



## An Insight Into Venture Capital Financing in India

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ABSTRACT

Starting and growing a business always require capital. There are a number of alternative methods to fund growth. These include the owner or proprietor's own capital, arranging debt finance, or seeking an equity partner, as is the case with private equity and venture capital. The venture capital sector is the most vibrant industry in the financial market today. Such capital is provided by venture capital funds which are prepared to finance an untried concept that appears to have promising prospects. Venture capital, a relatively new phenomenon on the Indian scene has already taken off and is expected to assume even greater importance in the following years. In this article an attempt has been made to provide an insight into the various aspects of venture capital financing in India.

KEYWORDS

Venture Capital, Financing, India.

### INTRODUCTION :

Starting and growing a business always require capital. There are a number of alternative methods to fund growth. These include the owner or proprietor's own capital, arranging debt finance, or seeking an equity partner, as is the case with private equity and venture capital. 'Venture Capital' is an important source of finance for those small and medium-sized firms, which have very few avenues for raising funds. The term "Venture Capital" refers to investment in new and untried enterprises which are lacking a stable record of growth. Though such business firm may possess huge potential for earning large profits in the future and establish itself into a larger enterprise, but the common investors are generally unwilling to invest their funds in them due to risk involved in these type of investments. In order to provide financial support to such entrepreneurial talent and business skills, the concept of venture capital emerged.

Venture capital may be visualized as "your ideas and our money" concept of developing business. A venture capital firm acts as an intermediary between investors on one hand, who are aspiring for high returns on their investment and the entrepreneurs, on the other who are looking for capital needed for their start-ups. The venture capitalist joins the entrepreneur as a co-promoter in new projects and shares the risks and rewards of the enterprise with the objective of long-term capital appreciation. The venture capital industry is not a well defined economic sector like banking or public securities. However, venture capitalist's participation is far more extensive than that of a traditional banker. They not only provide monetary resources but also help the entrepreneur with guidance in formalizing his ideas into a viable business venture.

The venture capital industry in India has really taken off in. India did have a number of strengths. It had an enormous number of small businesses and a public equity market. India moving beyond supplier of low cost services to higher value products. Wages are low, not only for physical labour, but also for trained engineers and scientists, of which there was a surfeit. India also boasted a homegrown software industry that began in the 1980's and became visible upon the world scene in the mid-1990s. The quality of entrepreneurship is also on the ascending curve. Thus, by virtue of its inherent strength in human capital, technical skills, cost competitive workforce, research and entrepreneurship, India can unleash a revolution of wealth creation and rapid economic growth in a sustainable manner. This necessitates the creation of a venture capital environment in India which can leverage innovation, promote technology and harness knowledge based ideas.

### EMERGENCE OF VENTURE CAPITAL BUSINESS :

The concept of "Venture Capital" is new in the global world. It came into light after the Second World War to finance the small and medium-scale industries in the developed countries. The first appearance of venture was searched out in 1946 in U.S.A. Georg Poriot is the founder successful venture capital supplying firm. American Research and Development Corporation (ARDC) was established in Boston in 1946 to finance the commercial promotion of advanced technology in the US universities. This was followed in 1958 by the Small Business Investment Company (SBIC) with the object of financing small business. The venture capital funds in America is categorized in the following groups :

- (i) Small Business Investment Companies (SBICs);
- (ii) Private Venture Capital Funds (PVCs);
- (iii) Subsidiaries of Finance Corporations;
- (iv) Subsidiaries of Non-finance Corporations.

The concept of venture capital in Europe began in the eighth decade of the twentieth century. In 1983, they are the members of the European Venture Capital Association. About three-fourths of total investment of total venture capital in Europe is confined to three countries – U.K., France and Netherlands. Unlisted Securities Market (USM) and Business Expansion Scheme (BES) were designed in England to motivate private investors. In France to provide venture capital Societes Financiers d' Innovation (SFI) was established in 1972. The Government of Netherlands in 1981 introduced the Particuliere Participate Maatschappijen (PPM) Scheme.

Venture Enterprise Centre has been established by International Commerce Industry Ministry in Japan. In 1963, this ministry has formed Small Business Investment Company for supplying equity capital to small concerns. A rapid growth of venture capital was noticed in Japan in 1980's. Other countries like Indonesia, New Zealand, Philippines, Sri Lanka, Switzerland, Sweden, Germany, Korea, etc. have also taken different measures for the growth and development of venture capital business.

### EVOLUTION OF VENTURE CAPITAL BUSINESS IN INDIA :

The evolution of the concept of venture capital in India is recent. It is still in the infancy stage and for rapid development, promotional effort and eagerness in policy determination are essential. This concept of venture capital business was introduced in India in the budget 1986-87. It was followed by venture capital funds being launched by Industrial Development Bank, Industrial Finance Corporation, State Financial

Corporation, different commercial banks, etc. to meet the capital requirement of the small and medium-scale ventures. Since 1981, Reserve Bank of India (RBI) has been assisting small enterprises through credit guarantee scheme. RBI established Deposit Insurance and Credit Guarantee Corporation (DICGC) to support lending to small industries. Venture Capital Association of India has been developed with the principal indigenous participant. At the end of 1994, there were eleven active members engaged in supplying venture capital in business, who after procuring Rs. 610 crores have invested Rs. 426 crores in 488 projects. Apart from this, some private venture capital funds are established to provide venture capital like Credit Capital Venture Fund (CCVF) which launched Information Technology Fund (ITF) to provide financial assistance to technologically developed ventures. Indus Venture Capital Fund (IVCF) was established in 1991 to invest in the equity of the ventures. In 1992, the Twentieth Century Finance Company was established to provide venture capital. The Infra-structural Leasing and Financial Services Limited has also been providing venture capital. The SBI's Capital Market Funds, the ANZ Grindlays Bank's India Investment Fund and Canara Bank's Can Bank Venture Capital Fund also provide venture capital. In the state level, Gujrat Venture Finance Limited (GVFL), Andhra Pradesh Venture Capital (APVCL) provide venture capital. The IDBI Venture Capital Fund, The Risk Capital and Technology Finance corporation (RCTFC) of ICICI, The Technology Development and Information Company of India (TDICI) of ICICI and Venture Capital Units Scheme (VECAUS-I) of UTI are the principal venture capital suppliers in India.

From 1992, all activities of venture capital supplying industry have been controlled through directives issued by SDBI. These directions have been revised and modified till July, 1995 and at the same time certain new directives are also introduced. Investment activities are controlled by The Central Board of Direct Taxes (CBDT) guidelines in situations when the Venture Capital Fund and companies do not control the source and structure of their capital association. Those investments which comply with the guidelines of CBDT will get whole tax relief on income from dividend and long term capital gains.

The venture capital funds under the controlled new scheme which intends to get tax relief, have to be registered under Security and Exchange Board of India, as it is responsible to supervise regarding these aspects. K.B. Chandrasekhar Committee which was formed in 1999-2000 has highlighted upon the harmonization of the multiplicity of regulations, venture capital fund structures, resource raising, investments, SEBI regulations, Company Law related issues and other related issues. SEBI norms were amended in 2004 by virtue of which they can now invest in real estate, NBFC's in equipment leasing, companies engaged in gold financing in jewellery. The minimum investment limits were altered and they were allowed to invest in financially weak companies whose shares are listed. 1-year lock-in of shares on listing removed and investments can also be made in Special Purpose Vehicles.

#### **VENTURE CAPITAL FIRMS IN INDIA :**

Venture capital firms in India can be divided into four categories

1. All India –Developmental Financial Institutions – The following are the major financial institutions providing venture capital on all India basis.
  - (a) Industrial Development Bank of India (IDBI) - The formation of venture capital fund of IDBI begins in 1986. In the venture financing scheme, it considers all those projects whose financial need extends from Rs. 5 lakhs to Rs. 205 crores. It is also successful in introducing technological innovations, reduction in material consumption, energy consumption, cost, etc.
  - (b) Industrial Finance Corporation of India (IFCI) – Industrial Finance Corporation of India is the oldest concern in venture capital business. In 1975, the corporation patronized Risk Capital Foundation, which was later converted into a

company on January, 1988, to provide risk capital to first generation entrepreneurs for establishment of industrial projects.

- (c) Industrial Credit and Investment Corporation of India (ICICI) – The ICICI established Technology Development and Information Co. of India (TDICI) in January, 1988 and started its operation in July, 1988 to finance the new and established entrepreneurs for the development of indigenous technology. The function of this company relates to supply of data relating to technology and to giving advice and to support technology and technology-management and to supply administrative service regarding Programme for Advancement and Commercial Technology and Programme for Acceleration of Commercial Energy Research. TDICI has also introduced Venture Capital Units Scheme (VECAUS II) for providing financial assistance to the ventures.

2. State-level Developmental Financial Institutions - In supply of venture capital the remarkable financial institution in state level is Gujrat Venture Finance limited, promoted by Gujrat Industrial Investment Corporation, being established in the year 1990 to provide venture financing to the new and existing companies along with technological innovations to reduce cost and increase profit. Besides this, in the state-level of Andhra Pradesh, the Andhra Pradesh Venture Capital Ltd. is established by Andhra Pradesh State Industries Corporation to supply venture capital in the state.

3. Venture Capital Fund created by Commercial Banks – Different commercial banks have introduced different programmes for providing venture capital. Among them three banks are remarkable – State Bank, Canara Bank and Grindlays Bank. The State Bank of India launched Capital Market Funds which is used to invest in equity share of a new and unknown ventures. Canara Bank of India launched its Venture Capital Fund in August, 1989 to provide finance to ventures which have technological innovations and high-tech technology and high return to the funds. ANZ Grindlays Bank launched a Venture Capital Fund to provide facilities to non-resident Indians to enjoy the benefits of getting funds from them in selective investment for new-technology based ventures.

4. Private Sector Venture Capital Funds – In our country some venture capital funds have been established in private sectors. Credit Capital Venture Fund (CCVF) was established in January, 1990 to provide venture finance and invest in the primary market. Indus Venture Capital Fund (IVCF) was established in 1991 as a private venture capital financier to invest in the equity of the ventures. The Twentieth Century Finance Company (TCFC) was established in 1992 to provide venture capital. Infra-structural Leasing and Financial Services Limited (ILFSL) has also been providing venture capital.

#### **FUTURE PROSPECT OF VENTURE FINANCING IN INDIA :**

In a developing country like India, venture capital is much prospective and plays the developmental role. The unification of managerial and marketing expertise with the riskful finance makes venture capital an effective tool to transfer enterprise development and technology in developing countries. In India the presence of the following factors are essential for venture capital to succeed.

1. The presence of creativity, innovation and initiative on the part of the entrepreneur along with inspiration from the society and the government.
2. An economic environment with the opportunity for creation of high technology and quality goods.
3. The existence of a liquid share market to meet the demands of the small and medium entrepreneurs.
4. Creation of confidence among the investors to invest in equity.
5. Introduction of a venture-trend system of education where the scientists and engineers have knowledge about accounting, economics, finance and the accountant also acquire knowledge in physical science and engineering.
6. To increase venture capital proper marketing, promotion,

- implementation of new ideas, etc. are needed.
7. To ensure technological upgradation, adequate amount of research and development project should be inspired by the government, public and private sector companies.
  8. Effective management education and training programmes are needed to develop professionals who can properly manage venture capital.

#### CONCLUSION :

The stringent policies of the Indian Government regarding venture capital is acting as an obstacle in the smooth flow of venture capital in India. This has resulted in the decrease in the venture capital business in the recent years. The recent amendments in the regulations regarding venture capital has been a remarkable step towards promoting the inflow of funds into venture capital pool from long-term providers of capital. In spite of this, it is not sufficient because there exists scope for improvements of several aspects. The present scenario in India is such that many investments of venture capitalists remain on paper due to the absence of other means of exit. Thus it calls for making of appropriate changes in the existing system, making it easier for the venture capitalist to realize their investments after holding on to them for a certain time period.

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