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VENTURE CAPITAL FINANCING IN THE INDIAN CAPITAL MARKET

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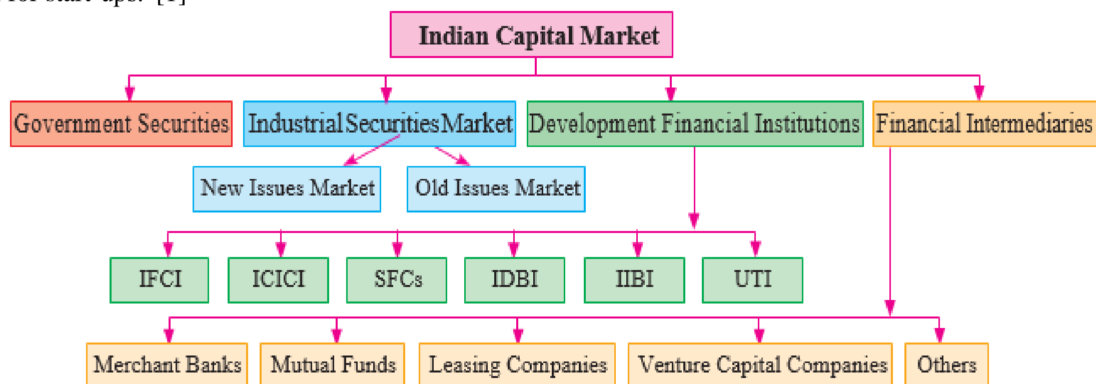
ABSTRACT

Venture Capital refers to the finance provided by Venture Capitalists, who invest in relatively new, high growth companies or startups that have a potential to grow and develop into highly profitable ventures. It has high-risk and high-return characteristics. Therefore, it acts as an important source of finance for entrepreneurs with new ideas. A new private company which does not want to take finance from public markets may have their eyes on venture capital. Venture capital is provided to any business firm by those who are willing to invest in the projects that are risky but have a promising future prospect. Such funds are known as venture capital funds.Venture capital has now gained a certain degree of densification, maturity and edification in the US. The phenomenon of venture capital is new for the Indians but it was one of the much talked things about financing alternatives in India in and around the nineties.

KEYWORDS: ***venture, capital, financing, Indian, market, projects, company, entrepreneurs***

INTRODUCTION

The Indian government's budget for 2014-15 is clearly an investor-friendly one with a slew of provisions and funds earmarked for start-ups in India. Also, a start-up fund worth Rs 10,000 crore is being mulled by the government. According to Finance Minister Arun Jaitley, it will be "equity, quasi-equity, soft loan and other risk capital for start-ups."[1]



This is encouraging news although angel investors and venture capitalists (VCs) have kept the start-up ecosystem thriving in India till date. Venture capital is an investment in the form of shares or a later stock option in potentially high-risk businesses. The beneficiary companies are usually small or medium-sized firms, requiring seed or early-stage funding for innovation and development of technology or products with high growth potential. High annual returns ranging from 25-75% are expected on such investments. In a venture capital deal, large ownership chunks of a company are created and sold to a few investors through independent limited partnerships that are established by

venture capital firms. Sometimes these partnerships consist of a pool of several similar enterprises. One important difference between venture capital and other private equity deals, however, is that venture capital tends to focus on emerging companies seeking substantial funds for the first time, while private equity tends to fund larger, more established companies that are seeking an equity infusion or a chance for company founders to transfer some of their ownership stakes.[2,3]

A series of regulatory innovations further helped popularize venture capital as a funding avenue.

- The first one was a change in the Small Business Investment Act (SBIC) in 1958. It boosted the venture capital industry by providing tax breaks to investors. In 1978, the Revenue Act was amended to reduce the capital gains tax from 49% to 28%
- Then, in 1979, a change in the Employee Retirement Income Security Act (ERISA) allowed pension funds to invest up to 10% of their assets in small or new businesses. This move led to a flood of investments from rich pension funds
- The capital gains tax was further reduced to 20% in 1981.

These three developments catalyzed growth in venture capital and the 1980s turned into a boom period for venture capital, with funding levels reaching $4.9 billion in 1987. The dot-com boom also brought the industry into sharp focus as venture capitalists chased quick returns from highly-valued Internet companies. According to some estimates, funding levels during that period went as high as $30 billion. But the promised returns did not materialize as several publicly-listed Internet companies with high valuations crashed and burned their way to bankruptcy.[4]

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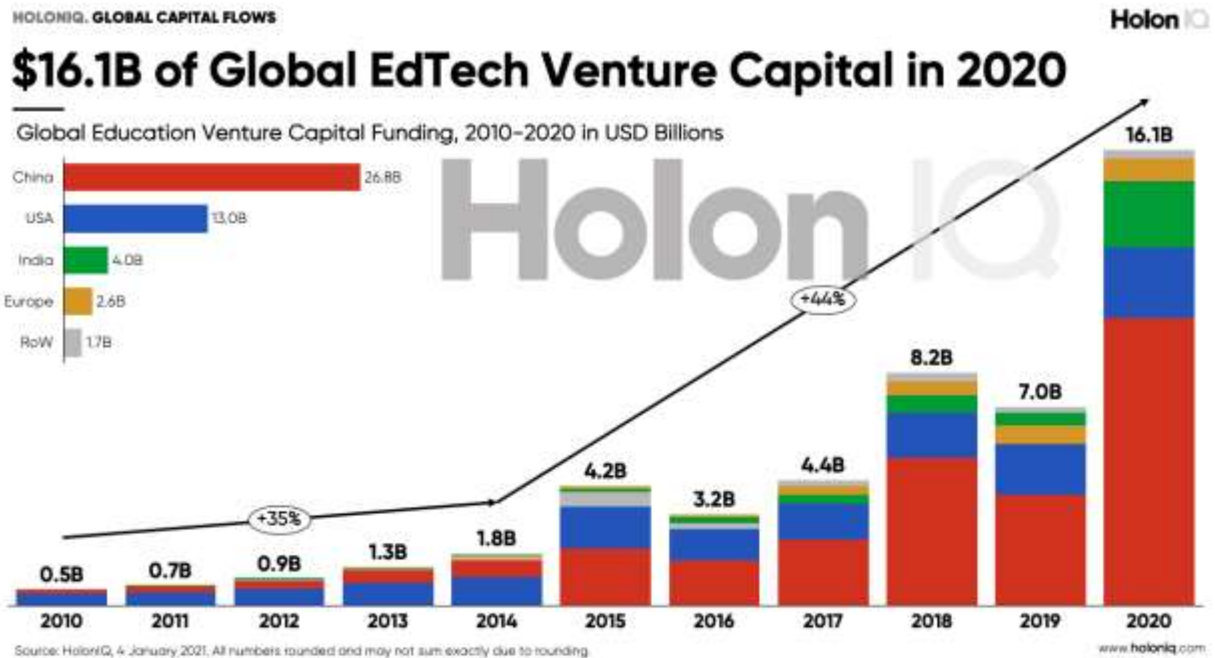
DISCUSSION

Venture capital (VC) may be defined as a support to entrepreneurial talents and appetite by turning ideas and basic science into products and services which are expected to envy the world. Venture capital funds are able to build companies from the simplest form to mature organizations. Venture capital investors generally actively engage with management of the company by typically taking place on the board. Through the due diligence process the venture capital firms concentrate on the founders, the management team, the concept, the marketplace, the revenue model, the value-added potential of the firm, the amount of capital needed to heal the business and whether all these fit to the fund's objectives. Over the next three to eight years, the venture firm works with the founding entrepreneur/s to grow the company. Once a company funded by venture capital matures and becomes successful, venture funds generally exit by taking it public through an initial public offering (IPO) or by selling it to big companies. [5,6]

This allows the venture funds to be free from the previous investment and invest in the next generation of companies. United States, Europe, Israel, Canada, China and India have the most developed markets for venture capital environment. The size of the venture capital market is nowadays about $50 billion and the United States has the most funds for venture capital of $33.1 billion in 2013. Venture capital firms may invest in promising firms in stages of seed, first round, second round or later. The median investment amounts in the United States in 2013 are $0.5 million for seed, $2.5 million for first round, $5.7 million for second round and $10 for later stage. The most attractive sector for venture capital is information technology for the United States, Israel and Canada, invested over $10 billion in 2013, while the most attractive sector is consumer products for Europe, China and India, invested over $4.8 billion in 2013.[7]

The first major analysis on risk capital for India was reported in 1983 . It indicated that new companies often confront serious barriers to entry into capital market for raising equity finance which undermines their future prospects of expansion and diversification. It also indicated that on the whole there is a need to revive the equity cult among the masses by ensuring competitive return on equity investment. This brought out the institutional inadequacies with respect to the evolution of venture capital. The role of venture capital was met initially by the following institutions: Industrial Development Bank of India. Industrial credit and investment corp of India State Finance Corporations and Small Industries Development Bank of India The first origins of modern venture capital in India can be traced to the setting up of a Technology Development Fund in the year 1987-88, through the levy of access on all technology import payments . Technology Development Fund was started to provide financial support to innovative and high risk technological programmes through the Industrial Development Bank of India. Subsequently, Government of India gave the procedures that can be used for starting venture funding.[8,9]



RESULTS

From its inception, the Indian venture capital industry has been affected by international and domestic developments; its current situation is the result of the evolution of what initially appeared to be unrelated historical trajectories. The creation of a venture capital industry in India through transplantation required the existence of a minimal set of supportive conditions. They need not necessarily be optimal, because, if the industry survived, it would likely set in motion a positive feedback process that would foster the emergence of successful new firms, encourage investment of more venture capital, and support the growth of other types of expertise associated with the venture capital industry; in other words, if the venture capital industry experienced any success it could entrain a process of shaping its environment. In other words, in contrast to Israel and Taiwan, India would have to experience a hybrid of Interactions C and D discussed in the introduction, if venture capital was to thrive: It would have to change its environment to allow the sustenance of a venture capital industry and the societal institutions would have to modify themselves. In other words, venture capital could begin with a sub-optimal though minimally sustainable set of conditions, the venture capital industry could take root and shape its environment to a more optimal situation, while the institutions themselves would also need to change. Small and medium-sized enterprises have a long history and great importance to India. The leaders of the Independence movement were supporters of small businesses as an alternative to "exploitation" by multinational firms. And yet, despite the emphasis upon and celebration of small enterprises, the Indian economy was dualistic. It was dominated by a few massive private-sector conglomerates, such as the Tata and Birla groups, and various nationalized firms, even while there was an enormous mass of small shopkeepers and local industrial firms. As anywhere else, these small firms were in traditional industries and were not relevant for the emergence of venture capital, but they do indicate a culture of private enterprise.[10,11]

This entrepreneurial propensity also has been demonstrated by the willingness of Indians emigrating in other countries to establish shops, restaurants, hotels and enterprises of all sorts.

Already, under the British, Indians valued education very highly. After Independence, the Indian government invested heavily in education, and Indian universities attracted excellent students. In the 1960s, the Ford Foundation worked with the Indian government to establish the Indian Institutes of Technology (IIT), which adopted MIT's undergraduate curriculum. These Institutes and other top Indian educational institutions very quickly became the elite Indian engineering schools with extremely competitive entrance examinations and to which only the most intelligent students could gain entry. The excellent Indian students were very desired by overseas university graduate programs, generally, and in engineering, particularly. [12,13]

After graduating from overseas programs many of these Indian students did not return to India. However, many other Indian graduates remained in India working in the large family conglomerates, the many Indian universities, and various top-level research institutes such as those for space research . This meant that there remained in India a large pool of capable engineers and scientists that were underpaid (by global standards), and potentially mobile. Despite these strengths, India had many cultural rigidities and barriers to entrepreneurship and change, beginning with an extremely intrusive bureaucracy and extensive regulations. Until recently the labor market was quite rigid. For well-educated Indians the ideal career path was to enter the government bureaucracy, a lifetime position; enter the family business, which was then a lifetime position; or join one of the large conglomerates such as Tata and Birla, which also effectively guaranteed lifetime employment. The final career path was to emigrate; not surprisingly, among the immigrants were many seeking better opportunities and release from the rigidities at home. In summation, the institutional context discouraged investment and entrepreneurship. The next sections examine the features of the Indian economy that would evolve to make the creation of the Indian venture capital industry possible.[14]

The Venture Capital Assistance Scheme, Ministry of Agriculture and Farmers Welfare:

Venture Capital Assistance is financial support in the form of an interest free loan provided by SFAC to qualifying projects to meet shortfall in the capital requirement for implementation of the project.

APPLICATION PROCEDURE

One can only apply online, offline application forms will not be accepted. Also, below are the checklist before applying for the scheme.

Sno.	Checklist
1	Promoter’s request letter addressed to the Managing Director SFAC, New Delhi on original letterhead of firm/company
2	Sanction letter of Sanctioning authority addressed to recommending branch
3	Bank’s approved Appraisal/Process note bearing signature of sanctioning authority with terms of sanction of term loan
4	Up-to-date statement of account of Term loan and Cash Credit (if sanctioned)
5	Equity Certificate: a)C.A. certificate in case of Partnership or Proprietorship firms. b)Form-2(PAS-3), FORM-5(SH-7) and other documents in lieu of FORM-23 filed with ROC for
6	Farmer’s list/backward linkage duly supported by agreement
7	Affidavit of promoters that they have not availed VCA in the past
8	Unsecured loans raised by the promoters (If any). CA Certificate to be enclosed
9	Copy of last Bank's inspection report
10	Bank’s confirmation that they will not release primary & collateral security without SFAC consent
11	Justification for margin on working capital taken in the project cost

CONCLUSION

The Union Budget for 1999-2000 stressed the need for higher investment in venture capital activity. As it is difficult to access capital market to raise funds for technology development/ demonstration, especially for small and medium industries,VCF has a major role to play in this area. The National Venture Fund for Software and IT industry (NVFSIT) launched in the current financial year merits mention in this context. [15,16]

NVFSIT is managed by the Small Industry Development Bank of India (SIDBI) Venture Capital Ltd. (SVCL), which is a wholly owned subsidiary of SIDBI. In the backdrop of these developments, SEBI initiated a process of interaction with industry participants and experts to identify the various issues and key areas critical for the development of the VCF industry in India. The SEBI Committee on Venture Capital headed by Shri K.B. Chandrasekhar, (Chairman, Exodus Communications, Inc.) set up in July, 1999, examined the impediments to the growth of VCF and suggested several measures to facilitate the growth of venture capital activity in India. In order to obtain a global perspective, Indian entrepreneurs from the Silicon Valley were also associated with this Committee. The thrust of the Committee's recommendations is to facilitate, through an enabling regulatory, legal, tax and institutional environment, the creation of a pool of risk capital to finance idea-based entrepreneurship with a disproportionate potential reward–to-cost ratio.

Major Recommendations of the SEBI Committee on Venture Capital Funds(VCF) :
Since SEBI is responsible for overall regulation and registration of VCF, multiple regulatory requirements should be harmonised and consolidated within the framework of SEBI Regulations to facilitate uniform, hassle-free, single window clearance. In view of the above, the Ministry of Finance guidelines for overseas venture capital investment in India dated September 20, 1995 may be repealed. The existing provisions of the IT Act need to be reframed to provide for automatic income-tax exemption to VCFs registered with SEBI. Necessary legislative provisions for incorporation of entities such as Limited Liability Partnership, Limited Liability Company, etc. may be made either by enactment of separate Act or by amending the existing Indian Partnership Act and Indian Companies Act. Mutual Funds, banks and insurance companies should be permitted to invest in SEBI-registered VCFs. SEBI Venture Capital Regulations should be amended to facilitate inclusion of funds set up, scheme floated by a trust, company, body corporate or other legal entities. The investment criteria should be redefined to permit investment by VCFs primarily in the equity or equity related instruments or securities convertible into equity and also by way of subscription to IPOs.[16]

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