CHAPTER – SIX

MAIN OBSERVATIONS, DISCUSSION AND RECOMMENDATIONS

• Section – A
  - Main Observations

• Section – B
  - The Discussion

• Section – C
  - The Unified Recommendations
In the concluding chapter, an attempt has been made to record major inferences, present a critical appraisal and suggest certain unified recommendations on the subject. Accordingly, the chapter is divided into three distinct sections. Section ‘A’ sub-titled ‘Main Observations’ includes objective-wise inferences of the present research endeavour. The critical appraisal has been made in section B’, titled ‘The Discussion’. In this section, the focus of discussion has been on various strategies concerning pre-investment, post-investment activities and post-investment monitoring, investor– investee relationships and future prospects of venture capital industry in the country as adopted by venture capitalists for better management of funds in general. Based on the discussion and appraisal of current venture capital industry in India, we seek to make a set of unified recommendations that could be taken on with an explicit eye on the determined targets in terms of level of venture capital activity in the country. This constitutes the prime theme of section ‘C’ under ‘The Unified Recommendations’.
An important objective of the present study is to examine the significance and role of venture capital industry in present business scenario in India. The venture capital industry in our country is still at nascent stage. With a view to promoting innovation, enterprise and conversion of scientific technology and knowledge-based ideas into commercial production, it is very important to promote venture capital industry in India.

Venture capital industry has, as a first step, created in India many success stories in the field of Information Technology. This shows tremendous potential for growth of knowledge-based industries for Indian markets. At an average, around 100 IT companies will get funded in their start-up phase over next two years. Role of venture capitalists is not confined only to Information Technology sector but is equally relevant in several areas such as biotechnology, pharmaceuticals and drugs, agriculture, food processing, telecommunications and services etc. India, on account of its inherent strength in skilled and cost-competitive manpower, technology, research and entrepreneurship, can achieve rapid economic growth and competitive global strength given conducive environment and policy support.

Finance is generally called ‘lubricating oil’ in the process of the economic development. Without financial resources, it is impossible even for the most daring individual or the best idea to succeed. Dependence upon traditional lending institutions is also limited so far as risk factor is concerned. A flourishing venture capital industry will fill the gap between the capital
requirements of technology and knowledge enterprises and funding available from traditional lenders such as banks.

In various developed and developing economies, venture capital has played a significant developmental role. 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 that India is having. India has the second largest English speaking scientific and technical manpower in the world. Some of the management and technology institutions such as the IIMs and IITs are globally known as centres of excellence. Every year lacs of students graduate from numerous such institutes. What is the implication of all this in terms of employment generation within India? Achieving a reasonable development in information technology and other knowledge-based industries, there can be big employment generation in India.

The net FII investment in Indian markets is around US $ 10 billion and the flows for the last few years have generally been positive. With enhanced interest in India as compared to some of the other emerging and Asian markets, given the right environment, good amount of money would flow as venture capital investment. This is more so because India has already acquired credibility particularly in the area of information technology and sectors like media, pharmaceuticals etc. While the proportion of offshore to local capital, which is around 80 per cent foreign and 20 per cent domestic, may remain the same for the first few years, the recycling of entrepreneurial wealth and skills within the industry will gradually lead to greater presence of domestic venture capital industry.
India has a vast pool of scientific and technical research carried out in research laboratories, defence laboratories as well as in universities and various technical institutes. A conducive environment in relation to availability of finance on account of venture capital activity in the country can help a great deal in identifying and actualising some of such research endeavours into commercial production.

Another thing that is happening is the growing number of young, technically qualified entrepreneurs in India. There is an increasing number of international savvy and senior managers leaving established multinationals to start new companies. The quality of enterprise in India is on an ascending curve. To promote inherent entrepreneurial qualities in this manner, venture capital can be a stimulant.

Venture capital can also play an important role in development of technology, growth of exports as is evident from the examples of UK, Australia and Hong Kong. The success stories created in Israel and Taiwan can also be repeated in India.

Development of a proper venture capital industry particularly in the Indian context is important for bringing high quality public offerings to the market. In the present situation, investors are taken in by public offerings of unproven and dubious quality. The solution lies in venture capital backed successful enterprises accessing the capital market so as to protect the small investor.

Thus, in a broad sense, venture capital connotes risk finance as well as managerial support. This very blend of risk financing and handholding of entrepreneurs by venture capitalists will
create an environment particularly suitable for knowledge and technology based enterprises resulting in revival of the economy.

Objective - 2

Another important objective of the present study is to find out various reasons behind poor growth of venture capital industry in India. The Indian venture capital industry is just about a decade old as compared to that in the US and the Europe. In this short span only, it has nurtured close to 1000 ventures in the country. However, full potentialities of venture capital industry have not been realised on account of various roadblocks existing in the environment. Various causes which are responsible for poor growth of venture capital industry in India have been identified in the present study.

Venture capital funds in India are structured in the form of a company or trust fund and are required to follow a three-tier mechanism comprising investors, trustee company and AMC. A proper tax efficient vehicle in the form of ‘Limited Liability Partnership Act’ is not made available for structuring of venture capital funds in India. Thus structuring of venture capital funds has been considered as a major flaw in the growth of venture capital industry in India.

In the USA, primary sources of funds are insurance companies, pension funds, corporate bodies etc. While in India, domestic financial institutions, multilateral agencies, state government undertakings are dominating the scene. Pension funds and insurance companies are not allowed to participate in venture capital activity in the country, which results in limited supply of funds for venture capital funds. Allowing pension funds and insurance companies to invest in the venture capital funds would enlarge the possibility of setting up of domestic venture capital funds. Moreover, it may lead to increased availability of funds for venture capital financing.
Presently, high net worth individuals and corporates are not provided with any investments in venture capital funds. The problem of raising funds from these sources further gets aggravated with the differential tax treatment applicable to venture capital funds and mutual funds. While the income of the Mutual Funds is totally tax exempted under the Income Tax Act, income of the domestic venture capital funds, which provide assistance to small and medium enterprises, is not totally exempted. Thus venture capital funds are not treated at par with mutual funds with regard to their tax status. In absence of any incentive, it is extremely difficult for domestic venture capital funds to raise money from this investor group that has a good potential.

Another issue is anomaly between SEBI regulations and CBDT rules. CBDT tax rules recognise investment in financially weak companies only in case of unlisted companies as venture investment. On the other hand, SEBI regulations recognise investment in financially weak companies as venture investment irrespective of their listing status. If investment in financially weak companies offers an attractive opportunity to venture capital funds, the same may be allowed by CBDT for availing of tax exemptions on capital gains at a later stage. SEBI regulations do not restrict size of an investment in a company. However, as per income tax rules, maximum investment in a company is restricted to less than 20 per cent of the raised corpus of Venture Capital Fund and paid-up share capital in case of Venture Capital Company. Thus, lack of harmony between regulations imposed by SEBI and CBDT rules regarding governance of venture capital funds results in inconsistencies and lack of proper guideline regarding the same.

The domestic VCFs' operations in the country are governed by the regulations as prescribed by SEBI and investment restrictions as placed by CBDT for availing of the tax benefits. They
are required to pay maximum marginal tax in respect of non-exempt income such as interest through debentures etc., while offshore funds are able to overcome the investment restriction of SEBI and also get exemption from Income Tax under tax avoidance treaties. Thus, there is lack of incentive for domestic venture funds. Domestic venture funds have to suffer on two accounts: Competition from off-shore funds and lack of incentives enjoyed by the off-shore funds.

One major aspect facing venture capital industry in India is limitation on investment instruments. As per the Income Tax Act, income from investments only in equity instruments of venture capital undertakings is eligible for tax exemption whereas SEBI regulations allow investments in the form of equity shares or equity related securities issued by company whose shares are not listed on the stock exchange. Harmonisation of SEBI regulations and Income tax rules of CBDT would provide better flexibility to venture capitalists in structuring the investment instruments as well as availing of tax breaks.

The success stories created in Silicon Valley can be owing to the backing provided by angel investors. In Silicon Valley, which is a nurturing ground for venture capital fund financed IT companies, the angel investors provide initial/seed stage financing till the company becomes eligible for the venture funding. Later on, venture capitalists provide financial support and various non-financial inputs to the investee company to enable it to achieve better growth rate and facilitate its listing on stock exchanges. In India, venture capital industry lacks presence of angel investors, which causes obstacles in VC industry in India running on full stream.

In sharp contrast to other countries where telecom services and software bag the largest share of venture capital investments, in India, other conventional sectors dominate venture finance.
However, the present scene shows that venture capitalists are getting inclined towards technology sector but it has a long way to go. Lifting of restrictions and technology oriented financing would result in growth possibilities of venture capital.

Another area of concern posing a great challenge to venture capital industry in India is the exit mechanism. Venture capitalists in India are not able to exit from their investments due to limited exit routes and unsatisfactory performance of OTCEI. The threshold limit placed by various stock exchanges acts as deterrent for listing of companies with smaller equity base.

Legal framework is another aspect which acts as a major issue before the venture capitalists. Lack of requisite legal framework resulting in inadequate penalties in case of suppression of facts by the promoters results in low returns even from performing companies. This has bearing on equity investments particularly in unlisted companies.

So these are some of the issues as identified under present study, which are responsible for poor growth of the industry in the country. The issues discussed above have been derived from the study of macro environment existing in India for venture capital industry. Another important aspect which may be held responsible for poor growth of venture capital funds is the management of each individual unit operating in the industry. Management of funds may comprise a wide spectrum of issues such as pre-investment strategies adopted by venture capital funds, post-investment activity profile, post-investment monitoring of investee companies, investor–investee relationship and strategic choices in view of challenges posed to venture capital industry in India. How funds are to be managed is an important issue deciding the success or otherwise of the venture capital funds. In India, venture capital activity is gaining momentum causing a considerable rise in level of competition faced by the players in
the market. In view of the same, the manner in which funds are to be managed cannot be ignored. In this respect, Indian venture capital funds have to learn from their counterparts who have made a mark in Israel, Taiwan, Japanese and US economies.

Recommendations in this regard have been summarised in the section 'The Unified Recommendations'.

Objective – 3
As the present research endeavour is concerned with management of venture capital funds, an important objective of this study is to analyse various strategies adopted by venture capitalists in India in relation to management of venture capital funds. Strategies covered under management of venture capital funds have been discussed under following aspects: pre-investment strategies, post-investment strategies, post-investment monitoring of investee company activities, investor-investee relationships and strategies in view of future challenges faced by Indian venture capital industry.

Following generalisations have been drawn out of the responses of the units covered in present study covering micro aspect of the management of venture capital funds.

Most of the venture capitalists disclosed that entering venture capital business was on account of strategic and planned decision and as a part of diversification strategy in some cases. After entering into venture capital business world, one comes across sources of deals. Referral system is the most popular source of deals for Indian venture capitalists. Sources can be referred to venture capital funds by their parent organizations, trade partners and friends etc. Prior investees are also given due consideration on account of their past track record. It
implies that entrepreneurs approaching venture capitalists must look for a suitable reference. Alternatively, they can have the benefit of earlier experiences with the venture capital company. Thus, preferences of venture capital from regarding sources of deals should give a clear indication to the entrepreneur. So far as the issue of use of specialists is concerned, Indian venture capitalists do not agree to a common point. It means whether in-house or external specialists will be made use of, depends upon the in-house capabilities of the venture capitalists as well as the availability of external experts. It may also count as a policy matter of venture capital firms. However, use of external expertise can provide excellent access to venture capital company regarding information on marketing, legal and technology aspects. Alternatively, a venture capital company can also opt for using in-house capabilities and taking help of an external expert wherein venture capital management lacks.

Coming to another aspect of evaluation criteria, five categories of evaluation criteria have been identified from the point of view of Indian venture capitalists. ‘Characteristics of the entrepreneurs’ are assessed by the venture capitalists to evaluate various proposals/ventures. In India, entrepreneurs are assessed mainly in terms of integrity, long term vision, urge to grow, attentiveness to details and familiarity with the target market. It is an important point to note that venture capital industries per say has reached the stage of maturity. However in India, it is still at infancy stage. Because of this, attributes of the entrepreneur as advocated by Indian venture capital firms differ from those in the UK and the US. Asian countries, however, speak of more or less same attributes as advocated by Indian venture capital firms. Among the characteristics of the product, Indian venture capital funds emphasise mainly technology of the product, its uniqueness and any protection granted to it. There is an indication in this regard that Indian venture capitalists are becoming more and more technology oriented as contrary to
the results shown by an earlier study in regard to the same wherein low priority was given to the technology part.

Venture capitalists in India consider growth rate of market to be a major consideration while putting their money into any venture. Level of competition, both existing and potential with regard to market also accounts for an important consideration by the venture capitalists. I.M. Pandey has rightly quoted India as an untapped market, which implies large potential for firms operating within the market. But keeping in view the increasing level of competition, venture capitalists are now paying much heed to it.

Financial consideration also forms an important part of overall evaluation criteria. Regarding the financial part, Indian venture capitalists consider mainly exit routes, liquidity and expected returns out of the venture. Venture capital funds in India seem to be more concerned about exit routes and liquidity on account of limited exit routes and also because of unsatisfactory performance of OTCEL. In this regard, a supportive role of regulatory authorities SEBI and CBDT is required. Moreover, Indian venture capital industry being at infancy stage, investors are also concerned about expected returns out of the venture which lies within range of returns of over 100 per cent over five years.

Another important aspect of the evaluation concerns is the characteristics of management team of the entrepreneur. Indian venture capitalists want management teams to possess all kinds of skills- technical, management, financial and marketing skills. It carries great implication for the entrepreneur to equip his management team with all the above said skills as desired by the venture capitalist.
An important aspect relating to management of venture capital funds, which has been studied in the present work is portfolio management strategy. So far as present scene is concerned, established venture capital funds have small/young portfolios implying their intention to act as a major finance of finance for projects that tend to be young. On the other hand, the upcoming venture funds have larger portfolios with major concentration on young projects. Hence in future, the scene tends to get inclined towards large portfolio sizes with newly established firms opting for ‘large/ young’ portfolio sizes and old players turning towards it. This pattern is in confirmation with the patterns apparent in the Japanese economy with larger portfolio sizes with smaller size funds. Another issue is the percentage of investment to be put in individual venture investment. Here also, some venture capitalists put major portion of the funds under management so as to keep the size of the portfolio small and some opt for larger portfolio sizes with smaller investments in individual ventures.

Venture capital financing can be provided in the form of equity, debt and convertible instruments (having characteristics of both debt and equity). With a view to opting for easy exit routes and maximize return on investments, Indian venture capitalists provide venture capital financing to investee company through equity participation. Investment in debt form is also not preferred by venture capitalists because of risk element in financing. Convertible instruments can, up to some extent, be used for the purpose. Stage of financing is another important aspect. Earlier studies conducted show that development and growth stages occupy the major investment in the world. Indian venture capitalists do not agree to a common point regarding stage of financing. Stage of financing can be an area for venture capitalists to specialize in, which, later on, can become a core-competency factor for them. Indian venture capital funds tend to invest in a project that implies financing in form of seed capital. Growth capital for major expansion of the company is also preferred by venture capitalists for reaping
the benefits arising on account of development recorded by the venture. Location preferences regarding the investment matter a lot for the venture capitalists. Investors are very particular while choosing the location. In Indian context, however, venture capitalists do not have any regional preferences. One reason for this can be the stage of venture capital industry in India. Since venture capital industry started just a decade ago, it has a long way to go.

Venture capitalists in India now have understood the importance of syndication strategy. Experienced venture capitalists primarily syndicate first round investments to venture investors with similar levels of experience. Indian venture capitalists consider superior selection of investments and risk avoidance through risk sharing as two major objectives behind syndication. It is quite apparent that in order to avoid risk inherent in such type of financing, Indian venture capitalists now days are opting for syndication. This sort of arrangement can be made at any stage of investment, which may depend upon the strategy of the venture capitalists regarding the same. In Indian context, syndication at exit stage has been considered insignificant by venture capitalists. Thus, the concept of syndication has been highly advocated signifying the benefits arising out of venture funds joining hands. It should be noted that syndication is suitable for Indian venture capitalists who strive for risk avoidance through superior selection of investments.

One important aspect that has been covered under management of venture capital funds comprises venture culmination strategy. In this regard, the US venture capitalists opt for project strategy while the Japanese venture capital funds go in for option strategy. Most Indian venture capitalists opt for maximisation of return on investment as their strategic choice among ‘return on investment vs. technology’ by public sale of their interest in the market. Some of the funds, however, have started redirecting their objective from maximising to
investment in technology. That is why most of the venture capitalists tend to invest in venture through equity participation.

Thus, from point of view of an Indian venture capital firm, exit mode is of due consideration. Out of the available exit routes, the most preferred is going public. But Indian venture capitalists seems to be dissatisfied on account of unsatisfactory functioning of OTCEI and lack of appropriate exit routes. An important dimension in this regard is that of time dimension of exit policy. Most of the venture capitalists in India favour exiting out of the venture within 1-5 years, which implies an objective of short-term direct gains. This finding is in conformance with the strategic objective of the US firms, while on the other hand, the Japanese firms opt for long term gains. Venture capital firms in India do not seem to be interested in long term gains (resulting from long term investments 10 years and above) implying their preference for returns rather than going for technology.

As said earlier, most of the venture capitalists in India opt for exiting out of the venture through public sale. IPO is a critical issue affected by a number of factors. Indian venture capitalists consider quality of the venture capitalist and quality of the entrepreneur’s management as important factors, which affect pricing of IPO. It implies that pricing of IPO can be improved on account of track record of venture capital fund as well as of investee company.

Venture capital funds can be managed through in-housing team depending upon the capabilities of the team. Alternatively help of a management consultant company can also be taken. However, in Indian context, venture capitalists depend largely on in-housing team. One possible reason behind this is lack of availability of specialised services in the country.
Another indication in this regard is maintenance of a competent team capable of managing the fund, which is a pre-requisite for success for every venture capital fund. However, the better policy in this regard can be to make use of in-house team and take help from external experts in areas where internal people lack required competence.

As said earlier also, investee company is not only the recipient of cash/financial assistance provided by the venture capitalist but a number of non-financial contributions are also made in the form of managerial assistance. Venture capitalists in India now tend to provide value-added financing to their investee company. So far as the level of involvement of venture capital funds in investee company management is concerned, Indian VC firms opt for medium level of involvement. They do so to avoid any chances of conflicts between the two on account of high involvement and non-fulfilment of purpose on account of low or no involvement at all. Venture capital firms in India have disregarded investment being passive.

Indian venture capitalists are getting more and more inclined towards hands-on approach. This involvement can be in various functional areas. However, in Indian context venture capital firms like to get them involved in finance, technology and general management of the investee company. Involvement in financial aspects is maximum. Involvement in marketing areas has not been considered important from the point of view of Indian venture capitalists.

Venture capital funds agree to the fact that involvement of any venture capitalist is more in financial areas as compared to other areas. The reason behind this as advocated by Indian venture capital funds is that the venture capitalists have to communicate the performance of investee company to the investors who are more concerned about the performance of the venture in terms of returns on investment.
Involvement in investee company affairs can be made by various means depending upon the level of understanding between the two and style of the individual venture capitalist regarding the same. Indian venture capital funds want to make contributions to investee company by means of helping in selection of top management people and involvement in accounting activities, the area of their prime concern. Other forms of participation may also exist depending upon the perception of the same in the minds of venture capitalists. To get information about the venture, Indian venture capitalists rely largely on management reports. In order to exercise strict control over investee company operations, venture capital funds in India maintain close interaction with the investee company management and take advantage of their special position on account of being on board of directors.

Any venture financed by a venture capital company indicates dual management of the same. Venture capitalists affect the behaviour of investee company. Indian venture capital firms consider that their perceptions regarding involvement in affairs of investee company and their level of knowledge and expertise affect the behaviour of Investee Company. It implies that, in order to give desired shape to the venture, the venture capitalist can introduce changes in its level of involvement and expertise accordingly. An investee company stands to benefit on account of knowledge and expertise of the venture capitalists. On the other hand, level of involvement in the investee company determines the extent to which things will be put at discretion of the venture capitalist.

A venture capitalist is not only a source of finance for the investee company but also of various non-finance contributions. Indian venture capitalists consider money, networks, image and general business knowledge as the most important inputs for the investees. It implies that investees evaluate various venture capitalists on these parameters so that venture capital funds
can have competitive edge with regard to any one or all of these attributes. Thus, venture capitalists should develop themselves in these areas so as to serve their investees in a better way.

The post investment activity profile of the venture capitalists determines the level of support and assistance provided to the investee company, which in turn is dependent upon the level of involvement and post investment activity profile of the investee company. Indian venture capitalists seem to be more concerned about financial aspects of any venture, which defines their strategic objective as return on investment as against technology.

Investee companies in India also feel satisfied on account of various contributions (financial and non-financial) made by the venture capitalists. It implies that venture capital firms in India tend to provide managerial assistance to the company in receipt of financial assistance keeping in view the needs/requirements of the same and to keep the level of investee company satisfaction quite high.

Since all investments do not create success stories, failures are experienced by almost all venture capitalists during the course of their operations. Failure can be attributed to shortcomings of the either party. Indian venture capitalists owe failure of any venture to shortcomings of senior management and lack of any sound strategy to be followed. Venture capitalists, if faced with any instance of failure of investment must probe into the reasons contributing to such failure. Venture capital funds in India are concerned about the success or otherwise of their investment and want to learn from their earlier experiences.
It is evident that Indian venture capital firms want to exercise firm control over investee company. However, the definition of venture capital suggests that venture capital funds have no right to control investee company legally as in that sense it would bring investees under the category of their subsidiaries. But on the other hand, the venture capital do not want that ventures should be left to chance. So as to fulfil the objective, some control areas are identified by the venture capitalists agreed upon by the investee company management. These control areas may differ from company to company depending upon levels and modes of involvement as perceived by the venture capitalists. However, ‘Working Capital maintenance’ and ‘listing of employees’ are two main control areas considered to be of utmost importance by the venture capitalists.

For formal monitoring of operations of investee company, the venture capital funds have to identify some performance measures. These performance measures become the basis for post-investment monitoring by the venture capitalists. Indian venture capital funds rely on net profits, sales volume and return on investment as measures of performance of investee company so far as monitoring by formal means is concerned. There is an implication that results brought out by any change initiated by the venture capitalist get reflected by these performance measures.

Indian venture capitalists are very particular about post-investment monitoring of the operations of investee company. Such monitoring can be carried out through formal as well as informal means. Formal monitoring of investees is carried out with the help of budgets and business plans. Budgets and business plans become the basis for comparing actual performance with the desired one, which indicates whether or not the venture is moving in
desired direction. Apart from these, other means can also be adopted depending upon their utility for the purpose.

Venture capitalists monitor financial performance of the investee companies so as to know whether the venture is moving in desired direction concerning the returns. Indian venture capital firms make use of accounting rate of return and sensitivity analysis methods for financial evaluation of ventures. Since the relative importance of methods generally used for the above said purpose differs, it depends upon the individual venture capital fund to decide upon the issue.

It is evident that more and more venture capitalists are turning towards hand-on approach by exercising strict control over operations of the investee company. Control is exercised by ensuring conformance of actual performance to the objective established in the plans and continuous monitoring and review of results as disclosed by Indian venture capital funds. It implies that Indian exercise strict control over the investee companies they put funds in.

So far the collection of information about investee company is concerned, Indian venture capital funds rely on board meetings and visits paid to the same. Being on the board gives an advantage to venture capitalist to gain an insight into the overall affairs of the investee company which determines whether the venture is moving in desired direction or not. Here is also an indication that venture capitalists in India make use of formal power to gain an access to investee company management.

Venture capital funds opt for performance review of their investee company on quarterly basis. It shows that frequency of performance reviews is quite high in India indicating strict
control exercised by the venture capitalists over their investee companies. So far as visits to investee company business are concerned, Indian venture capital funds would like to pay monthly visits to their investees implying regular and rigorous monitoring of their activities. Frequency and intensity of monitoring of investee companies should be decided carefully so as to avoid unnecessary interference and ban on freedom on one hand and to ensure fulfilment of objective on the other hand.

To remain competitive in the marketplace, which is becoming more and more challenging for the players, Indian venture capitalists tend to appraise their portfolio so as to identify the status of their individual investments. Status of portfolio of venture capital funds in India has been regarded as winners. It implies that all venture capitalists strive for excellence with regard to their financing activities.

Indian venture capitalists have understood the importance of mutual relationship between the Venture Capital Company and Investee Company. But sometimes there can be a threat to the very survival of the venture on account of conflicts between the two. According to the venture capital firms in India, difference in level of information known to the entrepreneurs and the venture capitalists and difference in perception regarding role of venture capital with regard to managerial assistance among the two can be the possible reasons for arising of a conflict. However, the reasons may be many more depending upon the earlier experiences of the venture capitalists regarding the same.

The relationship between the venture capitalists and investee company management is of utmost importance, which is generally decided by the involvement of venture capitalists in investee company. The status of relationship determines the level and extent of conflicts
between the two. Indian venture capitalists endeavour to achieve the maximum harmonization with the investee company management regarding level and type of managerial assistance. It implies that venture capital firms design their non-cash contributions as per the needs of and mutual consent with the investee company.

Indian venture capitalists are also paying adequate consideration to their relationship with the investee company. Relations can be business relations as well as personal relations. Venture capital firms in India would like to conduct joint research programmes, product technology development arrangements and arranging licensing agreements for the venture’s new technology so as to strengthen their business relations with the investee company management. The venture capitalists strive to improve business relations and to ensure better sense of participation of both the parties.

Venture capital funds in India would like to establish good personal relationships with the investee company by means of establishing mutual trust between the two. They have also recommended establishment of principal-agent relationship, wherein the venture capitalists are regarded as principal and investees as agents acting on behalf of principals.

The venture capitalist is in a position to exercise power over investee company management. In India, use of formal power is generally made by venture capitalists. Their formal power can be exercisable in form of either voting rights or other contractual rights arising out of financing arrangement. Relationship power is also considerable so as to resolve conflicts between the two.
In India, venture capital industry although started a decade ago, is now-a-days catching fire. Indian venture capitalists are facing increasing competitive threat in the market. Since venture capital industry is gaining momentum in Indian market and Govt. is also trying to make environment conducive for its growth, the market is becoming lucrative for the players encouraging more and more entrants for the same. Growth of new entrants is a major source of competitive threat for the existing venture capital firms. In India, there is no room for substitute products to venture capital finance since risk financing is still at its initial stages with venture capital available as the only tool for such purposes. However, in coming future need for more risk-oriented financing may give birth to some substitute products to venture capital firms.

In view of venture capital industry becoming a challenging marketplace for the venture capitalists, they are finding way-outs for the same. One of the alternatives as suggested by some of venture capital funds is differentiation between individual venture capitalists products/services, which probably is not possible presently when venture capital industry is at nascent stage. However, it can be an important method to face competition in future. Specialisation is also considerable which requires venture capital funds to opt for a particular ‘niche’ on account of industry specific, instrument-specific or stage-specific expertise, knowledge and earlier experiences regarding the same.

Just opposite specialisation stands diversification, which takes any venture capitalist away from its present market and products. Diversification can be in related or unrelated areas to the original products. However, in case of venture capital industry in India, presently, diversification in unrelated product may not be relevant. A combination of back-ward, for-
ward and horizontal diversification strategies has been preferred by Indian venture capitalists depending upon their resources and strategies regarding the same.

Given a choice among specialisation and diversification strategies, so far as portfolio management is concerned, Indian venture capitalists put more emphasis on specialisation. They are conscious of their involvement in particular industries or particular stage of financing. It can be said that, in view of challenges posed to Indian venture capital industry, the venture capital firms can maintain their competitive position by means of specialisation on account of specialised knowledge and experience.

As told earlier, Indian venture capital industry is still at an initial stage. Growth of risk capital industry can be encouraged on many accounts. The solution lies with regulatory authorities, stimulation from Govt. side and enhancing entrepreneurial qualities. Indian venture capitalists have lot of expectations from the Govt. side to make environment more conducive for the purpose.

In this regard, the report of K.B. Chandershekhar Committee, January 8, 2000, on Venture Capital offers a comprehensive analysis of the role of venture capital in promoting the Indian Economy and suggests a number of measures to strengthen Venture Capital industry in India so that it is able to bridge the gap between the available funding from banks and other traditional lenders and the total capital requirements of the technology and knowledge based new enterprises. The committee has attempted to suggest various steps, which would help to create a vibrant VC industry in India. It has examined in Indian context:

1. The vision for venture capital
2. Strategies for its growth, and
Objective - 4

Recommendations concerning strategies for effective management of venture capital funds have been included in 'The Unified Recommendations'.

SECTION - B

THE DISCUSSION

An endeavour has been to make recommendations that will facilitate, through an enabling regulatory, legal, tax and institutional environment, the creation of a pool of risk capital to finance start-up enterprises with the underlying objective of helping India achieve: a) rapid economic growth and b) integration with the global economy from a position of strength.

The following factors have been identified as critical for the success of the VC industry in India:

- The regulatory, tax and legal environment should play an enabling role. This also underscores the facilitating and promotional role of regulations. Internationally, venture funds have evolved in an atmosphere of structural flexibility, fiscal neutrality and operational adaptability. India needs to provide regulatory simplicity and structural flexibility on the same lines. There is also the need for a level playing field between domestic and offshore venture capital investors. This has already been done for the mutual fund industry in India.
- Investment, management and exit should provide flexibility to suit the business requirements and should also be driven by global trends. Venture capital investments have typically come from high net worth individuals who have risk taking capacity. Since high risk is involved in venture financing, venture investors globally seek investment and exit on very flexible terms which provide them with certain levels of protection. Such exit should be possible through IPOs and mergers/acquisitions to Indian players in conformance with the global trends.

- There is also the need for identifying and increasing the domestic pool of funds for venture capital investment. In US, apart from high net worth individuals and angel investors, pension funds, insurance funds, mutual funds etc provide a very big source of money. No doubt, the share of corporate funding is increasing and it was as high as 25.9 percent in the year 1998 as compared to 2 percent in 1995. Corporations are also setting up their own venture capital funds. Similar avenues need to be identified in India also. Pension funds and insurance funds can play a major role by contributing in the funds available for financing.

- With increasing global integration and mobility of capital, it is important that Indian venture capital firms as well as venture financed enterprises be able to have opportunities for investment abroad. This would not only enhance their ability to generate better returns but also add to their experience and expertise to function successfully in a global environment. It is, therefore, needed that Indian enterprises become global and create their own success stories. Therefore, automatic, transparent and flexible norms need to be created for such investments by domestic firms and enterprises.
• Venture capital should become an institutionalised industry financed and managed by successful entrepreneurs, professional and sophisticated investors. Globally, venture capitalists are not merely finance providers but are also closely involved with the investee enterprises and provide expertise by way of management and marketing support. This industry has developed its own ethos and culture. Venture capital has only one common aspect that cuts across geography i.e. it is risk capital invested by experts in the field. It is important that venture capital in India be allowed to develop via professional and institutional management.

• Infrastructure development also needs to be prioritised using government support and private management. This involves creation of technology as well as knowledge incubators for supporting innovation and ideas. Research and Development also needs to be promoted by government as well as other organizations.

At present, the Venture Capital activity in India comes under the purview of different sets of regulations namely:

(i) The SEBI (Venture Capital Funds) Regulation, 1996 [Regulations] lays down the overall regulatory framework for registration and operations of venture capital funds in India.

In addition to the above, off-shore funds also require FIPB/RBI approval for investment in domestic funds as well as in venture capital undertakings. Domestic funds with off-shore contributions also require RBI approval for the pricing of securities to be purchased in venture capital undertakings. Likewise, at the time of disinvestment, RBI approval is required for the pricing of the securities.

The multiple sets of guidelines and other requirements have created inconsistencies and detract from the overall objectives of development of venture capital industry in India. All the three sets of regulations prescribe different investment criteria for VCFs as under:

- **SEBI regulations** permit investment by venture capital funds in equity or equity related instruments of unlisted companies and also in financially weak and sick industries whose shares are listed or unlisted. The Government of India Guidelines and the Income Tax Rules restrict the investment by venture capital funds only in the equity of unlisted companies.

- **SEBI Regulations** provide that at least 80 percent of the funds should be invested in venture capital companies and no other limits are prescribed. The Income Tax Rule until now provided that VCF should invest only up to 40 percent of the paid-up capital of VCU and also not beyond 20 percent of the corpus of the VCF. The Government of India
guidelines also prescribe similar restriction. Now the Income Tax Rules have been amended and provide that VCF shall invest only upto 25 percent of the corpus of the venture capital fund in a single company.

SEBI Regulations do not provide for any sectoral restrictions for investment except investment in companies engaged in financial services. The Government of India Guidelines also do not provide for any sectoral restriction. However, there are sectoral restrictions under the Income Tax Guidelines which provide that a VCF can make investment only in companies engaged in the business of software, information technology, production of basic drugs in pharmaceutical sector, bio-technology, agriculture and allied sector and such other sectors as notified by the Central Government of India and for production or manufacture of articles or substance for which patent has been granted by National Research Laboratory or any other scientific research institution approved by the Department of Science and Technology, if the VCF intends to claim Income Tax exemption. Infact, erstwhile in Income Tax Act was much wider in its scope and permitted VCFs to invest in VCU's engaged in various manufacture and production activities also. It was only after SEBI recommended to CBDT that at least in certain sectors as specified in SEBI's recommendations, the need for dual registration / approval of VCF should be dispensed with, CBDT instead of dispensing with the dual requirement, restricted investment to these sectors only. This has further curtailed the investment flexibility.

The Income Tax Act provides tax exemptions to the VCFs subject to compliance with Income Tax Rules. The Income Tax Rules inter alia provide that to avail the exemption, VCFs need to make an application to the Director of Income Tax (Exemptions) for approval. One of the
conditions of approval is that the fund should be registered with SEBI. Rule 2D also lays down conditions for investments lays down sectors in which VCF can make investment in order to avail tax exemptions. Once a VCF is registered with SEBI, there should be no separate requirement of approval under the Income Tax Act for availing tax exemptions. This is already in practice in the case of mutual funds.

The regulatory environment has proved to be ineffective. The concurrent prevalence of multiple sets of guidelines of different organisations has created inconsistencies and also the negative perception about the regulatory environment in India. Since SEBI is responsible for overall regulation and registration of venture capital funds, the need is to harmonise and consolidate within the framework of SEBI regulations to provide for uniform, hassle free, one window clearance. A functional and successful pattern is already available in this regard in the case of mutual funds which are regulated through one set of regulations under SEBI Mutual Fund Regulations. Once a mutual fund is registered with SEBI, it automatically enjoys tax exemption entitlement. Similarly, in the case of FIIs, tax benefits and foreign inflow/ outflow are automatically available once these entities are registered with SEBI.

It is, therefore, necessary that there is a single regulatory framework under SEBI Act for registration and regulation of VCFs in India. It may be mentioned that Government of India Guidelines were framed on September 20, 1995 and SEBI regulations were framed in 1996 pursuant to the amendment in the SEBI Act in 1995 giving SEBI the mandate to frame regulations for venture capital funds. After the notification of SEBI regulations, separate GOI Guidelines for venture investments should have been repealed. Further, once a VCF including the fund having contribution from off shore investors, is registered with SEBI, the inflows and outflows of funds should be under transparent automatic route and there should be no need for
SEBI regulations provide flexibility in selection of investment to the VCF, however, in the event of subscription to the fund by an overseas investor or the fund choosing to seek income tax exemptions, the investment flexibility is curtailed to a great extent. It is worth mentioning that one of the conditions for grant of approval under the Income Tax Rules for seeking exemption under the Income Tax Act is that the fund should be registered with SEBI which makes it obligatory for the venture capital fund not only to follow Income Tax Rules but also the SEBI Regulations. Further, a VCF has to seek separate registration under the SEBI Act and approval under the Rules of Income Tax apart from seeking approval from FIPB/RBI in the event of subscription of the fund by an overseas investor.

SECTION – C
THE UNIFIED RECOMMENDATIONS

Under this section, an effort has been made to identify various factors critical for the success of venture capital industry in India. This has been done by means of critical appraisal of the existing environment so as to comment upon the suitability of the same for Venture Capital industry. The endeavour of present study has been to examine the management aspect of venture capital funds. This aspect can have two dimensions: Management of venture capital funds at macro level and at micro level. Macro level consists of governance of the whole
venture capital industry. In this respect it requires an appraisal of the environment for the industry in India. On the other hand, micro level management of venture capital funds speaks, more or less, of the manner in which individual venture funds are managed. It comprises various pre-investment and post-investment strategies, post-investment monitoring of investee companies, investor-investee relationships and future prospects of venture capital industry as perceived by the units covered under the study. Under this section some recommendations have been made for both the micro and macro level aspect on account of results drawn from the appraisal of macro factors affecting Venture Capital industry in India and on basis of the responses of individual venture funds covering micro aspects of venture capital funds.

MACRO LEVEL RECOMMENDATIONS FOR EFFECTIVE MANAGEMENT OF VENTURE CAPITAL FUNDS

Various macro factors responsible for success of venture capital industry have been examined in the present study. It believes that a conducive regulatory tax and legal environment characterised by structural flexibility, fiscal neutrality and operational adaptability should be created in India for Venture Capital to flourish and act in keeping with global trends. In order to simplify and bring about flexibility in resource raising, investment, management and exit in market scene, the following are the recommendations:

1. **Structural flexibility:** The main source of funding for the industry is either financial institutions or the Banks. The investment structure must be relaxed and the pension funds and provident funds must be allowed to invest a certain portion of inflows in venture capital
funding. More and more capital can be infused in the economy by allowing provident funds and pension funds to put a part of their sources into risk financing.

2. **Investment equality:** Venture Capital firms in India suggest that equal status should be given to them as is given to mutual funds so far as their tax liabilities and other incentives are concerned. The capital gains of Venture Capital firms must be treated at par with mutual funds to make it more attractive.

3. **Operational Flexibility and Liberal exit policy:** Exit mechanism also needs revision and modifications. Exit scheme should be made investor friendly so as to encourage level of venture capital activity in the country.

a) **Safe Guarding Venture Capital Risk:**
Eligibility for registration as venture capital funds should be neutral to firm structure. The government should consider creating new structures, such as limited partnerships, limited liability partnerships and limited liability corporations. At present, venture capital funds can be structured as trusts or companies in order to be eligible for registration with SEBI. Internationally, Limited Partnerships, Limited Liability Partnership and Limited Liability Corporations have provided the necessary flexibility in risk-sharing, compensation arrangements amongst investors and tax pass through. Therefore, these structures are commonly used and widely accepted globally specially in the USA. Hence, it is necessary to provide for alternative eligible structures. Venture Capital funds should be allowed to be framed in the form of Limited Liability Companies and Limited Liability Partnership.
b) Relaxation in buy back policy of unlisted companies:  
A venture capital fund incorporated as a company/venture capital undertaking should be allowed to buyback up to 100 percent of its paid up capital out of the sale proceeds of investments and assets and not necessarily out of its free reserves and share premium account or proceeds of fresh issue. Such purchases will be exempt from the SEBI takeover code. A venture-financed undertaking will be allowed to make an issue of capital within 6 months of buying back its own shares instead of 24 months as at present. Further, negotiated deals may be permitted in unlisted securities where one of the parties to the transaction is VCF.  

c) Relaxation in IPO norms:  
The IPO norms of 3-year track record or the project being funded by the banks or financial institutions should be relaxed to include the companies funded by the registered VCFs also. The issuer company may float IPO without having three years track record if the project cost to the extent of 10 percent is funded by the registered VCF. Venture capital holding, however, shall be subject to lock in period of one year. Further, when shares are acquired by VCF in a preferential allotment after listing or as part of firm allotment in an IPO, the same shall be subject to lock in for a period of one year. Those companies which are funded by venture capitalists and their securities are listed on the stock exchanges outside the country, should be permitted to list their shares on the Indian stock exchanges.  


d) Liberal Takeover Code:  
The venture capital fund while exercising its call or put option as per the terms of agreement should be exempt from applicability of takeover code and 1969 circular issued by the Government of India.
e) **Issue of Shares with Differential Right with regard to voting and dividend:**

In order to facilitate investment by VCF in new enterprises, the Companies Act may be amended so as to permit issue of shares by unlisted public companies with a differential right in regard to voting and dividend. Such flexibility already exists under the Companies Act in the case of private companies, which are not subsidiaries of public limited companies.

f) **QIB Market for unlisted securities:**

A market for trading in unlisted securities by QIBs be developed.

g) **Requirement of No Objection Certificate:**

In the case of transfer of securities by FVCI to any other person, the RBI requirement of obtaining NOC from joint venture partner or other shareholders should be dispensed with.

4. **Relaxed Government Provisions for Unlisted Companies:**

The Govt. of India should permit trading of unlisted companies on the OTC exchange of India. 70 percent of a venture capital fund’s investible funds must be invested in unlisted equity or equity-linked instruments, while the rest may be invested in other instruments. Though sectoral restrictions for investment by VCFs are not consistent with the very concept of venture funding, certain restrictions could be put by specifying a negative list which could include areas such as finance companies, real estate, gold-finance, activities not legally permitted and any other sectors which could be notified by SEBI in consultation with the Government. Investments by VCFs in associated companies should also not be permitted. Further, not more than 25 per cent of a fund’s corpus may be invested in a single firm. The investment ceiling has been recommended in order to increase focus on equity or equity-linked
instruments of unlisted start-up companies. As the venture capital industry matures, investors in venture capital funds will set their own prudential restrictions.

5. Dissemination of Venture Capital Concept:
The awareness about the concept of venture capital must be promoted by business schools in India by designing the courses on Entrepreneurship and Venture Development. Venture Fairs must be organised in various parts of the country to bring together venture capitalists and entrepreneurs and raise the level of awareness.

6. Creating Benevolent Environment:
Venture capital companies must be encouraged to establish distress funds/turnaround funds for helping ailing companies.

7. Attracting Banks and Conventional lenders in to Venture Capital Investment.

8. Tax Benefits for Venture Capital Companies:
VCFs constitute a dedicated pool of capital and as such operate in fiscal neutrality and are regarded as pass through vehicles. In any case, the investors of VCFs are liable to tax and so are the investee companies in respect of their earnings. There is a well established successful precedent in the case of Mutual Funds which once registered with SEBI are automatically entitled to tax exemption at pool level. It is an established principle that taxation should be only at one level, hence taxation at both the level of VCFs and investors amount to double taxation. Since like mutual funds, VCF is also a pool of capital of investors, it should be treated as a tax pass through. Once registered with SEBI, it should be entitled to automatic tax
pass through at the pool level while maintaining taxation at the investor level without any other requirement under Income Tax Act.

9. Simplification of regulations and Control:

Furthermore, to stimulate venture capital industry in India, standing committees of Govt. and industry can be framed which will undertake the job of continuous appraisal of environment for venture capital industry in the country. Relaxation can also be granted so far as framing of venture capital funds are concerned. Thus on the whole, three fronts have been mainly advocated by venture capitalists in India. These include solid steps taken by Govt. of India and Indian financial institutions, amendments in regulatory framework and enhancements of venture capital skills and capabilities.

10. Creation of Conducive Environment:

a) Forging Linkages with NRIs and Foreign Venture Capital Investors: Presently, FIIs registered with SEBI can freely invest and disinvest without taking FIPB/RBI approvals. This has brought positive investments of more than US $10 billion in the country. At present, foreign venture capital investors can make direct investment in venture capital undertakings or through a domestic venture capital fund by taking FIPB/RBI approvals. This investment, being long term and in the nature of risk finance for start-up enterprises, needs to be encouraged. Therefore, at least on par with FIIs, FVCIs should be registered with SEBI and having once registered, they should have the same facility of hassle free investments and disinvestments without any requirement for approval from FIPB/RBI. This is, in line with the present policy of automatic approvals followed by the Government. Further, generally foreign investors invest through the Mauritius-route and do not pay tax in India under a tax treaty. FVCIs therefore should be provided tax exemption. This provision will put all FVCIs,
whether investing through the Mauritius route or not, on the same footing. This will help the development of a vibrant India-based venture capital industry with the advantage of best international practices, thus enabling a jump-starting of the process of innovation.

b) Mobilisation of Domestic Resources: The present pool of funds available for venture capital is very limited and is predominantly contributed by foreign funds to the extent of 80 per cent. The pool of domestic venture capital needs to be augmented by increasing the list of sophisticated institutional investors permitted to invest in venture capital funds.

This should include banks, mutual funds and insurance companies up to prudential limits. Later, as expertise grows and the venture capital industry matures, other institutional investors, such as pension funds, should also be permitted. The venture capital funding is high-risk investment and should be restricted to sophisticated investors. However, investing in venture capital funds can be a valuable return-enhancing tool for such investors while the increase in risk at the portfolio level would be minimal. Internationally, over 50 per cent of venture capital comes from pension funds, banks, mutual funds, insurance funds and charitable institutions.

11. Incentives for Global opening up of Domestic Venture Capital industry: Domestic venture capital industry can be successful only if it invests globally and to be a global industry, certain incentives should be taken care of as detailed below:

a) Incentives for Employees: The limits for overseas investment by Indian Resident Employees under the Employee Stock Option Scheme in a foreign company should be raised from present ceilings of US$10,000 over 5 years, and US$50,000 over 5 years for employees
of software companies in their ADRs/GDRs, to a common ceiling of US$100,000 over 5 years. Foreign employees of an Indian company may invest in the Indian company to a ceiling of US$100,000 over 5 years.

b) **Incentives for Shareholders:** The shareholders of an Indian company that have venture capital funding and are desirous of swapping its shares with that of a foreign company should be permitted to do so. Similarly, if an Indian company having venture funding is desirous of issuing an ADR/GDR, venture capital shareholders (holding saleable stock) of the domestic company and desirous of disinvesting their shares through the ADR/GDR should be permitted to do so. Internationally, 70 percent of successful start-ups are acquired through a stock-swap transaction rather than being purchased for cash or going public through an IPO. Such flexibility should be available for Indian start-ups as well. Similarly, shareholders can take advantage of the higher valuations in overseas markets while divesting their holdings.

c) **Global investment opportunity for Domestic Venture Capital Funds (DVCF):** DVCFs should be permitted to invest higher of 25 per cent of the fund’s corpus or US $10 million or to the extent of foreign contribution in the fund’s corpus in unlisted equity or equity-linked investments of a foreign company. Such investments will fall within the overall ceiling of 70 per cent of the fund’s corpus. This will allow Domestic Venture Capital Funds to invest in synergistic start-ups off-shore and also provide them with global management exposure.

12. **Investment in Promoting Research and Development:** Infrastructure development needs to be prioritized using government support and private management of capital through programmes similar to the Small Business Investment Companies in the United States, promoting incubators and increasing university and research laboratory linkages with venture-
financed startup firms. This would spur technological innovation and faster conversion of research into commercial products.

13. **Creation of Self-regulatory Organisation:** A strong SRO should be encouraged for evolution of standard practices, code of conduct, creating awareness by dissemination of information about the industry.

14. **Effective Regulatory Structure:**

Presently there are three sets of Regulations on venture capital activity i.e. SEBI (Venture Capital Regulations) 1996, Guidelines for Overseas Venture Capital Investments issued by Department of Economic Affairs in the MOF in the year 1995 and CBDT Guidelines for Venture Capital Companies in 1995 which was modified in 1999. It is needed to integrate these into a new single regulation of SEBI to provide for uniformity, hassle free single window clearance. A pattern is already there in this regard; the mutual funds have only one set of regulations and once a mutual fund is registered with SEBI, the tax exemption by CBDT and inflow of funds from abroad is available automatically. Similarly, in the case of FIIs, tax benefits and foreign inflows/outflows are automatically available once these entities are registered with SEBI. Hence, SEBI should be the prime regulator for VCFs to provide uniform, hassle free, single window regulatory framework.

Implementation of these recommendations would lead to creation of an enabling regulatory and institutional environment to facilitate faster growth of venture capital industry in the country. Apart from increasing the domestic pool of venture capital, around US$ 10 billion are expected to be brought in by offshore investors over 3-5 years on conservative estimates. This would, in turn, lead to increase in the value of products and services adding up to US$100
billion to GDP by 2005. Venture supported enterprises would convert into quality IPOs providing overall benefit and protection to the investors. Additionally, judging from the global experience, this will result into substantial and sustainable employment generation of around 3 million jobs in skilled sector alone over next five years. Spin-off effect of such activity would create other support services and further employment. This can put India on a path of rapid economic growth and a position of strength in global economy.

It is interesting to note that K.B. Chandershekhar committee’s recommendations to promote Venture Capital industry in India fall in line with the findings and unified recommendations of the present study.

Success of venture capital industry is also dependent upon the management of VC funds in respect of individual venture running. Apart from a conductive environment, another factor that has gained considerable attention in the success/failure of venture capital industry has been the venture capitalists and Entrepreneur’s relationship. Following are few strategies at micro level that can help in management of Venture Capital organization and in turn, boosts the venture capital industry.

MICRO LEVEL RECOMMENDATIONS FOR EFFECTIVE MANAGEMENT OF VENTURE CAPITAL FUNDS

PRE INVESTMENT STRATEGIES

1 Entering Venture Capital Business:

Entering venture capital business should be a strategic and planned decision rather than ad-hoc. Any firm planning to enter venture capital business should perform great deal of research
so as to identify the sectors/industries it is going to focus upon, the stages it is going to specialise in, team they are going to choose and other factors on similar lines. Since venture capitalists expect very high rates of return from the venture, at the outset, it may seem a very lucrative option to enter the venture capital business, but the process of managing the venture capital funds i.e. from arranging the seed capital and checking the business plan to managing all the controls required with the investee company and finally, timing for the exit stage demands lot of experience and knowledge on venture capitalist's part and that can be obtained only if entering above business has been planned strategically. The above, thus, calls for strategical planning before foraying into venture capital business. Lot of firms enter into the above business as a part of the diversification strategy for instance the Mahindra Group but again, that is a part of the overall strategy of the group rather then entering on Ad-hoc basis.

The major source of potential deals should the 'referral system' i.e. deals may be referred by the firm's parent organizations, trade partners or friends and calls originating within the venture capital communities should be given consideration. The above is very essential as a successful venture might not only require a good business plan but a combination of several intangible factors like entrepreneur's abilities, characteristics of the team and more that can be well judged by the business partners who deal with them. Thus, network has a major role to play in the deal origination.

For the purpose of the Evaluation of the proposed venture, it is essential for the venture capitalist firm to use a combination of both In-house specialists and external specialists having great expertise in that particular area or sector. The above is very important as the in-house specialist would be kind of generalist and evaluation might require in depth knowledge of
particular sector or any specific technology process and thus, it becomes imperative to take the help of external specialist also.

Besides, the above also calls for Selection of personnel from varied backgrounds. Various proposals from varied industries are to be evaluated and ranked according to their positive or negative features. The above, thus, suggests that venture capital firms requires staff with more experience in organization building to ensure that intelligent bets are made and sound strategies are developed. Thus, venture capital firms should consider recruiting officers with varied backgrounds- in businesses, institution building, and consulting so as to possess cross-industry experience and hence better evaluation of the proposed ventures.

The above would help in developing T-Shaped expertise whereby people in venture capital team can not only act as a generalist but they also possess sector specific knowledge that can be utilized for different ventures since the inception stage i.e. the idea generation upto post-investment activities. The above would help in better evaluation and guidance to each of the proposal and therefore, increase the probabilities of making a venture capital proposal successful.

2 Evaluation Criteria to be considered by Venture Capitalist:

The evaluation criteria to be considered by the venture capitalist can be divided into five major categories as characteristics of the entrepreneur, characteristics of the product, characteristics of the market, financial considerations and characteristics of the venture management team.

The most important characteristics of the Entrepreneur to be taken into consideration while evaluating the proposed venture should be integrity, long-term vision, urge to grow, attention...
to details and familiarity with the target market. The above characteristics are very important as aspiring entrepreneurs should see that conceptualising and starting a company is totally different from managing its growth. Hence, if the promoter does not grow with the company, at times he might become the biggest bottleneck in the success of any venture. Besides, it is very important for the entrepreneurs to take on new ventures that build upon the existing competencies to minimize the liabilities associated with newness. Because the resource base of most new ventures is insufficient to support a protracted period of development, the inability to rapidly overcome the liabilities of newness often results in bankruptcy. Thus, prior experience of the entrepreneurial team with the target markets and technologies comes across as a vital element in the success of the new ventures. Thus, all the above characteristics are essential in an entrepreneur before starting a new venture.

The essential characteristics desired from the product on which a new project is going to be launched should be that it is a proprietary or otherwise protected product, preferably a high-tech product and very unique. The entrepreneur should understand that competition being so stiff, differentiation should be maintained right from the beginning. The current boom in IT industry in India advocates that venture capital and high-growth technology and knowledge-based enterprises go very well simultaneously. Also, the proposed ventures are without any resource base in terms of capital required and if the product is also not unique and high tech, the survival in the market does not seem viable. Thus, the product to be considered should be a high technology product.

The most important criteria to be considered while evaluating the characteristics of the market should be high market growth, little threat of competition during initial years and easy market accessibility. Indian market has relatively been an untapped market but because of increasing
competition levels and the market becoming more challenging for the venture capital firms, more emphasis should be put on the above-mentioned factors. There are around seventy funds operating with their focus on India, and hence, the above market characteristics are going to be the most important considerations while evaluating the proposed venture in terms of desired market traits.

While evaluating the financial considerations, the most important parameters that should be kept in mind are opportunities for exit, expected returns, and whether venture can be easily made liquid or not. The focus should be significantly upon liquidity and exit options because of the fact that attractive exit routes are not available to the Indian venture capital industry. Also, venture capital industry in India is still in infancy stage and therefore, very high returns can be expected. However, this situation is not going to last on account of market place turning challenging for the players.

Next, in the evaluation criteria, characteristics of the venture capital team must be taken into consideration. The factors to be evaluated in the above should be that the team possesses the required Technical, Management and Financial Expertise but the most importantly, it must be a balanced team. Any new venture to be successful would require expertise on all the fronts and hence, a balanced team is a must.

3 Strategies in regard to size of investment:

The most important factor in this regard is the portfolio size to be maintained by the Indian venture capital firms. Indian venture capital firms must initially keep their portfolio size as large so that they can achieve the objective of risk diversification by investing in a number of
projects. The preferred investment would be in young projects as suggested by the stage of Indian venture capital industry as against their US, UK and Japanese counterparts.

The next factor in this regard stands is the *stage of financing*. Venture capitalists tend to invest at every stage of the venture however they must start concentrating upon *Stage Specialisation* in coming years. The Indian venture capital market is still in the nascent stage and as the market matures, the venture capitalists should look forward to develop expertise to make investments in specific stages of projects. Thus, this would help in giving proper co-ordination at each stage and also the initial seed stage venture capital investor may offload the share to venture capitalist who specialises in expansion stage. The above would help in exit and entrance routes and in the process, units also get benefited from venture capitalists expertise in respective areas of operation.

Another factor that is important in the above category is *Instruments used for financing* venture capital. Indian VCFs should focus upon using equity or convertible instruments i.e. bearing characteristics of both equity and debt for financing the ventures. Since strategic objective of VCFs is maximization of ROI rather than Technology, therefore, equity stands as the most lucrative option as it helps giving venture capitalists the option of withdrawing from the venture once the venture is in a position to attract capital from market. Also, it helps in pursuing the objective of stage specialisation rather than concentrating on all stages.

Another essential consideration in this context is the *choice of the investment area*. At this point of time, venture capitalists should focus upon investments within India only. The reason for this is that VCFs are not only capital providers but also are strategic partners and need to provide resources other than capital only but due to limitations regarding their resources in
terms of funding abilities, skills and business knowledge, it is not possible for them to meet global challenges and hence, focus within India only. In continuation of the above, next are the regional preferences in the area of Investment. VCFs in the various regions of India have not been able to exploit the regional benefits till now. A regional focus could lead to concentrated efforts and specialisation and thus, leading to take full advantage of the regional benefits

4 Syndicated strategic options:
Syndication basically leads to superior selection of investment. It has been little scrutinized in the corporate literature due to difficulty in analysing syndicated patterns empirically and the complexity of motives behind syndication. Venture capitalist should always go for syndication of investments as an entrepreneur who approaches the VCF might represent any sector or any technology not known to the venture capitalist. Hence, syndication becomes necessary for superior selection of investments as well as it helps in risk avoidance through risk sharing.

5 Venture Culmination strategies:
In this context, VCFs can go for both Option strategy as well as Project strategy. Different venture capitalists opt for different strategies as per their strategic objective behind the investments. Most of the venture capitalists have maximization of ROI as their strategic objective and hence, they should always opt for public sale under project strategy, and this option also helps in pursuing their stage specialisation strategy. Venture capitalists having technology focus can thus, go for Option strategy i.e. up gradation of the technology or retaining the stock in the venture.
Exit Route strategies:

The above strategies refer to different exit routes that can be taken by the venture capitalists. The most preferred route in above context should be going public i.e. IPOs as there are not lot of options available in Indian context and thus, it seems to be the most lucrative option.

Another aspect that requires consideration in this regard is the Time horizon of Exit policy. Venture capitalists in Indian context generally favour short-term direct gains with a time frame of 1-5 years. The survey of different venture capital firms also yield that the exit time horizon they consider is generally one to five years. In the Indian context, however the market is not yet very mature so it is not feasible to exit from a venture in such a short span of time. The recent state of all the technological stocks indicates that such short time horizons are not very viable. Therefore, venture capitalist should have a slighter long-term focus and should be ready to work along with the firms. This longevity would give them time to become intimate with the start-up’s organizational needs and to find ways to fill them.

One more factor that is important in this context refers to factors affecting pricing of initial IPOs. The venture capital firms should always launch IPO of their venture in such a manner so as to maximize the return on investment. In this regard venture capitalist should always take advantage of his own reputation and that of the entrepreneur as these two factors considerably affect the pricing of IPO. Thus, any venture always stands to get benefited on account of quality of venture capitalist as well as that of entrepreneur’s management as far as issue of going public is concerned.
Strategies for management of venture capital funds:

Management of venture capital funds is done by a combination of both i.e. through an in-housing team and through management consultant company. For the above reason, maintenance of a competent team capable of managing the funds is a prerequisite for the venture capitalist. Thus, VCFs need experienced and competent managers, with initiative, drive and vision, who could identify potentially sound ideas and innovative and visionary entrepreneurs. Such managers are not easily available particularly in a developing country like India pointing a strong need for adequate development of such human resources. Management schools and institutes in India need to develop special training programmes to train venture capital managers. More than knowledge, it is the risk taking and entrepreneurial attitude that needs to be inculcated in those managers. The above, thus calls for the mangers to reassess their own capacity for a hands-on, organization centred approach.

POST INVESTMENT STRATEGIES:

1 Involvement Strategies:

The most important strategy wrt involvement with the entrepreneur is the level of involvement. More and more venture capitalists are moving towards “Hands-on” approach but the level of involvement may, however, differ on case-to-case basis. Most of the venture capital firms are involved in two activities i.e. selection of Top Management and accounting activities like keeping a watch over the financial performances of the company. The venture capitalists due to their cross industrial experience should broaden the scope of their involvement and act as a strategic advisor to the firm on different aspects as they have
witnessed the basic reasons for the failure of the different projects. Thus, they can help in guiding the fundamentals of the company. Secondly, the major reasons cited for failure of different venture in the above survey have been Lack of Sound Strategy and Shortcomings of the senior management. Therefore, Venture capitalists active involvement would help in minimising failures as Venture Capitalists have different projects experience.

Methods of involvement is yet another important aspect to be considered in the above category. Most of the VCFs are primarily involved in selection of top-level management and accounting activities. Venture capitalists should increase the scope of their working with the company as they are having cross industrial experience and thus, can effectively work for making a venture successful. Thus they should also look forward to help management in number of operating problems and to some extent having contacts with the outsiders in this regard.

Besides, another factor to be given consideration should be means of involvement in Investee’s business. Venture capitalists in India have generally relied upon management reports to get information about the position of the venture but role of venture capitalists has changed to a strategic partner from merely being financial in nature, therefore, it should start using periodic company visits and close involvement with the investee’s business also as its tools to have involvement in the investee’s business. The above would help the venture capitalists in exercising desired control over the activities of the investee company.

2 Inputs for Investee Company:
Along with financial contributions, venture capitalists should also look forward to various non-financial contributions that they can provide to the investee company. Venture capital financing differs from traditional equity financing in the manner that the venture capitalist
plays a role in the management of the companies receiving investment and they tend to have significant impact on the firms in which they invest. Thus, in addition to providing funding, venture capitalists should look forward to add various other inputs to the investee company and the above inputs can become a factor of core competency for the venture capitalist. Venture capitalist should always look forward to provide inputs in form of Networks, Money resources and Inherited business knowledge to the investee company and any one of the above can also become the competency factor for the venture funds. Since venture capitalists are involved in different projects from varied industries and therefore, possess an expert in-house team, and thus are in a strong position to provide the above resources to the investee company.

3 Post investment activity profile of venture capital:

In developed countries like UK, more and more venture capital funds are moving towards hands-on approach as against hands-off approach. Indian venture financing market should also follow the same phenomenon as the level and support and assistance is dependent upon the post-investment activity profile of the venture capitalist. The most important areas in which the venture capitalists should focus upon in this regard should be monitoring of financial performance followed by obtaining alternate sources of equity financing and interfacing with the investor group.

Following above, another important strategy should be in regard to satisfaction of the investee company. Venture capital funds in India should strive to achieve the highest level of satisfaction for investee companies. They can do so by designing their post investment activity profile in such a way that suits the requirements of investee company in conformance with their own policy regarding the same. Thus, Indian venture capitalist should get themselves
involved in the affairs of the investee company by keeping the level of involvement reasonable so as to serve the purpose.

Another important factor that requires consideration refers to reasons so as to why different investments fail and the strategies required for avoiding them. Most of the investments in Indian context fail due to shortcomings of the senior management and also due to lack of sound strategy on part of venture capitalist. Therefore, venture capitalist should always act as a strategic partner so as to rectify the shortcomings of the senior management and should always try to build a strategy so as to have a planned development of the portfolio and thus, avoid failures on these fronts.

4 Control areas for Venture Capital Company:

Venture capital firms should structure their investments in such a way so as to maintain firm control over investee company. The range of controls that can be exercised by investors upon investees by means of venture agreements include control over dividend payment levels, participation in mergers, sale of assets, debt/gearing levels, capital expenditure, management remuneration, working capital maintenance and hiring of employees. In view of greater competition, smaller margins and concentration of market power, the provision of more advice to investees on the part of venture capitalists seem to be essential. The control areas that should be used by venture capitalist in above regard are working capital maintenance and hiring of employees. However, there can be differences in the control areas on account of difference in levels and modes of involvement as perceived by the venture capitalists in both the markets.
Following this, an important aspect arises namely means of exercising control over investee company. Since venture capitalists are moving towards more hands on approach, they require different means for exercising control over the investee company. The above can be achieved by means like conformance to objectives established in the plans, continuous monitoring and review of results and to some extent, evaluation and replacement of management. Thus, the above can be used as means for exercising control over investee company.

Another important aspect that should be taken into consideration refers to forms of formal monitoring of investees. Different forms that can be used in this regard are budgets, business plans, monthly accounts and yearly audited financial statements. The above, thus, help in giving key financial figures that can become the basis for formal monitoring of investees.

Yet another aspect that is important in this regard refers to methods of financial evaluation of venture capital funds. Different methods that can be used are internal rate of return, sensitivity analysis, and net present value. Any of these methods can be used depending upon their relative importance from the point of view of individual venture capitalists.

5 Sources of collection of Information regarding Investee Company:

Board meetings and company visits are the two most preferred sources of information about the investee company followed by telephone conversation. The problem with these sources is that they tend to give the information that is projected or desired rather than actuals which creates gap between level of information known to the entrepreneur and the venture capitalist. Besides, formal performance measures include ROI projections, net profits i.e. parameters largely financial in nature and the ones that are given after taking the most optimistic scenario
into consideration. Therefore, venture capitalist should take into consideration other sources of information so as to obtain a fair picture of the performance of the company.

6 Performance Measures of Investee Company:

The most important control checks used by venture capitalist are mainly financial in nature like projected ROI, net profit and market shares. As a venture, it is very important for the venture capitalist to take in consideration various non-financial factors. Thus, it becomes imperative for the firms to also look into non-financial factors, as they are very vital for success of these kinds of ventures.

With regard to frequency of performance reviews, venture capitalists should at least give quarterly visits and thus, obtain the performance reviews. Venture capitalists can also go for semi-annual or annual monitoring of activities but these would not serve the purpose of exercising proper control over affairs of the investee company. Besides, more frequent visits than quarterly visits would be detrimental to venture, as entrepreneur needs some degree of freedom to work. Thus, venture capitalists should focus upon quarterly visits to investee company.

7 Checking the status of the Investment made by Venture Capitalist:

Any venture capitalist strategically invests his money into various ventures bearing various characteristics. Therefore, time-to-time appraisal of such investments should be done so as to ensure conformance to the strategy drawn. Thus, reappraising the status of the portfolio forms a very important aspect of the management of the venture capital.
8 **Investor Investee relationship:**

Venture capital backed projects find dual management on account of venture capitalists participating in investee business. Therefore, status of relationship between venture capital and the investee company forms a very important aspect of the above. Most of the venture capitalists think that their involvement is much more than the investee companies' expectations as they have more valuable ideas than does the investee company has but, a good venture is only in which both parties agree on a common point. Thus, difference of opinion can create major differences among the investor and investee, and hence this factor has got lot of importance.

Therefore, the *perceptions of venture capitalists and the entrepreneurs* regarding the keys to venture success are very important because investor-investee relations could be influenced, for example, by the level of agreement between the venture capitalist and the entrepreneur regarding how to achieve venture vitality and growth. If the entrepreneur and the venture capitalist think differently regarding such things as technological and marketing orientation, conflicts may arise. Such conflicts will likely to be detrimental to venture performance causing a threat to the very survival of the venture. Thus, the entrepreneurs would have to adjust the role of a venture capitalist as an active collaborator and not merely as a passive financier. Once a proper perception is created in the minds of the parties involved, then only the fiscal and the legislative changes suggested in the macro factors above can help in making a venture financing attractive and enthuse private sector entry.

9 **Conflict management:**

Venture capital financing differs from more traditional equity financing in that the venture capitalist plays a role in the management of the companies receiving investment i.e. the
investee - company. The success of any venture depends to a large extent upon the mutual relations between the venture capitalist and the investee-company. As discussed earlier also, the success of any venture depends upon the mutual cooperation and trust between the venture capital funds and the investee-company. Sometimes the relations turn sour and conflicts arise between the two causing a threat to the very survival of the venture. It is, therefore, very important to work on this aspect.

The basic issues of conflict arise due to ambiguity in the roles of both the venture capitalist and the entrepreneur in the functioning. In any joint venture or such kind of association, it becomes very important to define the roles very clearly at the inception stage only. The level of the information shared should be same i.e. venture capital gets informed up till the same level and thus, acts as a part of the strategic planning at every stage and thus, both the parties act upon a common platform. The above would help in reducing the conflicts to great extent and thus, help in better management of venture capital funds.

One of the strategies that can be implemented in this regard is staging the capital commitment. The basic issue of conflict between investee company and venture capitalist is the gap between the levels of the information known to them. Since entrepreneurs are often committed to a single venture and venture capitalists have a portfolio of investment projects, there are potential conflicts over the amount to invest in a venture. Entrepreneurs have expectations that are incompletely known to the venture capitalist and, in the process of selling the venture, the entrepreneurs may overstate its likely outcomes. Staging the capital commitment is a very effective mechanism by which venture capitalist can reduce the above conflict. It implies that venture capitalist commits only a fraction of the capital needed for the ultimate development.
of the project. Subsequent financing is then tied to the successful completion of the intermediate objectives.

Staging the capital commitment creates an abandonment option and thereby increases the value of the investment. Further, an entrepreneur’s decision to accept such a contract will provide information about the entrepreneur’s beliefs in his or her own estimates and in the time and cost required to develop the first stage. Subsequent capital commitments will then benefit from additional information. The venture capitalist will be able to reduce risk before the second round of financing, and if all goes well, the entrepreneur may benefit from increase in valuation, leading to less dilution of his or her ownership interests in subsequent rounds.

Hence, stage capital commitments keep the entrepreneur focused on the task at hand and may motivate a more rapid pace of activity.

10 Strategies for facing future competitive threat:

Indian venture capital industry is at the infancy stage, it is going to be very competitive and challenging for the players causing a threat to their survival. To remain competitive, venture capitalists in India should plan for future strategies. Strategies may differ from organization to organization depending upon the perception of individual venture capitalists regarding the environment and availability of resources for implementation of the same.

One of the methods can be reappraising strategic positioning in the light of a likely constraint in future funds for investment. The strategic positioning can be based on a matrix offered by Ansoff (1968) called ‘growth matrix’ based on product and market factors suggesting of four alternative strategies based upon the products/market factors of each venture capital fund-
Market Penetration, Product Development, Market Development and Diversification. Alternatively, venture capital funds can go for differentiation between individual venture capitalists' products and services.

The venture capital firms can also go for specialization regarding investment in any particular industry/stage of financing. Another can be increasing inter firm rivalry to face cut-throat competitive threat in the market. Venture capital firms as determined by their competitive position can adopt many more strategies.

In the similar regard, firms can take on instrument or geographic specialization arguing the advantage of greater instrument specific knowledge. Specialization can be in any particular industry, a particular stage of financing or a particular investment of financing.

In the above context only keeping in view the competitive threat and sophistication of venture capital market, it is supposed that players in the market will have to go for alternate concepts of market development, product development and diversification strategies so as to remain in competitive position. Thus, most of the venture capital firms would have to go for a combination of backward, forward and horizontal diversification. With respect to individual diversification strategy, forward diversification should also be considered.

a) **Extending role of Venture Capitalist:**

Role of venture capitalist should not be restricted to merely financing the venture. He should be actively involved in managing the venture and providing input of skills needed to set up the firm, orient its marketing strategy and should help and organise it. If required, he would undertake spot studies of various problems faced by the assisted company so as to help them
to adjust or correct their production techniques or marketing strategies to suit marketing conditions. In short, he should act as *co-partner* in the business rather than just a financier.

Because they are a major source of funds, VCs can have a significant impact on the firms in which they invest. In addition to providing funding VCs can add a variety of other inputs, such as operating services, networks and moral support. The value of these inputs varies from a company to company, with VCs inputs being used to fill the gaps between the resources needed and those already available to the company. Thus, in the existing scenario, it becomes imperative for the firms to use venture capitalist as a constructive force.

b) **Overcoming the psychological barrier:**

In Indian context another barrier that exits is mainly psychological in nature. A typical characteristic of the Indian management is to have the cake and eat it too. Very often there is a credibility gap between the financier and the entrepreneur. By the very nature of the venture capital financing, the financier will have to be a part of the venture and would need an active say in the management. The entrepreneur in the venture capital case is never in a position to offer any assurances of success of his idea, hence perceived risk is very high in this case and therefore, requires venture capitalist association at all the stages. The above generally does not suit Indian management and they see venture capitalists role restricted as merely as a financier. Thus, above barrier needs to be overcome in the Indian context.

c) **Nature of new ventures:**

It's very important for the entrepreneurs to take on new ventures that build upon the existing competencies to minimize the liabilities associated with newness. Because the resource base of most new ventures is insufficient to support a protracted period of development, the inability
to rapidly overcome the liabilities of newness often results in bankruptcy. Thus, prior experience of the entrepreneurial team with the target markets and technologies comes across as a vital element in the success of the new ventures.

d) Knowledge management by Venture Capitalist:
Analyzing a venture proposal is a judicious mix of art and science. The art involves an opportunistic, intuitive and gut feel approach. The science involves systematic data gathering and an assessment of promoter background and their capability. A comparative data on similar companies in the industry might give an indication of future prospects. Moreover, the expertise of its people and its own experience with respect to past decisions also helps a great deal in taking a decision. The ventures generally involve new technology that may never have been commercially tested. The entrepreneur, therefore, may not be in a position to offer any assurances of success as his idea may require a lot of research and prototype development before it can be commercially exploited. Thus, it becomes necessary on the part of the venture capitalist firms to undertake knowledge management that helps in giving them a complete scenario so as to why the previous ventures failed, case-specific reasons, existing environmental conditions and data related to same. Thus, the above would really give a boost to good ventures and even help in minimising the risks associated.

e) Better Interaction between Venture Capitalist and Entrepreneur:
A venture may acquire competencies in marketing or product technologies by seeking individuals experienced and knowledgeable in such matters. Indeed, venture capitalists are often sought for knowledge and experience that they can contribute to the venture. By supplying expertise, the venture capitalist helps the entrepreneur overcome the liabilities of newness. When entrepreneurs have access to such expertise, effective interaction between the
entrepreneur and the venture capitalist is necessary to realize its benefits and to ensure venture success. In the Indian context specifically, as the circumstances become more demanding, ventures become more uncertain and require greater information capabilities to maintain or improve performance. Thus, better interaction through a wider variety of channels is needed when circumstances are uncertain.

Besides, organizations process information to alleviate uncertainty and to reduce ambiguity. Additional information is of little value when the problem itself cannot be adequately defined. Thus, ambiguous circumstances require creative solutions involving subjective judgement and intuition. Interaction between the venture capitalist and the entrepreneur stimulates such creativity. Therefore, effective interaction between the venture capitalist and the entrepreneur enhances the quality of decisions made under uncertain and ambiguous circumstances.

f) Identification Of Industry/Sectors:
The survey of different venture capital firms gave results that entering the venture capital business had been a strategic and planned decision rather than an ad-hoc decision. Since the above had been a strategic decision, the venture capital firms should conduct proper market research and thus, identify the industry/sectors that project maximum opportunities and thus, concentrate on some specific industries.

VCFs in India have not so far prioritised high tech thrust areas for venture financing. The prioritisation of thrust areas will lead to development of technology speciality and expertise by VCFs.
g) **Stage Specialisation for Venture Capitalist:**

The Indian venture capital market is still in the nascent stage and as the market matures, the venture capitalists should look forward to develop expertise to make investments in specific stages of projects. Thus, this would help in giving proper co-ordination at each stage and also the initial seed stage venture capital investor may offload the share to venture capitalist who specialises in expansion stage. The above would help in exit and entrance routes and in the process, units also get benefited from venture capitalists’ expertise in respective areas of operation.

h) **Venture Capital as Intermediary:**

The venture capital process involves three parties i.e. Investors, Investees and the Venture Capitalist. Among these three, venture capitalist is the common link between all the three. Hence it is very important for the venture capitalist to effectively co-ordinate and monitor the money invested by the investors. Venture capitalists, therefore, should broaden their arena of functioning and perform the role of complementation at every stage and not only that of evaluator in later or initiator in the early stages.

i) **Venture capitalists role in innovative ventures:**

a) **Marketing Innovation:** Ventures that seek high levels of marketing innovation are likely to face uncertain circumstances. Whether marketing innovativeness is a response to rapidly changing market conditions or is a proactive thrust aimed at carving out a new niche, ventures attempting such innovations must process a great deal of customer, channel and competitor information. Under these conditions, the entrepreneur and the venture capitalist need to share information more openly and frequently. Further, given the pervasive belief that
entrepreneurs often pay too little attention to market development strategies, entrepreneurs who emphasize marketing are likely to meet with the wholehearted approval of the venture capitalist. On the other hand, those who make no attempt to seek innovative approaches to marketing problems may find themselves at odds with their venture capital investors. Thus, greater marketing innovativeness should be associated with greater openness in VC-Investees.

b) Technological Innovation: Relationship between openness and technological innovativeness depends upon the venture’s stage, with openness negatively related to technological innovativeness in early stage ventures and positively related in late stage ventures. Therefore, higher levels of technological innovativeness in high potential ventures are linked to greater conflict in VC-Investees relations and to less openness for early stage ventures. This is also important as increasing amounts of venture capital are being poured into high technology ventures and thus, effective communication is often crucial to the realization of technological advances. Thus, venture capitalists and entrepreneurs should be aware that high level of emphasis on technological innovativeness in early stages of venture is apt to result in conflict but overtime the perspectives of venture capitalists and entrepreneurs are likely to converge.

j) Research and Development Focus:
The focus of the venture capitalist should be on catalysing creation of commercial technologies in an environment that has a limited supply of new technologies. Since neither invention nor entrepreneurship is random, to reach the stage where the venture capital leads to spawning large and successful hi-tech businesses, it is imperative that an appropriate environment should be created having strong R&D focus.
k) Establishment of Venture Capital cells:

Venture capital cells should be established in research laboratories like ISRO. These cells should be managed, apart from the scientist and technologists, by experts from VCFs. The main advantage of such set up would be in form of management consultancy and on-line financial help that these institutions would be able to render to the emerging in-house entrepreneurs or outsiders. There are examples of scientists and engineers in research laboratories who developed new processes/products, and arranged funds and other resources to set up enterprises to commercially exploit such products/processes. Thus, scientists/engineers working in research organizations should not only be encouraged to become entrepreneurs but should also be provided with financial and other assistance.

l) Dos and Don’ts for SME's in management of venture capital funds:

The most important criteria considered by the VCFs for the evaluation of the proposed venture includes characteristics of the entrepreneur; characteristic of the product; characteristic of the market; financial considerations, characteristics of the venture management team and subsequently, sub factors in each of them.

The entrepreneur should understand that in all of the four stages in a new venture- start up, development, market engagement and rapid expansion—the value proposition for the customer is the key to success and thus, differentiation should be maintained right from the beginning.

While scouting for venture capital finance, it is important for entrepreneurs to realise that for a venture capitalist, it is better to invest in a good team with a bad business plan as the latter can be changed. In most cases, Indian entrepreneurs start with a business plan but there is very
little communication of the business opportunity. Therefore, to attract the attention of any venture capitalist, a compelling business plan must have management track record, clearly defined business opportunity and realistic financial projections.

Besides, during the product development phase, it is important to keep the core development team small. In the market expansion phase, entrepreneurs have to target early adopters. Since all these businesses are marked by intense competition, rapid expansion is the key to success and the business has to be scaled up before anyone else does. Thus, it is very important to keep a long term profitability roadmap and category leadership. Also, for building a sustaining enterprise, it is important to strengthen management team by bringing in experienced people. A successful start-up is generally very team oriented, but as the venture grows, in most cases core team breaks up and therefore, it is very important to pass on vision to employees.

m) Business focus:

In India, it is fashionable to diversify. But to make a mark any technology based start-up has to stay focussed. Entrepreneur should understand that he needs to expand only in related domain and that too through partnerships. Thus, the focus should not be on profit but on having a market size.

Besides, Indians tend to become emotionally attached to their companies and don’t pay any attention to exit routes. The whole game of high technology business is how fast one can capture the market. Therefore, one should always keep one’s ears and eyes open about strategic relationships. Also, aspiring entrepreneurs should see that conceptualising and starting a company is totally different from managing its growth. Hence, if the promoter does not grow with the company, at times he might become the biggest bottleneck in the success of any venture.
n) **Setting of Business Incubators:**

The concept of business incubators akin to those existing in the US may be attempted in India. These incubators are organizations that support and finance small business start-ups and expansions by providing inexpensive administrative services, management and marketing assistance and facilities like business library apart from professional services such as loan packaging, financial planning, legal assistance, and so on. In general, everything that contributes to reduction of the firm’s cost of operation during the initial stages of the life cycle comes under the purview of their activities.

o) **Focus on Entrepreneurial development:**

Though it is stated, the objective of VCFs is development of high technology, in which they are aiming at making Indian industry globally competitive, the need is that VCFs should adopt a broader approach in financing and supporting novel ideas of entrepreneurs which may not necessarily be high-tech in nature.

p) **Focus on units requiring Seed capital and Sick units:**

There has been a shift from VCFs financing firms requiring seed capital to expansion financing. Instead, VCFs should build up infrastructure facilities, advisory and training services, managerial and marketing support for new players in the market. The scope of the VCFs should be broadened to include development of sectors like tourism and health-care.

q) **Linkages between Research and Development institutions and industry:**

To ensure that VCFs play an effective role in technological development, they should provide an institutionalised linkage between educational institutions and industry, and between
Research and Development institutions and industry. A lot of useful research that is carried out in national laboratories is not commercially exploited as they lack managerial and marketing expertise and do not have the finances and hence, technology developed by them remains unutilised. Industry is not aware of the research done or technology developed by educational and R&D institutions. In some areas, the technology developed is not what the industry needs, or what is useful to the country. Thus, there is gap between educational and R&D institutions on the one hand, and industry on the other. VCFs can institutionalise the coordination between educational and R&D institutions and industry and provide financial support and assume risk. They should spot out entrepreneurs, spot technology and support it.

**DIRECTIONS FOR FUTURE RESEARCH:**

Research on venture capital is in its infancy. The problems encountered are not simple. Realistic treatment of the issues in venture capital research will require innovative approaches. The above research has been a small effort in this direction. Further, empirical research on venture capital was virtually non-existent before the decade of the 1990s. it is not easy to do so, mainly because of lack of data, but some good examples do now exist, and unanswered questions are available in abundance.

1. **Angels and Venture Capitalist:**

Angel investing is a process in which a wealthy person or group places funds in a venture without taking on the consulting role of venture capitalists. How successful is angel investing? Why do angel investors choose to bypass venture capital and invest directly? What motivates an entrepreneur to seek angel funds rather than venture capital? How do their rates of return compare to those attainable through investment in venture capital funds?
In many parts of the developing world, venture capital is virtually non-existent; raising funds for new ventures from private groups or family members is common. The so-called informal capital markets are often more important than the formal markets, especially early in the life of a market economy. The importance of the informal venture capital market arises, first, from the nature of the investments made by the business angels and, second, from the overall size of the market. Thus, in a developing economy like India where venture capital industry is still in its nascent stage the process of informal market can provide great insights in giving boost to the new and innovative ventures.

2. **Investee’s Perspective:**

The above study has only been carried out in perspective of the venture capitalist and the views of investee company have not been taken into consideration. Future research can be carried out so as to gain an insight into their viewpoints. To what extent control by the venture capitalist firm is acceptable to them? What is their perception about the different roles played by the venture capitalist? Do they believe that venture capitalist firms add value to their venture by providing expertise and skills other than financial in nature? Do they consider them as their strategic partner or still believe them to be providers of only capital?

All the above factors when considered would be able to present a better picture of the venture capital management scenario and thus, help in devising better strategies for management of the venture capital funds.

3. **Do Venture Capitalists add value within the portfolio firm?**

While the above research examines the role of the venture capitalist as an intermediary, a related issue that has not been resolved is whether or not venture capitalists add value within a
portfolio firm. IPOs with venture backing are often younger and less developed than are IPOs without venture backing but it is still unknown if the firms are more successful. Do companies perform better when venture capital is present than when it is absent, all else equal. This question ultimately suggests another: “Is more value created when venture capital is present than when it is absent?” Evidence based upon the price-earnings multiple of venture backed IPOs is not adequate to address this issue since the PE multiples could be a result of reputation and signalling effects rather than improved performance per se.

4. **Strategies for management of funds across different Sectors/Industries:**
The above-recommended strategies are basically generalised strategies for the management of the venture capital funds but do not take into consideration the fact that funds across different industries behave differently due to the effect of other factors present. Does the evaluation criteria remains same across all industries or it differs across high technology or low technology oriented industries? What are the differences between pre-investment strategies or post investment monitoring across different sectors? How do challenges posed to venture capital industry in general affects different sectors funding specifically?

Thus, for proper management of venture capital funds, it becomes imperative to study the different factors affecting funding of varied sectors and how do they in counter affect the management of venture capital funds.

5. **Exit strategies and value maximizations:**
Venture capitalists may exit an investment in a number of ways. The most common avenues for exiting a successful venture are via an IPO or merger. In other cases, exit may occur through liquidation or share repurchase. It appears that exit via IPO is the most profitable
form, although that does not mean that investments that are harvested via merger would have been better served by an IPO. What aspects of ventures themselves or the market environment characterize the decision to exit by way of an IPO rather than by a merger? Presumably venture capitalists and entrepreneurs make value-maximizing exit decisions at the time they are made, but what factors influence this decision? Are merged companies essentially not good candidates for an IPO? Do mergers occur earlier or later in a company’s development than would an IPO? Are there characteristics of the product market that dictate the IPO-versus-merger decision?

Thus further research needs to be carried out in light of the above-mentioned factors so as to manage venture capital firms in a better way.

6. Alternative Organizational Forms and Venture Capital Performance:

There are various types of venture capital organizations. Therefore, agency conflicts and their solution in one kind of venture capital firm do not apply fully to other forms. Because venture capitalists operating within different organizational forms differ in their relationships with their principal investors, their behaviour may be expected to be different. Their contracting technology may differ, the consulting role they play within a portfolio firm may differ, they may follow different investment strategies and they may exhibit differences in performances. Therefore, further research can be carried out so as to study the differences in different kind of firms and thus, to check how organizational form is associated with performance.