

STATE OF VENTURE CAPITAL IN INDIA

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Venture Capital (VC) a financial innovation of the twentieth century is a long term illiquid investment that can be in the form of equity, quasi-equity and some times debt in new and high risk ventures. It has required better recognition after the famous legend of Apple computers and has captured people's imagination through blockbuster successes like Intel, Hewlett-Packard and Microsoft etc. Eventually, the success of VC stimulated global countries to enter the arena of VC.

Venture capital refers to capital investment made in a business or industrial enterprise that carries elements of risk, insecurity and probability of business hazards. Capital investment may assume the form of either equity or debt or both i.e., entail total loss or be so insignificant as to lead to high gains. However, venture capital finance is different from conventional finance i.e., money lending and bank finance. However venture investments are taking place in venture capital because of the High Returns and Diversifications in investments. Not only that, when venture capital returns are compared to other asset classes, venture capital returns have a desirable low correlation with the returns in other asset classes. The high expected return and the low correlation with other asset classes suggest that an appropriate investment in venture capital class can lead to a higher risk adjusted rate of return for well-diversified portfolio.

Venture capital was introduced in India in mid eighties by All financial institutions with the inauguration of Risk Capital Foundation (RCF) sponsored by IFCI with a view to encourage the technologists and the professional to promoted new industries, consequently the government of India promoted the venture capital during 1986-87 by creating a venture capital fund in the context of structural development and growth of small-scale business enterprises. Since then several venture capital firms/funds (VCFs) are incorporated by Financial Institutions (FIs), Public Sector Banks (PSBs), Private Banks and private financial companies. The venture capital industry in India is still in a nascent stage. It has not been able to achieve its objectives as to provide risk capital to first generation entrepreneurs for setting up industrial projects and to accelerate the pace and quality of technological innovations for products having application in industry, agriculture, energy and other areas beneficial to the development process in India and make noticeable impact as compared to the countries in the west. The reasons for the tottering state of VC are the industry's suffering on the counts of lack of regulatory framework, anomaly in taxation, difficulties in fund raising and limitations on investment instruments, industry segments, exit mechanism and application of sweet equity and ESOPs.

The Indian Venture Capital (VC) industry is just about a decade old industry as compared to that in Europe and US. In this short span it has nurtured close to 1000 ventures, mostly in Small and Medium Enterprises

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(SME) segment and has supported budding technocrat/professionals all through. The VC industry, through its investments in high growth companies as well as companies adopting newer technologies backed by first generation entrepreneurs, has made a substantial contribution to economy. In India, however, the potential of venture capital investments is yet to be fully realized. There are around 30 venture capital funds, which have garnered over Rs.5000 crores. The venture capital investments in India representing 0.1 percentage of GDP as compared to 5.5 percent in countries such as Hong Kong. Not only that even after a decade also it has not reached its objectives due to the challenges and problems with which it is confronting. They are:

1. VCF's in India are structured in the form of a company or trust fund and required to follow a three-tier mechanism-investors, trustee and AMC. A proper tax-efficient vehicle in the form of 'Limited Liability partnership Act', which is popular in USA, is not made applicable for structuring of VCF's in India. In this form of structuring, investors' liability towards the fund is limited to the extent of his contribution in the fund and also formalities in structuring of fund are simpler.
2. Problems in rising of funds.
3. Lack of incentives to investors.
4. Absence of 'angel investors'.
5. Limitations on investment instruments.
6. The domestic VCFs operations in the countries are governed by the regulations are prescribed by SEBI and investment restrictions as placed by CBDT availing of tax benefits. They pay maximum marginal tax 35% in respect of non exempt income such as interest through Debenture etc., while off-shore Funds which are structured in tax havens such as Mauritius are able to overcome the investment restrictions of SEBI and also get exemption from Income Tax under Tax avoidance treaties. This denies a level playing field for the domestic investors for carrying out the similar activity in the country.
7. Limitations on industry segments.
8. Anomaly between SEBI regulations and CBDT rules.
9. Limitations on exit mechanism.
10. Limitations on application of sweet equity & ESOP.
11. Lack of requisite legal framework resulting in inadequate penalties in case of suppressing of facts by the promoters-results even from performing companies. This has bearing on equity investments particularly in unlisted companies.

Industries growth is also hampered by some stringent problems. But one cannot consider them as problems as they are challenges in the disguise of problems. Prominently among them are, venture capital is still not regarded as commercial activity, investors feel that they would like to retain control and to ensure that the business must pass on to their family, entrepreneurs sensitiveness to the mode of disinvestment etc.

When these problems were encountered in the developed countries, they were tackled more efficiently by creating social awareness, deregulating economy, providing fiscal incentives, encouraging technological competitiveness, offering training & development of venture capital managers, developing new and flexible exit strategies through financial engineering etc, to tackle the problems. However industry has been also facing so many other changes as challenges after the globalization, they are:

1. Capital is pouring into private equity funds.
2. Average ticket size of VC investment is increasing.
3. First generation entrepreneurs are finding easier to raise funds.
4. Investors are demanding non financial value additions.
5. Most states are setting regional VC funds.
6. VC firms are getting professionalized.
7. Incubators and serial entrepreneurs are germinating.
8. VC firms are getting specific industry focused.
9. Competition is stretching valuations.

Hence it can be inferred from the above that the industry is still at cross roads and striving hard to take the take off, but the success of venture capital industry ultimately depends on the contributions of both government and venture capitalists, so they have to play a significant and pervasive role in order to boost up the industry and achieve its goals. In this regard, as part of its responsibility the Govt of India has to make every effort hard in providing well developed and well functioning capital markets, establishment of OTC markets, boosting in entrepreneurial spirits, deregulation of sectors like telecom, low tax rates and abolition of capital gains tax and removal of cultural bias towards ownership in Indian promoters.

On the other hand the venture capitalists have to also play a different role unlike the existing one i.e. they are not suppose to just finance a venture but also see the undertakings preoperational and postoperational functioning. Moreover venture capitalists should provide all linkages and support to the entrepreneur for the growth of the enterprise and venture capitalists should provide moral support in forming the company besides their financial and technical support. Finally it can be said that they should play the role of a partner and a manager than a financier only.

Conclusion

It is beyond doubt that venture capital can play a more innovative and development role in a developing country like India. It could help the rehabilitation of sick units through people with ideas and turnaround management skills. A large number of small enterprises in India become sick even before the commencement of production. Venture capitalists could also assist small ancillary units to upgrade their technologies so that they could be in line with the developments taking place in their parent companies. As a developing economy,

Indian venture capital industry can draw direct inferences from the expertise shown by their western counterparts in dealing with the issues of VC. This not only saves time to industry to take-off but also provides as a chance to venture capitalists to improve their experience. Indian venture capitalists take this opportunity as a cushioning agent and open new avenues in VC market.

However it can be said that the industry can leap into high growth, if it is given necessary boost by taking proper measures by both government and the venture capitalists. Because there are so many challenges in front of the industry. Unless those challenges are rightly addressed, it is not possible to ensure the full success of the industry like in developed countries.