in sub-regulation (2) above shall contain the following namely:
   a. details of the securities that are being offered;
   b. details of investments that are proposed to be made;
   c. details of directors of the company;
   d. tax implications that are likely to apply to investors;
   e. manner of subscription to the securities that are to be issued;
   f. manner in which the benefits accruing to investors in the securities are to be distributed; and
   g. details of the asset management company, if any, and of fees to be paid to such a company.
**Circulation of placement memorandum.** The placement memorandum may be issued for private circulation only after the expiry of twenty-one days of its submission to the Board, provided that if, within twenty-one days of submission of the placement memorandum, the Board communicates any amendments to the placement memorandum, the venture capital fund shall carry out such amendments in the placement memorandum before such memorandum is circulated to the investors.

Changes in the placement memorandum to be intimated to the Board Amendments or changes to any placement memorandum already filed with the Board can be made only if

a. a copy of the placement memorandum indicating the changes is filed with the Board; and

b. within twenty-one days of such filing, the Board has not communicated any objections or observations on the said amendments or changes.

**Maintenance of Books and Records.**

1. Every venture capital fund shall maintain for a period of ten years books of accounts, records and documents which shall give a true and fair picture of the state of affairs of the venture capital fund.

2. Every venture capital fund shall intimate the Board, in writing, the place where the books, records and documents referred to in sub-regulation (1) are being maintained.

**Power to Call for Information**

1. The Board may at any time call for any information from a venture capital fund with respect to any matter relating to its activity as a venture capital fund.

2. Where any information is called for under sub-regulation (1) it shall be furnished to the Board within fifteen days.

**Submission of Reports to the Board**

The Board may at any time call upon the venture capital fund to file such reports as the Board may desire with regard to the activities carried on by the venture capital fund.

**Winding up**

1. A scheme of a venture capital fund set up as a trust shall be wound up,

a. when the period of the scheme, if any, mentioned in the placement memorandum is over;

b. if it is the opinion of the trustees or the trustee company, as the case may be, that the scheme shall be wound up in the interests of investors in the units;

c. if seventy-five per cent of the investors in the scheme pass a resolution at a meeting of unit holders that the scheme be wound up; or

d. if the Board so directs in the interests of investors.

2. A venture capital fund set up as a company shall be wound up in accordance with the provisions of the Companies Act, 1956 (1 of 1956).

3. The trustees or trustee company of the venture capital fund set up as a trust shall intimate the Board and investors of the circumstances leading to the winding up of the scheme under sub-regulation (1).

**Effect of Winding up**

1. On and from the date of intimation, no further investments shall be made on behalf of the scheme so wound up.

2. Within three months from the date of intimation the assets of the scheme shall be liquidated, and the proceeds accruing to investors in the scheme distributed to them after satisfying all liabilities.

**IV. Inspection and Investigation**

**Board’s Right to Inspect or Investigate**

1. The Board may appoint one or more persons as inspecting or investigating officer to undertake inspection or investigation of the books of accounts, records and documents relating to a venture capital fund for any of the following reasons, namely

a. to ensure that the books of account, records and documents are being maintained by the venture capital fund in the manner specified in these regulations;

b. to inspect or investigate into complaints received from investors, clients or any other person, on any matter having a bearing on the activities of the venture capital fund;

c. to ascertain whether the provisions of the Act and these regulations are being complied with by the venture capital fund; and

d. to inspect or investigate suo motu into the affairs of a venture capital fund, in the interest of the securities market or in the interest of investors.

**Notice before Inspection or Investigation**

1. Before ordering an inspection or investigation the Board shall give not less than ten days notice to the venture capital fund.

2. Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors no such notice should be given, it may by an order in writing direct that the inspection or investigation of the affairs of the venture capital fund be taken up without such notice.

3. During the course of an inspection or investigation, the venture capital fund against whom the inspection or investigation is being carried out shall be bound to discharge its obligations as given below.

**Obligations of Venture Capital Fund on Inspection or Investigation by the Board.**

1. It shall be the duty of the venture capital fund whose affairs are being inspected or investigated, and of every director, officer and employee thereof, of its asset management company, if any, and of its trustees or directors or the directors of the trustee company, if any, to produce before the inspecting or investigating officer such books, securities, accounts, records and other documents in its custody or
control and furnish him with such statements and information relating to the venture capital fund, as the inspecting or investigating officer may require, within such reasonable period as the inspecting officers may specify.

2. The venture capital fund shall allow the inspecting or investigating officer to have reasonable access to the premises occupied by such venture capital fund or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the venture capital fund or such other person and also provide copies of documents or other materials which, in the opinion of the inspecting or investigating, as the case may be.

3. The inspecting or investigating officer, in the course of inspection or investigation shall be entitled to examine or to record the statements of any director, officer or employee of the venture capital fund.

4. It shall be the duty of every director, officer or employee, trustee or director of the trustee company of the venture capital fund to give to the inspecting or investigating officer all assistance in connection with the inspection or investigation, which the inspecting or investigating officer may reasonably require.

Submission of Report to the Board
The inspecting or investigating officer shall, as soon as possible, on completion of the inspection or investigation submit an inspection or investigation report to the Board: Provided that if directed to do so by the Board, he may submit an interim report.

Communication of Findings, etc. to the Venture Capital Fund
1. The Board shall, after consideration of the inspection or investigation report or the interim report communicate the findings of the inspection officer to the venture capital fund and give him an opportunity of being heard.

2. On receipt of the reply if any, from the venture capital fund, the Board may call upon the venture capital fund to take such measures as the Board may deem fit in the interest of the securities market and for the due compliance with the provisions of the Act and these regulations.

V Procedure for Action in Case of Default
Suspension of certificate. The Board may suspend the certificate granted to a venture capital fund where the venture capital fund:

a. contravenes any of the provisions of the Act or these regulations;

b. fails to furnish any information relating to its activity as a venture capital fund as required by the Board;

c. furnishes to the Board information which is false or misleading in any material particular;

d. does not submit periodic returns or reports as required by the Board;

e. does “not co-operate in any enquiry, inspection or investigation conducted by the Board;

f. fails to resolve the complaints of investors or fails to give a satisfactory reply to the Board in this behalf.

Cancellation of certificate. The Board may cancel the certificate granted to a venture capital fund

a. when the venture capital fund is guilty of fraud or has been convicted of an offence involving moral turpitude; " 

b. the venture capital fund has been guilty of repeated defaults of the nature. Explanation - In this regulation, “fraud” has the same meaning as is assigned to it in section 17 of the Indian Contract Act, 1972 (9 of 1872); or

c. contravenes any of the provisions of the Act or these regulations.

Manner of Making Order of Cancellation or Suspension-
No order of suspension or cancellation of certificate shall be made by the Board, except after holding an enquiry.

Manner of Holding Enquiry before Suspension or Cancellation
1. For the purpose of holding an enquiry the Board may appoint one or more enquiry officers.

2. The enquiry officer shall issue to the venture capital fund, at its registered office or its principal place of business, a notice setting out the grounds which on action is proposed to be taken against it and calling upon it to show cause against such action within a period of fourteen days from the date of receipt of the notice.

3. The venture capital fund may, within fourteen days from the date of receipt of such notice, furnish to the enquiry officer a written reply, together with copies of documentary or other evidence relied on by it or sought by the Board from the venture capital fund.

4. The enquiry officer shall give a reasonable opportunity of hearing to the venture capital fund to enable him to make submission in support of its reply made under sub-regulation (3).

5. Before the enquiry officer, the venture capital fund may appear through any person duly authorised by the venture capital fund: Provided that not lawyer or advocate shall be permitted to represent the venture capital fund at the enquiry: Provided further that where a lawyer or an advocate has been appointed by the Board as a presenting officer under sub-regulation (6), it shall be lawful for the venture capital fund to present its case through a lawyer or advocate.

6. The enquiry officer may, if he considers it necessary, ask the Board to appoint a presenting officer to present its case.

7. The enquiry officer shall, after taking into account all relevant facts and submissions made by the venture capital fund, submit a report to the Board and recommend the penal action, if any, to be taken against the venture capital fund as also the grounds on which the proposed action is justified.

Show-cause Notice and Order
1. On receipt of the report from the enquiry officer, the Board shall consider the same and may issue to the venture capital fund a show-cause notice as to why the penal action as
proposed by the enquiry officer should not be taken against it.

2. The venture capital fund shall, within fourteen days of the date of the receipt of the show-cause notice, send a reply to the Board.

3. The Board, after considering the reply, if any, of the venture capital fund, shall, as soon as possible pass such order as it deems fit.

**Effect of Suspension and Cancellation of Certificate**

1. On and from the date of the suspension of the certificate, the venture capital fund shall cease to carry on any activity as a venture capital fund during the period of suspension, and shall be subject to such directions of the Board with regard to any records, documents or securities that may be in its custody or control, relating to its activities as venture capital fund, as the Board may specify.

2. On and from the date of cancellation of the certificate, the venture capital fund shall, with immediate effect, cease to carry on any activity as a venture capital fund, and shall be subject to such directions of the Board with regard to the transfer of records, documents or securities that may be in its custody or control, relating to its activities as venture capital fund, as the Board may specify.

**Publication of Order of Suspension or Cancellation**

The order of suspension or cancellation of certificate passed may be published by the Board in two newspapers.

**Venture Capital in India**

Globalisation may or may not have shrunk distance, but it certainly appears to have compressed time. After reading up on the venture capital industry in the US, it appears that what should have been a 10-year parable, a period of introspection about idiotic ideas let loose, has now been shortened to just four years. Venture capital is back in fashion, and perhaps with a difference. Comments from industry leaders suggest that a critical lesson in humility has been imbibed and the wild guys of the fraternity have been thrown out.

Who can argue with “We have learnt from our mistakes” or “Technology by itself is insufficient to create wealth, what matters is its innovative usage.” This we-have-been-reformed air almost makes you believe that the initial frenzy leading up to the dotcom bust of 2000 is over and a process of sensible recomposition has begun. It all sounds so unexceptionable, so reasonable and so really polite.

But just a few scratches below the surface, you still get some stuff that either makes no sense or is just old wine in new bottles. Instead of “eyeballs” and “angel investors”, the new terms are “audience management” and “permission filtering technology.” You still get the sense that many of these guys are overloaded with money, off on the hunt for the next Big Idea, and are having a jolly good time just trying to be different for the sake of it.

I came across an interesting study: in the US, from 1992 to 1996, about $10 billion per year of venture capital was invested, producing on average 25-40 per cent annual rates of return. Those were good years. But then came the bad. From 1997 to 2001, the amount per year soared, reaching $70 billion in 2000, but the returns became negative. Nobody knows exactly how much in the negative, since there is a cloak of secrecy, but estimates range from 10 to 30 per cent in the red. Of course, some of this has to do with the tanks of US equity markets, but many were just plain bad investments.

In India, reliable estimates of VC funding are also difficult, mostly because not all that is reported is real and because rules allow many VC transactions to fall outside official statistics by making them indistinguishable from routine foreign investment. Still, there is broad agreement that VC funding in India in the calendar year 2003 was in the $500-600 million range, a sharp drop from $1.1 billion in 2002 and $900 million in 2001. Over 80 per cent of new VC investments in India are in profitable companies rather than start-ups, with Internet companies clearly out of favour and BPO, media, entertainment and healthcare emerging as the new stars.

But Indian VC investment, for all its brouhaha, is essentially small, far less than China and Japan, and far less exciting. In fact, India has now slipped to the 5th position (from 3rd place in 2002) in Asia. More than the dotcom bust, this is perhaps due to the belated realisation that India remains an untested if not shaky market, and that success is often shaped by a combination of social circumstance and government role.

Take vaccines for instance, where a number of firms are in the race. On surface, the market opportunity looks huge; after all, infant mortality is high in India, over 3 million children under the age of five die each year and one in every 15 persons is a carrier of some immunisable disease. But while vaccine sales are robust and growing, around 20 per cent annually, they have hardly shown the dramatic growth that was projected by many venture capitalists.

Why? Because government is still the largest buyer. Official procurement remains mired in bureaucracy and corruption, while refrigeration and medical infrastructure needed for an effective immunisation programme simply does not exist in the far reaches of the country. The bottomline is that no matter how fantastic a discovery, a new vaccine will enjoy only limited market penetration due to the meagre resources of the public health system.

Venture and technology people (there is an 80 per cent overlap) are not stupid but they operate under far less checks and balances than do others. The business by its nature is very lonely, the rush to spot novel ideas and emerging technologies is both consuming and seductive, and there are few markers to help along the way. All these push VCs to believing in their own destiny. Confidence and risk-taking are essential for creating wealth, but not if you act as if you just had a conversation with God. Combined Indian industry estimates speak of reaching $1.5 billion financing in 2004, but more than quantity we need to focus on the quality and impact of this capital.

Venture Capital funding is different from traditional sources of financing. Finance innovation ideas have potential for high growth but with inherent uncertainties. This makes it a high-risk, high return investment for venture capitalists. Apart from finance, venture capitalists provide networking, management and marketing support as well. In the broadest sense, therefore,
venture capital connotes risk finance as well as managerial support.

In the global venture capital industry, investors and funded firms work closely together in an enabling environment that allows entrepreneurs to focus on value creating ideas and venture capitalists to drive the industry by the levers of control in return for the provision of capital, skills, information and complementary resources. This very blend of risk financing and hand holding of entrepreneurs by venture capitalists creates an environment particularly suitable for 200,000 and so engineer graduates from Government and private-run colleges in India. Scientific, technological and knowledge-based ideas properly supported by venture capital can be propelled into a powerful engine of economic growth and wealth creation in a sustainable manner. In various developed and developing economies venture capital has played a significant developmental role.

India, along with Israel, Taiwan and the United States, is recognized for its globally competitive high technology and human capital. The success India has achieved particularly in software and information technology against several odds such as inadequate infrastructure, expensive hardware, restricted access to foreign resources and limited domestic demand, is a pointer to the hidden potential it has in the field of knowledge and technology based industry.

India has the second largest English speaking scientific and technical manpower in the world. Some of the management (IIMs) and technology institutes (IITs) in India are globally known as centres of excellence. Every year thousands of young people specialize through diploma courses in computers and other technical areas. Management institutes produce 40,000 management graduates annually. Given this quality and magnitude of human capital India’s potential to create enterprises is unlimited.

In Silicon Valley, these very Indians have proved their potential and have carved out a prominent place in terms of wealth creation as well as credibility. There are innumerable well-known success stories of successful Indians backed by a venture capital environment in Silicon Valley and elsewhere in US, supporting their innovation and invention. At least 30 percent of the start-up enterprises in Silicon Valley are started / backed by Indians.

With the inherent skills and manpower that India has, it can be easily predicted that software exports will thrive with an estimated 50 percent growth per annum. The market capitalization of the listed software companies comprises of approximately 25 percent of the total market capitalization. Also greater visibility of the Indian companies globally is evident.

Given such vast potential, which is, not only confined to IT and software but also in other sectors like biotechnology, telecommunications, media and entertainment, medical and health etc., venture capital industry is playing and shall continue to play a catalyst’s role in industrial development.

Thus, venture capital is valuable not only because it makes risk capital available at the early stages of a project but also because of the expertise of venture capitalist that leads to superior product development. And the big focus of venture capital worldwide is - technology.

VCs as a whole invested US$ 79.9 billion in the first three quarters of 2000, a 137 percent increase over the corresponding period during 1999. Out of this, technology firms reportedly got around 75 percent. Besides this huge supply from organised venture funds there is an even larger pool of “angel” funds provided by private investors. In 2000, it was expected that angel investment would be of the order of US$ 105 billion, thus making the total “at-risk” investment of US$ 185 billion in high-end technology ventures in a single year.

By contrast, in India, cumulative disbursements to date are not more than US$ 950 million, of which technology firms have received about 52 percent.

**Venture Finance Glossary**

**Angel Financing** Capital raised for a startup company from angel investors. The capital is generally used as seed money.

**Angel Investors** Angels are individual who include professional investors, retired executives with business experience and money to invest, or high net worth individuals looking for investment opportunities.

**Affiliate** A venture firm that is an associate or subsidiary to commercial banks, investment banks or insurance company. They make investments on behalf of outside investors or parent company’s client.

**Balanced Funding** A venture fund investment strategy that includes the investment in portfolio companies at a variety of stages of development.

**Bootstrapping** A means of finding creative ways to support a startup business until it turns profitable. This method may include negotiating delayed payment to suppliers and advances from potential partners and customers.

**Business Plan** It is a statement of goals, and how to achieve those goals, and rewards the business will reap when those goals are met.

**Buyout Financing** Investment intended to support the management acquire a product line or business.

**Capital (or Assets) Under Management** The amount of capital available to a fund management team for venture investments.

**Corporate strategic investors** When you enter into a strategic partnership with another corporation, which will then extend finance to you, the firm, which provides the finance, is known as a corporate strategic investor. Such business agreements are referred to as strategic alliances or corporate partnerships.

**Corporate Venturing** A form of investing by big corporations in opportunities that are congruent with its strategic mission or that will provide business synergy.

**Cost of Capital** The rate of return required by investors on the capital provided by them.

**Early Stage Financing** Financing in seed stage, startup stage or first stage of a project.

**Entrepreneur** One who pursues new business opportunities and assumes inherent risk.
Equity Ownership in a company. While bonds represent debt, stocks represent equity.

Exit Option Options available for venture capital firms to liquidate its holdings to realize capital gains on their investment. Options depend on the exit climate including market conditions and industry trends.

Exit Strategy Strategy adopted by venture capitalists to liquidate its holding to realize capital gains on their investments. It includes providing for a stock buy-back by another firm, arranging a public offering of stock and providing for a merger with a larger firm.

Expansion Stage Financing Financing in second stage, third stage and mezzanine stage of a project.

First Stage Financing Financing provided when the firm has begun production and need additional fund for sales.

Flexibility This ability of a firm to raise further capital from any source it wishes to tap to meet the future financing needs.

Founder Capital It refers to the individuals own assets including bank balance, certificates of deposit, shares and bonds, cash value in insurance policies, real estate, pension funds, etc.

Fund Size The total amount of capital committed by the investors of a venture capital fund.

Initial Public Offering An issue of new stock by a once private company to transform itself into a publicly held one. Many entrepreneurs regard a successful initial public offering (IPO) as the conventional route to secure finance.

Institutional Investors Organizations whose primary purpose is to invest their own assets or those entrusted to them by others.

Interest The cost of borrowing money.

Investment The use of money for the purpose of making more money, to gain income or increase capital, or both.

Investment Philosophy The stated investment approach or focus of a fund manager/ firm.

Later Stage Financing Financing in third stage and mezzanine stage of a project.

Leveraged Buyout (LBO) A takeover of a company, using a combination of equity and borrowed fund. Generally, the target company’s assets act as the collateral for the loans taken out by the acquiring group. The acquiring group then repays the loan from the cash flow of the acquired company.

Love Money It is the finance obtained from family, relatives and friends. A common source of founder capital.

Mezzanine Financing Financing also called bridge financing, intended for additional expansion of market before the company goes public. Often this financing is structured so that it can be repaid from the proceeds of an IPO.

Partnering Partnering is a business arrangement with an investor, who intends to gain a quick access to new product/service.

Post-money Valuation The valuation of a company immediately after the most recent round of financing.

Pre-money Valuation The Valuation of a company just prior to the most recent round of financing.

Professionally Managed Pools A type of venture firm which functions in similar term as traditional partners do but the pool is made of institutional money. These funds are typically organized as fixed life partnerships, usually having a life of ten years.

Proposed Financing Statement of the amount of funds required to move the project from the initial concept stage till the revenue stage. It briefs on how money will be raised in parts and how the proceeds will be used.

Recapitalization The reorganization of a company’s capital structure. It can be an alternative exit strategy for venture capitalists.

Seed Money The combination of founder capital and love money. Generally, the amount of seed money raised is small and is suitable for early stage financing.

Second Stage Financing Financing the working capital requirement for initial expansion of company that is producing and shipping.

Seed Stage Financing An investment of relatively small size, made at a very early stage of the project where typically a little more than a prototype exist. An investment before there is any real product.

Startup Financing Financing provided for those companies, ready with a business plan, to support product and market development works.

Third Stage Financing Financing provided for major expansion of company that is breaking even and is growing.

Traditional Partnership A type of venture firm wherein, wealthy individuals to manage a portion of their fund establish a partnership. These are private individual firms having no affiliation with any financial institution. Generally investments are made in small companies.

Turnaround Financing Financing with the intention of turning around the company at the time of financial or operational difficulty.

Venture capital A main source of financing used to fund startups that do not have access to capital markets. It involves investing in high risk and high return projects that are usually innovative in nature and involving lot of uncertainties.

Venture Capitalist These are individuals or firm managers who fund startups for equity stake in the business. These are professional investors with vast experience, good contacts and sound business skills, which they bring along with money. They often look for highly profitable businesses that guarantee an immediate return on their investment.

Yield The amount of money returned to investors on their investments. Also known as rate of return.

Venture Capital Mr Ashish Gianani (Symbiosis Institute of Foreign Trade, Pune) conducted this study on behalf of India Infoline, as a part of his summer internship.
Introduction
A number of technocrats are seeking to set up shop on their own and capitalize on opportunities. In the highly dynamic economic climate that surrounds us today, few ‘traditional’ business models may survive. Countries across the globe are realizing that it is not the conglomerates and the gigantic corporations that fuel economic growth any more. The essence of any economy, today is the small and medium enterprises. For example, in the US, 50% of the exports, are created by companies with less than 20 employees and only 7% are created by companies with 500 or more employees.

This growing trend can be attributed to rapid advances in technology in the last decade. Knowledge driven industries like info-tech, health-care, entertainment and services have become the cynosure of bourses worldwide. In these sectors, it is innovation and technical capability that are big business drivers. This is a paradigm shift from the earlier physical production and ‘economies of scale’ model.

However, starting an enterprise is never easy. There are a number of parameters that contribute to its success or downfall. Experience, integrity, prudence and a clear understanding of the market are among the sought after qualities of a promoter. However, there are other factors, which lie beyond the control of the entrepreneur. Prominent among these is the timely infusion of funds. This is where the venture capitalist comes in, with money, business sense and a lot more.

What is Venture Capital?
Venture capital is money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors. Venture capital is an important source of equity for start-up companies.

Professionally managed venture capital firms generally are private partnerships or closely-held corporations funded by private and public pension funds, endowment funds, foundations, corporations, wealthy individuals, foreign investors, and the venture capitalists themselves.

Venture capitalists generally:
- Finance new and rapidly growing companies
- Purchase equity securities
- Assist in the development of new products or services
- Add value to the company through active participation
- Take higher risks with the expectation of higher rewards
- Have a long-term orientation

When considering an investment, venture capitalists carefully screen the technical and business merits of the proposed company. Venture capitalists only invest in a small percentage of the businesses they review and have a long-term perspective. They also actively work with the company’s management, especially with contacts and strategy formulation.

Venture capitalists mitigate the risk of investing by developing a portfolio of young companies in a single venture fund. Many times they co-invest with other professional venture capital firms. In addition, many venture partnerships manage multiple funds simultaneously. For decades, venture capitalists have nurtured the growth of America’s high technology and entrepreneurial communities resulting in significant job creation, economic growth and international competitiveness. Companies such as Digital Equipment Corporation, Apple, Federal Express, Compaq, Sun Microsystems, Intel, Microsoft and Genentech are famous examples of companies that received venture capital early in their development. (Source: National Venture Capital Association 1999 Yearbook).

In India, these funds are governed by the Securities and Exchange Board of India (SEBI) guidelines. According to this, venture capital fund means a fund established in the form of a company or trust, which raises monies through loans, donations, issue of securities or units as the case may be, and makes or proposes to make investments in accordance with these regulations. (Source: SEBI (Venture Capital Funds) Regulations, 1996)

Investment Philosophy
The basic principal underlying venture capital – invest in high-risk projects with the anticipation of high returns. These funds are then invested in several fledging enterprises, which require funding, but are unable to access it through the conventional sources such as banks and financial institutions. Typically first generation entrepreneurs start such enterprises. Such enterprises generally do not have any major collateral to offer as security, hence banks and financial institutions are averse to funding them. Venture capital funding may be by way of investment in the equity of the new enterprise or a combination of debt and equity, though equity is the most preferred route.

Since most of the ventures financed through this route are in new areas (worldwide venture capital follows “hot industries” like infotech, electronics and biotechnology), the probability of success is very low. All projects financed do not give a high return. Some projects fail and some give moderate returns. The investment, however, is a long-term risk capital as such projects normally take 3 to 7 years to generate substantial returns. Venture capitalists offer “more than money” to the venture and seek to add value to the investee unit by active participation in its management. They monitor and evaluate the project on a continuous basis.

The venture capitalist is however not worried about failure of an investee company, because the deal which succeeds, nets a very high return on his investments – high enough to make up for the losses sustained in unsuccessful projects. The returns generally come in the form of selling the stocks when they get listed on the stock exchange or by a timely sale of his stake in the company to a strategic buyer. The idea is to cash in on an increased appreciation of the share value of the company at the time of disinvestment in the investee company. If the venture fails (more often than not), the entire amount gets written off. Probably, that is one reason why venture capitalists assess several projects and invest only in a handful after careful scrutiny of the management and marketability of the project.

To conclude, a venture financier is one who funds a start up company, in most cases promoted by a first generation technocrat promoter with equity. A venture capitalist is not a lender, but an equity partner. He cannot survive on minimalism. He is driven by maximization: wealth maximization. Venture
capitalists are sources of expertise for the companies they finance. Exit is preferably through listing on stock exchanges. This method has been extremely successful in USA, and venture funds have been credited with the success of technology companies in Silicon Valley. The entire technology industry thrives on it.

A Brief History
The concept of venture capital is not new. Venture capitalists often relate the story of Christopher Columbus. In the fifteenth century, he sought to travel westwards instead of eastwards from Europe and so planned to reach India. His far-fetched idea did not find favor with the King of Portugal, who refused to finance him. Finally, Queen Isabella of Spain, decided to fund him and the voyages of Christopher Columbus are now empanelled in history.

The modern venture capital industry began taking shape in the post – World War II years. It is often said that people decide to become entrepreneurs because they see role models in other people who have become successful entrepreneurs. Much the same thing can be said about venture capitalists. The earliest members of the organized venture capital industry had several role models, including these three:

**American Research and Development Corporation**, formed in 1946, whose biggest success was Digital Equipment. The founder of ARD was General Georges Doriot, a French-born military man who is considered “the father of venture capital.” In the 1950s, he taught at the Harvard Business School. His lectures on the importance of risk capital were considered quirky by the rest of the faculty, who concentrated on conventional corporate management.

**J.H. Whitney & Co.**, also formed in 1946, one of whose early hits was Minute Maid juice. Jock Whitney is considered one of the industry’s founders.

**The Rockefeller Family**, and in particular, L. S. Rockefeller, one of whose earliest investments was in Eastern Airlines, which is now defunct but was one of the earliest commercial airlines.

The Second World War produced an abundance of technological innovation, primarily with military applications. They include, for example, some of the earliest work on micro circuitry. Indeed, J.H. Whitney’s investment in Minute Maid was intended to commercialize an orange juice concentrate that had been developed to provide nourishment for troops in the field.

In the mid-1950s, the U.S. federal government wanted to speed the development of advanced technologies. In 1957, the Federal Reserve System conducted a study that concluded that a shortage of entrepreneurial financing was a chief obstacle to the development of what it called “entrepreneurial businesses.” As a response this a number of Small Business Investment Companies (SBIC) were established to “leverage” their private capital by borrowing from the federal government at below-market interest rates. Soon commercial banks were allowed to form SBICs and within four years, nearly 600 SBICs were in operation.

At the same time a number of venture capital firms were forming private partnerships outside the SBIC format. These partnerships added to the venture capitalist’s toolkit, by offering a degree of flexibility that SBICs lack. Within a decade, private venture capital partnerships passed SBICs in total capital under management.

The 1960s saw a tremendous bull IPO market that allowed venture capital firms to demonstrate their ability to create companies and produce huge investment returns. For example, when Digital Equipment went public in 1968 it provided ARD with 101% annualized Return on Investment (ROI). The US$70,000 Digital invested to start the company in 1959 had a market value of US$37mn. As a result, venture capital became a hot market, particularly for wealthy individuals and families. However, it was still considered too risky for institutional investors.

In the 1970s, though, venture capital suffered a double-whammy. First, a red-hot IPO market brought over 1,000 venture-backed companies to market in 1968, the public markets went into a seven-year slump. There were a lot of disappointed stock market investors and a lot of disappointed venture capital investors too. Then in 1974, after Congress legislation against the abuse of pension fund money, all high-risk investment of these funds was halted. As a result of poor public market and the pension fund legislation, venture capital fund raising hit rock bottom in 1975.

Well, things could only get better from there. Beginning in 1978, a series of legislative and regulatory changes gradually improved the climate for venture investing. First Congress slashed the capital gains tax rate to 28% from 49.5%. Then the Labor Department issued a clarification that eliminated the pension funds act as an obstacle to venture investing. At around the same time, there were a number of high-profile IPO’s by venture-backed companies. These included Federal Express in 1978, and Apple Computer and Genetech Inc in 1981. This rekindled interest in venture capital on the part of wealthy families and institutional investors. Indeed, in the 1980s, the venture capital industry began its greatest period of growth. In 1980, venture firms raised and invested less than US$600 million. That number soared to nearly US$4bn by 1987. The decade also marked the explosion in the buy-out business.

The late 1980s marked the transition of the primary source of venture capital funds from wealthy individuals and families to endowment, pension and other institutional funds. The surge in capital in the 1980s had predictable results. Returns on venture capital investments plunged. Many investors went into the funds anticipating returns of 30% or higher. That was probably an unrealistic expectation to begin with. The consensus today is that private equity investments generally should give the investor an internal rate of return something to the order of 15% to 25%, depending upon the degree of risk the firm is taking.

However, by 1990, the average long-term return on venture capital funds fell below 8%, leading to yet another downturn in venture funding. Disappointed families and institutions withdrew from venture investing in droves in the 1989-91 period. The economic recovery and the IPO boom of 1991-94 have gone a long way towards reversing the trend in both private equity investment performance and partnership commitments.
In 1998, the venture capital industry in the United States continued its seventh straight year of growth. It raised US$25bn in committed capital for investments by venture firms, who invested over US$16bn into domestic growth companies in all sectors, but primarily focused on information technology.

**Venture Capital In India**

Most of the success stories of the popular Indian entrepreneurs like the Ambanis and Tatas had little to do with a professionally backed up investment at an early stage. In fact, till very recently, for an entrepreneur starting off on his own personal savings or loans raised through personal contacts/financial institutions.

Traditionally, the role of venture capital was an extension of the developmental financial institutions like IDBI, ICICI, SIDBI and State Finance Corporations (SFCs). The first origins of modern Venture Capital in India can be traced to the setting up of a Technology Development Fund (TDF) in the year 1987-88, through the levy of a cess on all technology import payments. TDF was meant to provide financial assistance to innovative and high-risk technological programs through the Industrial Development Bank of India. This measure was followed up in November 1988, by the issue of guidelines by the (then) Controller of Capital Issues (CCI). These stipulated the framework for the establishment and operation of funds/companies that could avail of the fiscal benefits extended to them.

However, another form of (ad?)venture capital which was unique to Indian conditions also existed. That was funding of green-field projects by the small investor by subscribing to the Initial Public Offering (IPO) of the companies. Companies like Jindal Vijaynagar Steel, which raised money even before they started constructing their plants, were established through this route.

The industry’s growth in India can be considered in two phases. The first phase was spurred on soon after the liberalization process began in 1991. According to former finance minister and harbinger of economic reform in the country, Manmohan Singh, the government had recognized the need for venture capital as early as 1988. That was the year in which the Technical Development and Information Corporation of India (TDICI, now ICICI ventures) was set up, soon followed by Gujarat Venture Finance Limited (GVFL). Both these organizations were promoted by financial institutions. Sources of these funds were the financial institutions, foreign institutional investors or pension funds and high net-worth individuals. Though an attempt was also made to raise funds from the public and fund new ventures, the venture capitalists had hardly any impact on the economic scenario for the next eight years.

However, it was realized that the concept of venture capital funding needed to be institutionalized and regulated. This funding requires different skills in assessing the proposal and monitoring the progress of the fledging enterprise. In 1996, the Securities and Exchange Board of India (SEBI) came out with guidelines for venture capital funds has to adhere to, in order to carry out activities in India. This was the beginning of the second phase in the growth of venture capital in India. The move liberated the industry from a number of bureaucratic hassles and paved the path for the entry of a number of foreign funds into India. Increased competition brought with it greater access to capital and professional business practices from the most mature markets.

There are a number of funds, which are currently operational in India and involved in funding start-up ventures. Most of them are not true venture funds, as they do not fund start-ups. What they do is provide mezzanine or bridge funding and are better known as private equity players. However, there is a strong optimistic undertone in the air. With the Indian knowledge industry finally showing signs of readiness towards competing globally and awareness of venture capitalists among entrepreneurs higher than ever before, the stage seems all set for an overdrive.

The Indian Venture Capital Association (IVCA), is the nodal center for all venture activity in the country. The association was set up in 1992 and over the last few years, has built up an impressive database. According to the IVCA, the pool of funds available for investment to its 20 members in 1997 was Rs25.6bn. Out of this, Rs10 bn had been invested in 691 projects.

Certain venture capital funds are Industry specific (i.e. they fund enterprises only in certain industries such as pharmaceuticals, infotech or food processing) whereas others may have a much wider spectrum. Again, certain funds may have a geographic focus – like Uttar Pradesh, Maharashtra, Kerala, etc whereas others may fund across different territories. The funds may be either close-ended schemes (with a fixed period of maturity) or open-ended.

**Classification**

Venture funds in India can be classified on the basis of

**Genesis**

Financial Institutions Led By ICICI Ventures, RCTC, ILFS, etc.

- Private venture funds like Indus, etc.
- Regional funds like Warburg Pincus, JF Electra (mostly operating out of Hong Kong).
- Regional funds dedicated to India like Draper, Walden, etc.
- Offshore funds like Barings, TCW, HSBC, etc.
- Corporate ventures like Intel.

To this list we can add Angels like Sivan Securities, Atul Choksey (ex Asian Paints) and others. Merchant bankers and NBFCs who specialized in “bought out” deals also fund companies. Most merchant bankers led by Enam Securities now invest in IT companies.

**Investment Philosophy**

Early stage funding is avoided by most funds apart from ICICI Ventures, Draper, SID BI and Angels.

Funding growth or mezzanine funding till pre IPO is the segment where most players operate. In this context, most funds in India are private equity investors.

**Size of Investment**

The size of investment is generally less than US$1mn, US$1-5mn, US$5-10mn, and greater than US$10mn. As most funds are of a private equity kind, size of investments has been
increasing. IT companies generally require funds of about Rs30-40 mn in an early stage which fall outside funding limits of most funds and that is why the government is promoting schemes to fund start-ups in general, and in IT in particular.

**Value Addition**
The venture funds can have a totally “hands on” approach towards their investment like Draper or “hands off” like Chase. ICICI Ventures falls in the limited exposure category. In general, venture funds who fund seed or start-ups have a closer interaction with the companies and advice on strategy, etc while the private equity funds treat their exposure like any other listed investment. This is partially justified, as they tend to invest in more mature stories.

A list of the members registered with the IVCA as of June 1999, has been provided in the Annexure. However, in addition to the organized sector, there are a number of players operating in India whose activity is not monitored by the association.

Add together the infusion of funds by overseas funds, private individuals, ‘angel’ investors and a host of financial intermediaries and the total pool of Indian Venture Capital today, stands at Rs50bn, according to industry estimates!

The primary markets in the country have remained depressed for quite some time now. In the last two years, there have been just 74 initial public offerings (IPOs) at the stock exchanges, leading to an investment of just Rs14.24bn. That’s less than 12% of the money raised in the previous two years. That makes the conservative estimate of Rs36bn invested in companies through the Venture Capital/Private Equity route all the more significant.

Some of the companies that have received funding through this route include:

- Mastek, one of the oldest software houses in India
- Geometric Software, a producer of software solutions for the CAD/CAM market
- Ruksun Software, Pune-based software consultancy
- SQLStar, Hyderabad based training and software development company
- Microland, networking hardware and services company based in Bangalore
- Satyam Infoway, the first private ISP in India
- Hinditron, makers of embedded software
- PowerTel Boca, distributor of telecomputing products for the Indian market
- Rediff on the Net, Indian website featuring electronic shopping, news, chat, etc
- Entevo, security and enterprise resource management software products
- Planetasia.com, Microland’s subsidiary, one of India’s leading portals
- Torrent Networking, pioneer of Gigabit-scaled IP routers for inter/intra nets
- Selectica, provider of interactive software selection
- Yantra, ITLInfosys’ US subsidiary, solutions for supply chain management

Though the infotech companies are among the most favored by venture capitalists, companies from other sectors also feature equally in their portfolios. The healthcare sector with pharmaceutical, medical appliances and biotechnology industries also get much attention in India. With the deregulation of the telecom sector, telecommunications industries like Zip Telecom and media companies like UTV and Television Eighteen have joined the list of favorites. So far, these trends have been in keeping with the global course.

However, recent developments have shown that India is maturing into a more developed marketplace, unconventional investments in a gamut of industries have sprung up all over the country. This includes:

- Indus League Clothing, a company set up by eight former employees of readymade garments giant Madura, who set up shop on their own to develop a unique virtual organization that will license global apparel brands and sell them, without owning any manufacturing units. They dream to build a network of 2,500 outlets in three years and to be among the top three readymade brands.

- Shoppers Stop, Mumbai’s premier departmental store innovates with retailing and decides to go global. This deal is facing some problems in getting regulatory approvals.

- Airfreight, the courier-company which has been growing at a rapid pace and needed funds for heavy investments in technology, networking and aircrafts.

- Pizza Corner, a Chennai based pizza delivery company that is set to take on global giants like Pizza Hut and Dominos Pizza with its innovative servicing strategy.

- Car designer Dilip Chhabria, who plans to turn his studio, where he remodels and overhauls cars into fancy designer pieces, into a company with a turnover of Rs1.5bn (up from Rs40mn today).

### Indian Scenario - A Statistical Snapshot

#### Contributors of Funds

<table>
<thead>
<tr>
<th>Contributors</th>
<th>Rs mn</th>
<th>Per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Institutional Investors</td>
<td>13,426.47</td>
<td>52.46%</td>
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<tr>
<td>All India Financial Institutions</td>
<td>6,252.90</td>
<td>24.43%</td>
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<tr>
<td>Multilateral Development Agencies</td>
<td>2,133.64</td>
<td>8.34%</td>
</tr>
<tr>
<td>Other Banks</td>
<td>1,541.00</td>
<td>6.02%</td>
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<tr>
<td>Foreign Investors</td>
<td>570</td>
<td>2.23%</td>
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<tr>
<td>Private Sector</td>
<td>412.53</td>
<td>1.61%</td>
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<tr>
<td>Public Sector</td>
<td>324.44</td>
<td>1.27%</td>
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<tr>
<td>Nationalized Banks</td>
<td>278.67</td>
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<tr>
<td>Non Resident Indians</td>
<td>235.5</td>
<td>0.92%</td>
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<tr>
<td>State Financial Institutions</td>
<td>215</td>
<td>0.84%</td>
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<tr>
<td>Other Public</td>
<td>115.52</td>
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</tr>
<tr>
<td>Insurance Companies</td>
<td>85</td>
<td>0.33%</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>4.5</td>
<td>0.02%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>25,595.17</td>
<td>100.00%</td>
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</table>
**Methods of Financing**

<table>
<thead>
<tr>
<th>Instruments</th>
<th>Rs million</th>
<th>Per cent</th>
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</thead>
<tbody>
<tr>
<td>Equity Shares</td>
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<tr>
<td>Redeemable Preference Shares</td>
<td>2,154.46</td>
<td>21.54</td>
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<tr>
<td>Non Convertible Debt</td>
<td>873.01</td>
<td>8.73</td>
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<tr>
<td>Convertible Instruments</td>
<td>580.02</td>
<td>5.8</td>
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<tr>
<td>Other Instruments</td>
<td>75.85</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>10,000.46</strong></td>
<td><strong>100</strong></td>
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**Financing by Investment Stage**

<table>
<thead>
<tr>
<th>Investment Stages</th>
<th>Rs million</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Start-up</td>
<td>3,813.00</td>
<td>297</td>
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<tr>
<td>Later stage</td>
<td>3,338.99</td>
<td>154</td>
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<tr>
<td>Other early stage</td>
<td>1,825.77</td>
<td>124</td>
</tr>
<tr>
<td>Seed stage</td>
<td>963.2</td>
<td>107</td>
</tr>
<tr>
<td>Turnaround financing</td>
<td>59.5</td>
<td>9</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>10,000.46</strong></td>
<td><strong>691</strong></td>
</tr>
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</table>

**Financing by Industry**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Rs million</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial products, machinery</td>
<td>2,599.32</td>
<td>208</td>
</tr>
<tr>
<td>Computer Software</td>
<td>1,832</td>
<td>87</td>
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<tr>
<td>Consumer Related</td>
<td>1,412.74</td>
<td>58</td>
</tr>
<tr>
<td>Medical</td>
<td>623.8</td>
<td>44</td>
</tr>
<tr>
<td>Food, food processing</td>
<td>500.06</td>
<td>50</td>
</tr>
<tr>
<td>Other electronics</td>
<td>436.54</td>
<td>41</td>
</tr>
<tr>
<td>Tel &amp; Data Communications</td>
<td>385.09</td>
<td>16</td>
</tr>
<tr>
<td>Biotechnology</td>
<td>376.46</td>
<td>30</td>
</tr>
<tr>
<td>Energy related</td>
<td>249.56</td>
<td>19</td>
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<tr>
<td>Computer Hardware</td>
<td>203.36</td>
<td>25</td>
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<tr>
<td>Miscellaneous</td>
<td>1,380.85</td>
<td>113</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,000.46</strong></td>
<td><strong>691</strong></td>
</tr>
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</table>

**Financing by States**

<table>
<thead>
<tr>
<th>State</th>
<th>Rs million</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maharashtra</td>
<td>2,566</td>
<td>161</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>1,531</td>
<td>119</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>1,372</td>
<td>89</td>
</tr>
<tr>
<td>Gujarat</td>
<td>1,102</td>
<td>49</td>
</tr>
<tr>
<td>Karnataka</td>
<td>1,046</td>
<td>44</td>
</tr>
<tr>
<td>West Bengal</td>
<td>312</td>
<td>22</td>
</tr>
<tr>
<td>Haryana</td>
<td>300</td>
<td>22</td>
</tr>
<tr>
<td>Delhi</td>
<td>294</td>
<td>21</td>
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<tr>
<td>Uttar Pradesh</td>
<td>283</td>
<td>29</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>231</td>
<td>2</td>
</tr>
<tr>
<td>Kerala</td>
<td>135</td>
<td>15</td>
</tr>
<tr>
<td>Goa</td>
<td>105</td>
<td>16</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>87</td>
<td>11</td>
</tr>
<tr>
<td>Punjab</td>
<td>84</td>
<td>6</td>
</tr>
<tr>
<td>Orissa</td>
<td>35</td>
<td>5</td>
</tr>
<tr>
<td>Dadra &amp; Nagar Haveli</td>
<td>32</td>
<td>1</td>
</tr>
<tr>
<td>Himachal Pradesh</td>
<td>28</td>
<td>3</td>
</tr>
<tr>
<td>Pondicherry</td>
<td>22</td>
<td>2</td>
</tr>
<tr>
<td>Bihar</td>
<td>16</td>
<td>3</td>
</tr>
<tr>
<td>Overseas</td>
<td>413</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>9994</strong></td>
<td><strong>691</strong></td>
</tr>
</tbody>
</table>

Source: IVCA

**Problems with VCs in the Indian Context**

One can ask why venture funding is so successful in USA and faced a number of problems in India. The biggest problem was a mindset change from “collateral funding” to high risk high return funding. Most of the pioneers in the industry were people with credit background and exposure to manufacturing industries. Exposure to fast growing intellectual property business and services sector was almost zero. All these combined to a slow start to the industry. The other issues that led to such a situation include:

**License Raj and the IPO Boom**

Till early 90s, under the license raj regime, only commodity centric businesses thrived in a deficit situation. To fund a cement plant, venture capital is not needed. What was needed was ability to get a license and then get the project funded by the banks and DFIs. In most cases, the promoters were well-established industrial houses, with no apparent need for funds. Most of these entities were capable of raising funds from conventional sources, including term loans from institutions and equity markets.

**Scalability**

The Indian software segment has recorded an impressive growth over the last few years and earns large revenues from its export earnings, yet our share in the global market is less than 1 per cent. Within the software industry, the value chain ranges from body shopping at the bottom to strategic consulting at the top. Higher value addition and profitability as well as significant market presence take place at the higher end of the value chain. If the industry has to grow further and survive the flux it would only be through innovation. For any venture idea to succeed there should be a product that has a growing market with a scalable business model. The IT industry (which is most suited for venture funding because of its “ideas” nature) in India till recently had a service centric business model. Products developed for Indian markets lack scale.

**Mindsets**

Venture capital as an activity was virtually non-existent in India. Most venture capital companies want to provide capital on a secured debt basis, to established businesses with profitable operating histories. Most of the venture capital units were offshoots of financial institutions and banks and the lending mindset continued. True venture capital is capital that is used to help launch products and ideas of tomorrow. Abroad, this problem is solved by the presence of ‘angel investors’. They are typically wealthy individuals who not only provide venture finance but also help entrepreneurs to shape their business and make their venture successful.

**Returns, Taxes and Regulations**

There is a multiplicity of regulators like SEBI and RBI. Domestic venture funds are set up under the Indian Trusts Act of 1882 as per SEBI guidelines, while offshore funds routed through Mauritius follow RBI guidelines. Abroad, such funds are made under the Limited Partnership Act, which brings advantages in terms of taxation. The government must allow pension funds and insurance companies to invest in venture
capitals as in USA where corporate contributions to venture funds are large.

Exit
The exit routes available to the venture capitalists were restricted to the IPO route. Before deregulation, pricing was dependent on the erstwhile CCI regulations. In general, all issues were under priced. Even now SEBI guidelines make it difficult for pricing issues for an easy exit. Given the failure of the OTCEI and the revised guidelines, small companies could not hope for a BSE/ NSE listing. Given the dull market for mergers and acquisitions, strategic sale was also not available.

Valuation
The recent phenomenon is valuation mismatches. Thanks to the software boom, most promoters have sky high valuation expectations. Given this, it is difficult for deals to reach financial closure as promoters do not agree to a valuation. This coupled with the fancy for software stocks in the bourses means that most companies are preponing their IPOs. Consequently, the number and quality of deals available to the venture funds gets reduced.

Regulatory Issues
This chapter aims to give a bird’s eye’s view of the various guidelines a venture fund has to adhere to in India. There are a number of rules and regulation for venture capital and these would broadly come under either of the following heads:

- The Indian Trust Act, 1882 or the Company Act, 1956 depending on whether the fund is set up as a trust or a company. (In the US, a venture capital firm is normally set up as a limited liability partnership)
- The Foreign Investment Promotion Board (FIPB) and the Reserve Bank of India (RBI) in case of an offshore fund. These funds have to secure the permission of the FIPB while setting up in India and need a clearance from the RBI for any repatriation of income.
- The Central Board of Direct Taxation (CBDT) governs the issues pertaining to income tax on the proceeds from venture capital funding activity. The long term capital gains tax is at around 10% in India and the relevant clauses to venture capital may be found in Section 10 (subsection 23).
- The Securities and Exchange Board of India has come out with a set of guidelines attached in the annexure.

In addition to the above there are a number of arms of the Government of India – Ministry of Finance that may have to be approached in certain situations. Also intervention allied agencies like the Department of Electronics, the National Association of Software and Computers (NASSCOM) and various taskforces and standing committees is not uncommon. Probably this explains why most of the funds prefer to take the easy way out by listing as offshore funds operating out of tax havens like Mauritius (where the Avoidance of Double Taxation Treaty, incomes may be freely repatriated).

Global Scenario in Brief
In the UK, more than 16,500 companies have received venture capital backing since 1983. In a survey carried out by the British Venture Capital Association and Coopers & Lybrand (now Price Waterhouse Coopers, over a period of four years from 1990-91 to 1994-95, on an average, venture-backed companies:

- Sales rose by 34 per cent per annum (Five times faster than that of the FT-SE 100 companies)
- Exports grew by 29 per cent
- Investment increased by 28 per cent
- As much as 88 per cent said that they benefited from their venture capital backers who provided “more than just money”
- Almost 90 per cent venture backed companies would have disappeared or would have grown less rapidly without Venture Capital

In the US, in 1997 venture capitals invested a record, US$11.4bn in nascent companies. According to VentureOne, San Francisco, CA,
- The surge in investments represented a 16 per cent increase over 1996
- Venture capitalists invested in 1,848 companies over the year, 162 more than in 1996

The Venture Capital pool in Hong Kong is 5.5 per cent of the country’s GDP, with similar figures in Singapore and South Korea. India, Malaysia and Thailand attract large-scale investible funds from abroad.

The prosperity of many rapidly growing Australian technology companies can be directly attributed to venture capitalists, according to a research conducted on behalf of Price Waterhouse Coopers. The findings of the survey, companies in the development/ expansion stage, where the majority of the venture capital funding is directed, exhibited increased:

- Employment at an average annual rate of 9.5 per cent between 1993 and 1997
- Sales at an average rate of 12.1 per cent
- Profits at 34.9 per cent
- Exports at 15.2 per cent
- 52 per cent of the respondents viewed the importance of venture capital to growth of business as crucial
- 56 per cent considered venture capitalists as being a ‘real partner’

Angels
Angels are important links in the entire process of venture capital funding. This is because they support a fledging enterprise at a very early stage – sometime even before commercialization of the product or service offering. Typically, an angel is an experienced industry-bred individual with high net worth.

Angels provide funding by “first round” financing for risky investments – risky because they are a young / start-up company or because their financial track record is unstable. This venture capital financing is typically used to prepare the company for “second round” financing in the form of an initial public offering (IPO). Example – A company may need “first round” financing to develop a new product line, (viz a new drug which would require significant research & development funding) or
make a strategic acquisition to achieve certain levels of growth &
stability.

It is important to choose the right Angel because they will sit
on your Board of Directors, often for the duration of their
investment and will assist in getting “second round” financing.
When choosing an ‘Angel’, it is imperative to consider their
experience in a relevant industry, reputation, qualifications and
track record.

Angels are people with less money orientation, but who play an
active role in making an early-stage company work. They are
people with enough hands-on experience and are experts in
their fields. They understand the field from an operational
perspective. An entrepreneur needs this kind of expertise. He
also needs money to make things happen. Angels bring both to
the table of an entrepreneur.

There are a number of professionally qualified people, especially
from IITs who had migrated to USA. Some of them have
made their millions riding the IT boom in Silicon Valley.
Having witnessed the maturity of the Silicon Valley into the
global tech hotspot and thrived in the environment there, these
individuals are rich in terms of financial resources and experience.
They are the latest angels in the Indian industry.

The IndUS Entrepreneurs (TiE), a networking society that
brings together highly influential Indians across the US was set
up in 1992. The aim of the organization is to get the community
together and to foster entrepreneurs and wealth creation.
The idea was sparked off in 1992, when a group of Silicon
Valley entrepreneurs with roots in the Indian sub-continent met
by chance for a meeting with a visiting dignitary from India. A
delayed flight kept the group waiting, and provided an opportu-
nity for people to get to know one another. It turned out that
most of the assembled invitees to the meeting had achieved
varying degrees of entrepreneurial success. The group saw value
in getting together on a regular basis to network with one
another. Thus, the idea of TiE was born as a mechanism for
high achievement-oriented IndUS entrepreneurs to network.

Over the years, a core group of about 10-15 individuals worked
to establish the organization. Meeting at least once a
month, successful veteran entrepreneurs, contributed as
speakers, participants and mentors. Gradually, the group started
attracting greater participation, and the TiE concept started
gaining momentum. TiE membership has now grown to over
600 members, and chapters in Boston, Austin and Los Angeles.
TiE is also supported by over 20 institutions that include
leading Silicon Valley venture capital investors, law firms,
accounting firms and banks.

Fifty percent of business plans submitted to venture capitalists
in the Valley and outside is now from Indians and TiE can take
the lion’s share of the credit for this. What’s more? About 30
per cent of the projects that are funded, are headed by Indians.
As of 1998, over two dozen start-up companies have benefited
from TiE, and two have already made successful IPOs.

TiE isn’t about venture capitalist funding. It’s about angel
investing. The issue here is to identify a good idea that hasn’t
attracted any money, and then fund it the money coming from
the member’s own pockets. The environment is traditional in
the sense of it following a gurukul environment of sorts,
where the gurus transfer knowledge on business plans,
management strategies and survival kits to new TiE members.
Some of the famous names include

- Vinod Dham, father of the Pentium chip and now the
  CEO of the Silicon Spice, one of the most closely watched
  start-ups in the Silicon Valley today.
- Sallesh Mehta, CEO & President of the US$15bn
  Providian Financial and the man who is using technology to
  re-order consumer finance.
- Kanwal Rekhi, one of the first Indians to become a big
  name in the valley; founder of Excelan, past CTO and
  member of Novell’s board, now invests in a number of
  new ventures. He is the current chairman of the TiE.
- Prabhu Goel, ‘serial entrepreneur’, who has started three
  hi-tech companies so far and is on the board of five other
  companies as a private investor.
- Suhas Patil, who founded the semiconductor company
  Cirrus Logic in 1984.
- Prakash Agarwal, whose NeoMagic integrates memory
  and logic on a single chip. The six year old company already
  has a market share of 50%.
- K.B. Chandrashekhar, heads the US$200mn Exodus
  Communications, whose fiber optic network carries 30% of
  all Internet content traffic and whose servers host such
  popular websites such as Yahoo, Hotmail and Amazon.

Corporate Venturing

Even though corporate venturing is an attractive alternative,
most companies find it difficult to establish systems, capabili-
ties and cultures that make good venture capital firms.

Corporate managers seldom have the same freedom to fund
innovative projects or to cancel them midstream. Their skills are
honored for managing mature businesses and not nurturing start-
up companies. If a firm is to apply the venture capital model, it
must understand the characteristics of the model and tailor its
venture capital program to its own circumstances without losing
sight of these essentials.

Success of venture capital firms rest on the following characteris-
tics:

- Focus on specific industry niches and look for business concepts
  that will
  - Although corporate managers have a clear focus in their
    business, they run into ambiguity with venture programs.
    Their biggest challenge is to establish clear, prioritized
    objectives. Simply making a good financial return is not
    sufficient.
  - Manage portfolios ruthlessly, abandon losers, whereas
    abandoning ventures has never been easy for large
    corporations, whose projects are underpinned by personal
    relationships, political concerns.
  - Venture capital firms share several attributes with start up
    they fund. They tend to be small, flexible and quick to make
    decisions. They have flat hierarchies and rely heavily on
    equity and incentive pay.
Apple Computers established a venture fund in 1986 with the dual objectives of earning high financial return and supporting development of Macintosh software. They structured compensation mechanisms, decision criteria and operating procedures on those of top venture capital firms. While they considered Macintosh as an initial screening factor, its funding decisions were aimed at optimizing financial returns. The result was an IRR of 90 per cent but little success in improving the position of Macintosh.

New ventures can be powerful source of revenues, diversification and flexibility in rapidly changing environments. The company should create an environment that encourages venturing. An innovative culture cannot be transplanted but must evolve within the company. Venture investing requires different mindset from typical corporate investors.

How relevant is corporate venturing in the Indian scenario? The firms, which launched the successful corporate ventures had created new products in the market operating at the higher end of the value chain and had attained a certain size in the market. Most Indian companies are yet to move up the value chain and consolidate their position as players in the global market. Corporate venturing models would probably benefit Indian companies who are large players in the Indian market in another five to 10 years by enabling them to diversify and at the same time help start up companies. Multinationals led by Intel are the best examples of corporate venturing in an Indian context.

Financing Options in General
The possibility of raising a substantial part of project finances in India through both equity and debt instruments is among the key advantages of investing in India.

The Indian banking system has shown remarkable growth over the last two decades. The rapid growth and increasing complexity of the financial markets, especially the capital market have brought about measures for further development and improvement in the working of these markets. Banks and development financial institutions led by ICICI, IDBI and IFCI were providers of term loans for funding projects. The options were limited to conventional businesses, i.e. manufacturing centric. Services sector was ignored because of the "collateral" issue. Equity was raised from the capital markets using the IPO route. The bull markets of the 90s, fuelled by Harshad Mehta and the FIIs, ensured that (ad)venture capital was easily available. Manufacturing companies exploited this to the full.

The services sector was ignored, like software, media, etc. Lack of understanding of these sectors was also responsible for the same. If we look back to 1991 or even 1992, the situation as regards financial outlay available to Indian software companies was poor. Most software companies found it extremely difficult to source seed capital, working capital or even venture capital. Most software companies started off undercapitalized, and had to rely on loans or overdraft facilities to provide working capital. This approach forced them to generate revenue in the short term, rather than investing in product development. The situation fortunately has changed.

The Venture Capital Process
Venture capitalists are a busy lot. This chapter aims to highlight the approach to an investor and the entire process that goes into the wooing the venture capital with your plan.

First, you need to work out a business plan. The business plan is a document that outlines the management team, product, marketing plan, capital costs and means of financing and profitability statements.

The venture capital investment process has variances/features that are context specific and vary from industry, timing and region. However, activities in a venture capital fund follow a typical sequence. The typical stages in an investment cycle are as below:

- Generating a deal flow
- Due diligence
- Investment valuation
- Pricing and structuring the deal
- Value Addition and monitoring
- Exit

Generating a Deal Flow
In generating a deal flow, the venture capital investor creates a pipeline of 'deals' or investment opportunities that he would consider for investing in. This is achieved primarily through plugging into an appropriate network. The most popular network obviously is the network of venture capital funds/investors. It is also common for venture capitals to develop working relationships with R&D institutions, academia, etc, which could potentially lead to business opportunities.

Understandably the composition of the network would depend on the investment focus of the venture capital funds/company. Thus venture capital funds focussing on early stage technology based deals would develop a network of R&D centers working in those areas. The network is crucial to the success of the venture capital investor. It is almost imperative for the venture capital investor to receive a large number of investment proposals from which he can select a few good investment candidates finally. Successful venture capital investors in the USA examine hundreds of business plans in order to make three or four investments in a year.

It is important to note the difference between the profile of the investment opportunities that a venture capital would examine and those pursued by a conventional credit oriented agency or an investment institution. By definition, the venture capital investor focuses on opportunities with a high degree of innovation.

The deal flow composition and the technique of generating a deal flow can vary from country to country. In India, different venture capital funds/companies have their own methods varying from promotional seminars with R&D institutions and industry associations to direct advertising campaigns targeted at various segments. A clear pattern between the investment focus of a fund and the constitution of the deal generation network is discernible even in the Indian context.

Due Diligence
Due diligence is the industry jargon for all the activities that are associated with evaluating an investment proposal. It includes carrying out reference checks on the proposal related aspects such as management team, products, technology and market. The important feature to note is that venture capital due diligence focuses on the qualitative aspects of an investment opportunity.

It is also not unusual for venture capital fund/companies to set up an ‘investment screen’. The screen is a set of qualitative (sometimes quantitative criteria such as revenue are also used) criteria that help venture capital funds/companies to quickly decide on whether an investment opportunity warrants further diligence. Screens can be sometimes elaborate and rigorous and sometimes specific and brief. The nature of screen criteria is also a function of investment focus of the firm at that point.

Venture capital investors rely extensively on reference checks with ‘leading lights’ in the specific areas of concern being addressed in the due diligence.

A venture capitalist tries to maximize the upside potential of any project. He tries to structure his investment in such a manner that he can get the benefit of the upside potential ie he would like to exit at a time when he can get maximum return on his investment in the project. Hence his due diligence appraisal has to keep this fact in mind.

**New Financing**

Sometimes, companies may have experienced operational problems during their early stages of growth or due to bad management. These could result in losses or cash flow drains on the company. Sometimes financing from venture capital may end up being used to finance these losses. They avoid this through due diligence and scrutiny of the business plan.

**Inter-Company Transactions**

When investments are made in a company that is part of a group, inter-company transactions must be analyzed.

**Investment Valuation**

The investment valuation process is an exercise aimed at arriving at ‘an acceptable price’ for the deal. Typically in countries where free pricing regimes exist, the valuation process goes through the following steps:

- **Evaluate future revenue and profitability**
- **Forecast likely future value of the firm based on experienced market capitalization or expected acquisition proceeds depending upon the anticipated exit from the investment.**
- **Target an ownership position in the investee firm so as to achieve desired appreciation on the proposed investment.**

The appreciation desired should yield a hurdle rate of return on a Discounted Cash Flow basis.

Symbolically the valuation exercise may be represented as follows:

\[ NPV = \left(\frac{\text{Cash}}{\text{Post}}\right) \times \left(\frac{\text{PAT} \times \text{PER}}{\text{Post}}\right) \times k \]

Where:
- **NPV** = Net Present Value of the cash flows relating to the investment comprising outflow by way of investment and inflows by way of interest/dividends (if any) and realization on exit. The rate of return used for discounting is the hurdle rate of return set by the venture capital investor.
- **Cash** represents the amount of cash being brought into the particular round of financing by the venture capital investor.
- **POST** is the pre-money valuation of the firm estimated by the investor. While technically it is measured by the intrinsic value of the firm at the time of raising capital. It is more often a matter of negotiation driven by the ownership of the company that the venture capital investor desires and the ownership that founders/management team is prepared to give away for the required amount of capital.
- **PAT** is the forecast Profit after tax in a year and often agreed upon by the founders and the investors (as opposed to being ‘arrived at’ unilaterally). It would also be the net of preferred dividends, if any.
- **PER** is the Price-Earning multiple that could be expected of a comparable firm in the industry. It is not always possible to find such a ‘comparable fit’ in venture capital situations. That necessitates, therefore, a significant degree of judgement on the part of the venture capital to arrive at alternate PER scenarios.

- ‘k’ is the present value interest factor (corresponding to a discount rate ‘r’) for the investment horizon.

It is quite apparent that PER time PAT represents the value of the firm at that time and the complete expression really represents the investor’s share of the value of the investee firm. The following example illustrates this framework:

Example: Best Mousetrap Limited (BML) has developed a prototype that needs to be commercialized. BML needs cash of Rs2mn to establish production facilities and set up a marketing program. BML expects the company will go public in the third year and have revenues of Rs70mn and a PAT margin of 10% on sales. Assume, for the sake of convenience that there would be no further addition to the equity capital of the company.

Prudent Fund Managers (PFM) propose to lead a syndicate of like minded investors with a hurdle rate of return of 75% (discounted) over a five year period based on BML’s sales and profitability expectations. Firms with comparable sales and profitability and risk profiles trade at 12 times earnings on the stock exchange. The following would be the sequence of computations:

In order to get a 75% return p.a. the initial investment of Rs2 million must yield an accumulation of \(2 \times (1.75)^5\) = Rs32.8mn on disinvestment in year 5.

BML’s market capitalization in five years is likely to be Rs (70 x 0.1 x 12) million = Rs84mn.

Percentage ownership in BML that is required to yield the desired accumulation will be (32.8/ 84) x 100 = 39%

Therefore the post money valuation of BML At the time of raising capital will be equal to Rs(2 / 0.39) million = Rs5.1 million which implies that a pre-money valuation of Rs3.1 million for BML.

Another popular variant of the above method is the First Chicago Method (FCM) developed by Stanley Golder, a leading professional venture capital manager. FCM assumes three possible scenarios – ‘success’, ‘sideways survival’ and ‘failure’.
Outcomes under these three scenarios are probability weighted to arrive at an expected rate of return:
In reality the valuation of the firm is driven by a number of factors. The more significant among these are:
Overall economic conditions: A buoyant economy produces an optimistic long-term outlook for new products/services and therefore results in more liberal pre-money valuations.

- Demand and supply of capital: when there is a surplus of venture capital of venture capital chasing a relatively limited number of venture capital deals, valuations go up. This can result in unhealthy levels of low returns for venture capital investors.
- Specific rates of deals: such as the founder’s/management team’s track record, innovation/unique selling propositions (USPs), the product/service size of the potential market, etc affects valuations in an obvious manner.
- The degree of popularity of the industry/technology in question also influences the pre-money. Computer Aided Skills Software Engineering (CASE) tools and Artificial Intelligence were one time darlings of the venture capital community that have now given place to biotech and retailing.
- The standing of the individual venture capital. Well established venture capitalists who are sought after by entrepreneurs for a number of reasons could get away with tighter valuations than their less known counterparts.
- Investor’s considerations could vary significantly. A study by an American venture capital, VentureOne, revealed the following trend. Large corporations who invest for strategic advantages such as access to technologies, products or markets pay twice as much as a professional venture capital investor, for a given ownership position in a company but only half as much as investors in a public offering.
- Valuation offered on comparable deals around the time of investing in the deal.

Quite obviously, valuation is one of the most critical activities in the investment process. It would not be improper to say that the success for a fund will be determined by its ability to value/price the investments correctly.

Sometimes the valuation process is broadly based on thumb rule metrics such as multiple of revenue. Though such methods would appear rough and ready, they are often based on fairly well established industry averages of operating profitability and assets/capital turnover ratios
Such valuation as outlined above is possible only where complete freedom of pricing is available. In the Indian context, where until recently, the pricing of equity issues was heavily regulated, unfortunately valuation was heavily constrained.

**Structuring a Deal**

Structuring refers to putting together the financial aspects of the deal and negotiating with the entrepreneurs to accept a venture capital’s proposal and finally closing the deal. To do a good job in structuring, one needs to be knowledgeable in areas of accounting, cash flow, finance, legal and taxation. Also the structure should take into consideration the various commercial issues (ie what the entrepreneur wants and what the venture capital would require to protect the investment). Documentation refers to the legal aspects of the paperwork in putting the deal together.

The instruments to be used in structuring deals are many and varied. The objective in selecting the instrument would be to maximize (or optimize) venture capital’s returns/protection and yet satisfy the entrepreneur’s requirements. The instruments could be as follows:

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan</td>
<td>clean vs secured</td>
</tr>
<tr>
<td></td>
<td>Interest bearing vs non interest bearing</td>
</tr>
<tr>
<td></td>
<td>convertible vs one with features (warrants)</td>
</tr>
<tr>
<td></td>
<td>1st Charge, 2nd Charge</td>
</tr>
<tr>
<td>Preference shares</td>
<td>redeemable (conditions under Company Act)</td>
</tr>
<tr>
<td></td>
<td>participating</td>
</tr>
<tr>
<td>Warrants</td>
<td>par value</td>
</tr>
<tr>
<td></td>
<td>nominal shares</td>
</tr>
<tr>
<td></td>
<td>exercise price, expiry period</td>
</tr>
<tr>
<td>Common shares</td>
<td>new or vendor shares</td>
</tr>
<tr>
<td></td>
<td>par value</td>
</tr>
<tr>
<td></td>
<td>partially-paid shares</td>
</tr>
<tr>
<td>Options</td>
<td>exercise price, expiry period, call, put</td>
</tr>
</tbody>
</table>

In India, straight equity and convertibles are popular and commonly used. Nowadays, warrants are issued as a tool to bring down pricing.

A variation that was first used by PACT and TDICI was “royalty on sales”. Under this, the company was given a conditional loan. If the project was successful, the company had to pay a % age of sales as royalty and if it failed then the amount was written off.

In structuring a deal, it is important to listen to what the entrepreneur wants, but the venture capital comes up with his own solution. Even for the proposed investment amount, the venture capital decides whether or not the amount requested, is appropriate and consistent with the risk level of the investment. The risks should be analyzed, taking into consideration the stage at which the company is in and other factors relating to the project. (eg exit problems, etc).

**Promoter Shares**

As venture capital is to finance growth, venture capital investment should ideally be used for financing expansion projects (eg new plant, capital equipment, additional working capital). On the other hand, entrepreneurs may want to sell away part of their interests in order to lock-in a profit for their work in building up the company. In such a case, the structuring may include some vendor shares, with the bulk of financing going into buying new shares to finance growth.

**Handling Director’s and Shareholder’s Loans**

Frequently, a company has existing director’s and shareholder’s loans prior to inviting venture capitalists to invest. As the money from venture capital is put into the company to finance growth, it is preferable to structure the deal to require these loans to be repaid back to the shareholders/directors only upon
monitoring the venture capitalist continuously.

It is to be understood that the providers of venture capital are not just financiers or subscribers to the equity of the project they fund. They function as a dual capacity, as a financial partner and strategic advisor. Venture capitalists monitor and evaluate projects regularly. They keep an eye on the pulse of the project. They are actively involved in the management of the investee unit and provide expert business counsel, to ensure its survival and growth. Deviations or causes of worry may alert them to potential problems and they can suggest remedial actions or measures to avoid these problems. As professionals in this unique method of financing, they may have innovative solutions to maximize the chances of success of the project. After all, the ultimate aim of the venture capitalist is the same as that of the promoters – the long term profitability and viability of the investee company.

Exit
One of the most crucial issues is the exit from the investment. After all, the return to the venture capitalist can be realized only at the time of exit. Exit from the investment varies from the investment to investment and from venture capital to venture capital. There are several exit routes, buy-back by the promoters, sale to another venture capitalist or sale at the time of Initial Public Offering, to name a few. In all cases specialists will work out the method of exit and decide on what is most profitable and suitable to both the venture capitalist and the investee unit and the promoters of the project.

At present many investments of venture capitalists in India remain on paper as they do not have any means of exit. Appropriate changes have to be made to the existing systems in order that venture capitalists find it easier to realize their investments after holding on to them for a certain period of time. This factor is even more critical to smaller and mid sized companies, which are unable to get listed on any stock exchange, as they do not meet the minimum requirements for such listings. Stock exchanges could consider how they could assist in this matter for listing of companies keeping in mind the requirement of the venture capital industry.

Accessing Venture Capital
Venture funds, both domestic and offshore, have been around in India for some years now. However it is only in the past 12 to 18 months, they have come into the limelight. The rejection ratio is very high, about 10 in 100 get beyond pre evaluation stage, and 1 gets funded.

Venture capital funds are broadly of two kinds - generalists or specialists. It is critical for the company to access the right type of fund, ie who can add value. This backing is invaluable as focused/ specialized funds open doors, assist in future rounds and help in strategy. Hence, it is important to choose the right venture capitalist.

The standard parameters used by venture capitalists are very similar to any investment decision. The only difference being exit. If one buys a listed security, one can exit at a price but with an unlisted security, exit becomes difficult. The key factors which they look for in

The Management
Most businesses are people driven, with success or failure depending on the performance of the team. It is important to distinguish the entrepreneur from the professional management team. The value of the idea, the vision, putting the team together, getting the funding in place are amongst others, some key aspects of the role of the entrepreneur. Venture capitalists will insist on a professional team coming in, including a CEO to execute the idea. One-man armies are passe. Integrity and commitment are attributes sought for. The venture capitalist can provide the strategic vision, but the team executes it. As a famous Silicon Valley saying goes “Success is execution, strategy is a dream”.

The Idea
The idea and its potential for commercialization are critical. Venture funds look for a scalable model, at a country or a regional level. Otherwise the entire game would be reduced to a manpower or machine multiplication exercise. For example, it is very easy for Hindustan Lever to double sales of Liril - a soap without incremental capex, while Gujarat Ambuja needs to spend at least Rs4bn before it can increase sales by 1mn ton. Distinctive competitive advantages must exist in the form of scale, technology, brands, distribution, etc which will make it difficult for competition to enter.

Valuation
All investment decisions are sensitive to this. An old stock market saying “Every stock is a buy at a price and vice versa”. Most deals fail because of valuation expectation mismatch. In India, while calculating returns, venture capital funds will take into account issues like rupee depreciation, political instability, which adds to the risk premia, thus suppressing valuations. Linked to valuation is the stake, which the fund takes. In India, entrepreneurs are still uncomfortable with the venture capital “taking control” in a seed stage project.

Exit
Without exit, gains cannot be booked. Exit may be in the form of a strategic sale or/ and IPO. Taxation issues come up at the time. Any fund would discuss all exit options before closing a
deal. Sometimes, the fund insists on a buy back clause to ensure an exit.

Portfolio Balancing
Most venture funds try and achieve portfolio balancing as they invest in different stages of the company life cycle. For example, a venture capital has invested in a portfolio of companies predominantly at seed stage, they will focus on expansion stage projects for future investments to balance the investment portfolio. This would enable them to have a phased exit. In summary, venture capital funds go through a certain due diligence to finalize the deal. This includes evaluation of the management team, strategy, execution and commercialization plans. This is supplemented by legal and accounting due diligence, typically carried out by an external agency. In India, the entire process takes about 6 months. Entrepreneurs are advised to keep that in mind before looking to raise funds. The actual cash inflow might get delayed because of regulatory issues. It is interesting to note that in USA, at times angels write checks across the table.

Current Trends

Capital is Pouring into Private Equity Funds
The IPO boom and its exceptional returns to venture and other kinds of private equity investments have led institutional investors, pension funds and endowments to park their money in these investments.

Bigger is Better
The most established venture funds now have more partners and therefore are able to put more money to work effectively. Also, venture firms are doing less deal syndication, which enables them to put more money to work in a single deal. Thirdly, many traditional early-stage venture firms have shifted to a multi-stage investment approach. They will back companies in technologies and industries they know intimately, almost regardless of the stage.

First-time Firms Never Had It So Good
During the 1989-91 downturn, new venture capital firms faced a problem in raising partnership capital, as there was a ‘flight to quality’ among investors who backed established funds in the private equity market. However, developments over the past few years have demonstrated that investing with an established firm is no more a sure-bet than an investment in a ‘first-time fund’.

The State Wants its Share of the Pie too
The Department of Electronics of the Government of India announced the creation of a Rs1bn IT fund. Many state governments are sponsoring the formation of new venture capital firms to spur the creation and growth of new business quickly followed this move. Andhra Pradesh, Karnataka, Kerala, Gujarat and West Bengal are among the states creating such programs. They are fairly controversial efforts, because they run the risk of sacrificing return for economic stimulus. Many would believe that they are not a good idea. However, some of them are better designed than others and few might actually work.

Venture Firms are Being Run More Like Businesses
One of the healthiest consequences of the growth in institutional funding has been increased scrutiny that venture firms have come under. Feedback from previous investments and suggestions from the investors in these funds are helping to increase the sense of professionalism in the industry.

No More Men in Gray Suits
Another trend that is emerging slowly is the change in the profile of a fund manager. The venture capitalist is no longer a hybrid investment banker trying to cash in on another market boom while still keeping his cards close to his chest. The new-age venture capitalist is industry-bred and highly regarded in the business and is fairly at ease with the technologies and processes in the market.

Tomorrow is Coming Faster
Rapid changes in technology have accelerated the pace and raised the efficiencies for getting from idea to market. Investors are specializing. Financing sources are becoming much more focused on their way to investment in today’s competitive environment. Today, from venture capital firms to leveraged buyout (LBO) houses and corporations, investors are devising specific plans for industries and technologies they want to be in.

More Venture Funds are Seeking Traditional Businesses
More venture capital funds are going after low-tech or no-tech companies. For example, Draper International has picked up a stake in Shoppers Stop and Indus League Clothing.

Financing Sources are More Flexible
More companies are acquiring new ideas, products and complementary operations to capture growth and gain market share. This means financing must allow for covenants that permit mergers, acquisitions and continued investments.

Financing Sources and Companies are Building Partnering Relationships
Companies need financing sources that allow them to move quickly and will tolerate risk, including acquisitions. Although financing sources are risking more, the rewards of such a partnering relationship can grow and be profitable for all concerned.

Competition is Affecting Buyer Prices
Historically, there has been a big difference between strategic buyers who paid a premium for the potential of synergy and financial buyers and LBO houses. Today, the two factions are more directly competitive.

All businesses are not evaluated equally. Venture houses today are looking at what enhances the value of a company, with different ‘value drivers affecting various industry segments. For example, when evaluating a technology company, investors may care about a unique technology or process with great potential. They won’t necessarily worry whether the company lacks audited financial statements or an organization structure. In a non-technology area, however, there must be more than a new idea; ‘value drivers’ might include historical performance, gross margins and return on investment.
Annexure: Summary Research Findings

In order to supplement the study on venture capital, India Infoline carried out a survey of some of the leading players in the venture capital environment today. As a part of the research, carried out in May and June 1999, 15 investing firms and intermediaries were interviewed about their expectations from the market and 30 promoters, CEOs or CFOs of IT companies were interviewed about their awareness of and perceptions about VC funding. The study was conducted in three cities – Mumbai, Pune and Bangalore.

The sample comprised of companies engaged in the IT segment – job contracting software development, offshore services, on-site development, systems and application software, hardware services and vendoring and training institutes.

A combination of judgement and convenience sampling was used and questionnaires were administered to the respondents after taking a prior telephonic appointment. The age-profile of the companies is included below.

Company Age Profile

<table>
<thead>
<tr>
<th>Years</th>
<th>No. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;1</td>
<td>7</td>
</tr>
<tr>
<td>1-3</td>
<td>6</td>
</tr>
<tr>
<td>3-5</td>
<td>9</td>
</tr>
<tr>
<td>5-10</td>
<td>6</td>
</tr>
<tr>
<td>&gt;10</td>
<td>4</td>
</tr>
</tbody>
</table>

What Do Entrepreneurs Expect in a Venture Capital Investment?

Venture capital investors boast of bringing ‘more than money’ to the projects that they fund. This part of the study aimed at eliciting a response from the promoters of the projects about their expectations of a ‘helping hand’. Listed below are the most common responses among the sample of IT investors and the percentage of people who agreed with them.

<table>
<thead>
<tr>
<th>Expectation</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assistance in terms of marketing advice, leads, networking</td>
<td>70%</td>
</tr>
<tr>
<td>Follow on/ later stage financing</td>
<td>66%</td>
</tr>
<tr>
<td>Financial management and strategy</td>
<td>63%</td>
</tr>
<tr>
<td>Non executive governance</td>
<td>57%</td>
</tr>
<tr>
<td>Manpower planning, recruitment of personnel</td>
<td>47%</td>
</tr>
<tr>
<td>Doing away with legal hassles, red tape, bureaucracy</td>
<td>33%</td>
</tr>
<tr>
<td>Transfer of technology</td>
<td>20%</td>
</tr>
</tbody>
</table>

What Attributes Do Venture Capitalists Look for in a Deal?

Unlike the entrepreneurs, the VCs seem to be more in unison as they agree on a few critical success parameters. The respondents have identified the following critical factors.

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management quality</td>
<td>100%</td>
</tr>
<tr>
<td>Promoter’s credentials and track record</td>
<td>86%</td>
</tr>
<tr>
<td>A focused development strategy</td>
<td>80%</td>
</tr>
<tr>
<td>A strong proprietary and competitive position</td>
<td>73%</td>
</tr>
<tr>
<td>A scalable business model</td>
<td>60%</td>
</tr>
<tr>
<td>An innovative concept, breakthrough technology</td>
<td>40%</td>
</tr>
<tr>
<td>Measurable milestones in the development strategy</td>
<td>27%</td>
</tr>
</tbody>
</table>