CHAPTER VI

SUMMARY AND CONCLUSION

A Venture Capital Fund (VCF) strives to provide entrepreneurs with the support they need to create up-scalable business with substantial growth, while providing their contributors with outstanding returns on investment for the higher risks they assume. It is well known from the success stories of a few giant corporations like Apple Computers, Federal Express, Microsoft, Satyam Infoway, Rediff, Pizza Corner, etc. In the last fifteen years, Venture Capital has emerged as an important area of finance for academic researchers.

The industrial scenario has changed considerably in the last decade with the advent of the era of liberalization and influx into the management field of top class technocrats exposed to global environment. Recent successes of many professionals in creating a whole new world of excellence can be largely attribute to Venture Capital Investments. Though the investments have grown reasonably well, the industry has not reached the divestment stage. Several Venture Capital Investments are in unlisted companies. It is said that the Venture Capital industry is in nascent stage. The reason is lack of adequate funds and unwillingness on the part of investors to invest in risky projects. Limited exit options, lack of proper legal framework and stringent legal provisions have also inhibited the progress.

World over, many studies have examined Venture Capital Investment Activity, Venture Capital specialization, Venture Capital Evaluation Criteria, Venture Capital Investors and Investees Performance, Influence of Internal and External Environment on Venture Capital Investment. There are no studies in
India which examined Venture Capital Investors’ and Investees’ Performance. The present study is an attempt in that direction.

The present study has examined the growth, development and investment pattern of Venture Capital Companies/Funds in India. The study examined the nature of relationship between VCCs/VCFs and their assisted units.

The study is based on the primary as well as secondary sources of data. The primary data were collected through a well structured questionnaire and was supplemented with information obtained through personal interview with a few experts and executives of VCCs. However, all relevant published information were collected. The investment activity reports of IVCA was the main secondary source of information for the study. The Venture Capital Companies are selected from 5 cities in India. The sample units for the study are all the 21 VCCs who are members of the IVCA. The 36 assisted units belonging to the 7 companies were also used for the present study. The reliability of the questionnaire was tested through a pilot study.

A scale with 20 statements was constructed to measure the relationship of assisted units with the Venture Capital firms. The promoters/executives were asked to indicate the extent to which they rate each of the items on a 5 point scale ranging from “Strongly Disagree (DS)” with a weightage of 1 to “Strongly Agree (SA)” with a weightage of 5. For negative statement the scoring pattern is reversed.

The data collected were subjected to multivariate statistical analysis. They include factor analysis and chi-square test and some descriptive statistics. The results are tabulated and interpreted.
MAJOR FINDINGS

The main findings of the study are:

1. Regulatory Framework

The early Venture Capital Schemes in India were in the form of risk capital (IFCI) and seed capital (IDBI). Later on the formal foundation stone for Venture Capital Financing was laid in 1983 with the formulation of National Technology Policy Statement, which encouraged the commercialization and exploitation of technologies developed in India.

The controller of capital issues made the formal beginning in 1988 with the issue of guidelines. The Public Sector Financial Institutions and banks started a few VCCs/VCFs.

In order to reduce the problems of Venture Capital Industry and allow private sector and foreign investors to enter in a large measure the Government of India brought out guidelines for overseas Venture Capital Investors and SEBI released new set of guidelines in 1996.

SEBI and Government of India have initiated a series of measures to minimize the problems byway of fulfilling certain recommendations of Shri K.B.Chandrasekhar Committee. A few laudable steps introduced are as follows:

a. SEBI has been made as a single nodal agency.

b. Section 115U of the Income Tax Act 1961 has been introduced from the assessment year 2001-02 to assist Venture Capital funds.

c. Introduction of "Sweat" equity
d. Allowing VCFs to offset losses incurred in one company against profits from another company.

2. Analysis of Growth and Development of VCCs/VCFs

The growth of industry in terms of number of VCCs, number of assisted units and amount invested are satisfactory. The entry of FVCIs has changed the colour and pattern of growth of the industry. The industry domination has slowly drifted from the public sector financial institutions and banks into the hands of private and foreign investors. The study has clearly showed that the growth in Venture Capital Companies among the government sponsored institutions is low whereas growth in private participation is high.

The contributors of Venture Capital by banks, public and SFCs have decreased over the period considerably. Also the contribution by insurance companies, and mutual funds are highly negligible. given an ideal environment the FIIs may contribute more funds to the industry. In addition, the domestic sources such as insurance companies, mutual funds and high net growth individuals, etc., shall be encouraged to invest more in the industry. An analysis of overall investment among the Venture Companies indicated that the investment is low (30%) among the offshore companies whereas among domestic companies it is high (70%).

Analysis of industry-wise investments reveals that the share of investments in industrial products and machinery in high throughout the period followed by computer related units. The investment in consumer related units has increased over the period followed by Medical and Food & Food
Processing units. However, with the infrastructure development taking place in IT industry, more investments may be expected in this sector.

The study has observed that among the instruments, preference shares, non-convertible debt and other instruments are given low priority (7.59%, 7.27% and 1.13%). Convertible debt is moderate (19.75%) and investment through equity shares is very high (64.27%).

The special features of Venture Capital is providing finance to a project at different stages of its development such as seed stage, start-up, turnaround, etc. An analysis of Stage-wise investment by the Venture Capital Companies indicated that it is low at seed stage and turnaround stage (Rs.64.35 crores and Rs. 8.30 crores) and is high at the start up and later stages (Rs. 668.70 crores and Rs. 514.64 crores).

Stage-wise average investment per project makes an interesting study. An analysis shows that the average investment per project is the maximum in the later stage. It has increased over the period, which is not in conformity with the principle of Venture Capital. The average investment made in seed stage has decreased over a period.

The study has observed that the Southern Region and Western Region have attracted more investments (Rs.487.02 cores and Rs.478.44 Crores) from VCFs in terms of total amount invested when compared to other regions. In recent times offshore funds have invested funds outside India also. The Southern and Western regions have attracted more investments from VCF’s in terms of number of units assisted. On the whole it may be concluded that the industry performance in recent years has improved a lot. However, still a lot is to be done to activate the Venture Capital firms to achieve a very fast and balanced growth.
3. VCCs/VCFs Practices and Procedures

The study provides a brief description of selected 7 VCCs/VCFs out of 21 VCCs/VCFs.

Venture Capital Financing needs a different outlook and approach. But in India the procedures adopted are not much different from conventional methods used for term lending. The typical investment cycle starts with the generating of a deal and ends with the exit from the investment. Due diligence, investment evaluation, pricing and structuring the deal, valuc addition and monitoring are the other stages to be carried out very carefully.

The contributions to the VCFs have been classified into 12 categories. The maximum contribution to 6 out of 7 companies is come from AIF1, to 4 from multilateral developments agencies and to 3 from State Level Financial Institutions and nationalized banks.

Analysis of instrument-wise contribution to the selected VCCs/VCFs reveals that above 70% of total contribution have been made in the form of equity and balance in other form like units, funds, etc. Out of the 7 companies 4 specify their expected rate of return for contribution. For contribution to the VCCs, the contributors stipulated some terms and conditions such as participation in funds’ management, assisted companies’ management, size of investment, method of investment etc.

Analysis of the project selection reveals that above 65% of Indian Venture Capital Companies/Funds are providing assistance to the projects as per the SEBI guidelines. The study has clearly showed that above 80% of Indian Venture Capital Companies financed in all stages.
The venture capital investors received the venture projects from different sources. The study has clearly showed that above 90% of the VCCs received projects from existing companies and entrepreneurs and consultants. One Venture Capital Company has got the project idea from the other Venture Capital Companies/Banks/Financial Institutions/Merchant Banker.

The study has clearly showed that Venture Capital sample companies among the State Level Financial Institution and Nationalised banks have contributed less (Rs. 36.50 crores and Rs. 43.38 crores). Multilateral Development Agencies made a moderate (Rs. 229.86 crores) contribution and the All India Financial Institution have made a high contribution (Rs. 772.75 crores) in Venture Capital Financing.

The project proposal is appraised very carefully and the proposal is judged by evaluating different factors. The key factors for venture financing are the entrepreneur and enterprise. The study has revealed that the entrepreneurs’ managerial skill and professional/technical qualification are the important factors. The enterprise factors also form important element for approval of project. An analysis revealed that the soundness of business plan is most important factor for approval of the project. It was follow by profitability of the product and market potential.

Venture capital always includes some form of supporting service particularly managerial assistance. In this regard, the VCFs in India take active role as investor and do close monitoring with ‘hands on approach’ as well as ‘hands holding approach’.
4. *Analysis of Assisted Companies*

An analysis of the relationship between the Venture Capital Investors and Investees, capacity utilization of the assisted companies, nature of assistance received and monitoring of the assisted companies showed the following.

The sample units are classified on the basis of ownership into three types. In developed countries like USA, UK, Canada, Venture Capitalists have invested in the individual research idea or project because their motto was "your mind and my money". The study showed that the Indian Venture Capital investors mostly preferred public limited companies (61% in the sample).

The study revealed that the computer software/hardware business constitutes a larger share (30.6%) in the sample. More than 47% of the sample received the finance in the expanding companies. Usually in this stage the risk is less compared with young (new) companies. Indian Venture Capital investors seem to minimize their risk by way of investing in expanding business.

The study revealed that more than 58% of the sample companies, which received the financial assistance were in high tech-project business.

An analysis revealed that the capacity utilization in the assisted firms is dependent on the age of the firm and stage of assistance. Form of business, type of business, risk and return profile, technology level, total investment (size), product type, timing of assistance, approach to supporting assisted units do not have significant impact on capacity utilization of assisted units.
Analysis revealed that eight factors determining the relationship between Venture Capital Funds and assisted units are identified. Among them proactive attitude and quality of service factors are the two most dominant factors determining the relationship between Venture Capital Funds and assisted units.

Form of assistance rendered by Venture Capital Funds is significantly associated with the approach of Venture Capital fund and the type of business, type of product, size, level of technology of assisted units.

SUGGESTIONS

Regulatory reforms

The basic requirement for the development of Venture Capital activities is the existence of a clean and user friendly environment. The legal, financial, tax and other regulatory systems should function effectively. The present environment needs a lot to be improved.

First, multiplicity of regulations in the form of Acts and Guidelines should be dispensed with. There should be one regulator operating a single window system with one set of guidelines for Venture Capital. SEBI has been made a nodal agency and it should be recognized as the same for all purposes including for tax concessions/exemptions.
Regulatory inconsistencies should be eradicated and consistency in policy formulation and implementation should be maintained. This will create confidence in the minds of investors on the system.

Regulatory discriminations between mutual funds and Venture Capital Funds and between FIIs and FVCIs (fully) should be abolished. All concessions, facilities, and other benefits available to mutual funds should be made available to VCFs also. In fact, VCFs deserve additional concessions for taking up high risk projects particularly at seed and start up stages.

FVCIs should be given tax exemptions (tax holidays) in order to encourage them to operate from India instead of through Mauritius route. This will attract a large pool of foreign risk capital directly into India.

Expanding tax and other concessions should create more domestic sources of Venture Capital. Mutual funds, insurance companies, banks, and pension funds shall also be allowed to invest in VCFs registered with SEBI. High net worth individuals and angel investors should be attracted to invest more in Venture Capital firms by offering them some tax concessions.

**Conceptual Refinements**

The SEBI’s definition of VCF should be changed so as to include other structures such as limited partnership, limited liability partnership and limited liability companies. Necessary changes shall be made in the Partnership Act or Indian Companies Act to give effect to above changes and in the SEBI’s Regulations to include the new types of entities.
This will facilitate easy liquidation and tax pass through. The definition should also be amended to include new but low technology and service sector projects.

However, the negative list, which restricts or prohibits VCFs from investing in certain projects maybe continued keeping the overall economic interest of the nation into consideration. Once SEBI permits VCF to invest in certain projects, then such VCF should be eligible to get all tax exemption and other concessions. No other authority such as MoF, or CBDT should maintain separate lists restricting VCFs form investing and claiming tax exemptions.

Efficient financial system is an essential prerequisite for the successful operations of VCFs. Effective policy implementation is more important than the good policy formulation.

The investor should be made to believe the system through certain confidence creation measures. Violators of the rules and perpetrations of fraud should be dealt with iron hand without any fear or favour. Instances of innovative financial frauds are abound in the Indian Financial System. Venture capital being high risk capital needs more safeguards and transparency in the system. It is the bounden duty of the administrators/ regulators of the system to see that the Indian financial system functions efficiently.

**Infrastructure Development**

Venture capital needs more number of fundable projects. Innovation and new ideas are to be generated in large numbers and converted into commercially workable projects. It requires a lot of infrastructure facilities for the same. More number of incubators, technology parks and research and
development laboratories are to be established. In recent times Central and State Governments and private organizations have taken steps in this direction. However, the development of such facilities is yet to bear fruits and no commendable venture capital projects have come out from such efforts. The VCFs should involve themselves directly having tie ups with the University departments, technical institutes and other research and development laboratories. All VCFs - domestic and offshore -should jointly take steps to create such facilities. Government should provide all assistance- financial and non-financial- to encourage them to take up such endeavors. Technical consultancy organizations in each State shall act as the nodal agency for coordinating and rendering all assistance to VCFs and other R&D and technical institutes for developing venture capital projects and extending other value added services to the needy units.

Syndication of investment for sharing risks and returns is required. In India, all VCFs carry on their activities independently, and invest their funds in different stages of projects belonging to different types of industries located in different regions. Venture capital needs special skills to appraise the project and understand the complications and extend the other supporting services. Three or four VCFs may form a syndicate and each fund shall specialize in one stage or the other and develop expertise in that area. For example fund A may concentrate in seed stage of funding and B in start up and C in later stage, etc. A enters the project at seed stage and take to the next stage and hand over the project to B, and then B takes it to the next stage and hands it over to C. This will reduce the commitment of funds by each VCF in one project and at the same time the success rate shall be increased. The total risk shall be shared by all and the returns also. Offshore funds shall also be taken into syndicate. Necessary guidelines should be formulated in this regard to encourage the formation of such syndicates.
Portfolio balancing for risk-return optimization. Individual VCFs shall design their project portfolios in such a way as to minimize the risk or maximize the return. While investing their funds, they may invest partly in early stages [seed and start up i.e., very high risky financing] and partly in later stages [expansion, mezzanine, buy outs etc., i.e., low risk projects]. The portfolio mix may be in a predetermined ratio. The portfolio balancing may also be done based on industry groupwise and/or region-wise.

Self-Regulatory Organization [SRO]

Just as the Association of Mutual Funds of India and Foreign Exchange Dealers Association of India, the venture capital industry must have a SRO, which would help in the evolution of standard practices, code of conduct, apart from generating and disseminating information about the industry. All VCCs/VCFs should become the members of the association for operating their activities in India. IVCA was acting as a representative organization and only a few venture capital firms chose to become the members of the association. It has no place of operation. The members were submitting information about their activities voluntarily and the association used to publish annually a report called Venture Activity Report. This was the only source of information to know about the industry activities. Now the Association has become inactive and suspended the publication of the annual report. Hence, it is essential to see that one SRO is established to protect the interests of VCCs/VCFs in India. Or IVCA is made the official SRO of the venture capital industry and recognized by SEBI.
It may be concluded that venture capital has a greater role to play in the post liberalization era of economic activities. For which an ideal environment should be created and administered in an effectively efficient manner. Investors, VCCs/VCFs, Regulators and Assisted units should play their roles properly keeping the interests of the national economy in view. Sincerity of purpose, Integrity in attitude, responsibility for actions and accountability for results should be their guiding principles in achieving their objectives. This will definitely transform Venture capital into Success capital.