CHAPTER – ONE

THE OVERTURE

- The Problem
- Recapitulation of Existing Literature
- The Conceptual Framework
- The Focus of Study
- The Objectives of the Study
- The limitations of the Study
- The Utility of the Study
- The Organisation of the Study
The present chapter highlights the problem of the study. The study recognizes the problem of lack of availability of risk capital for financing new and untried ideas capable of making into the market, as main obstacle in acceleration of growth of Indian economy and poor ranking of India as compared to other countries. An attempt has also been made in the present chapter to identify the significance of venture capital in India witnessing the IT boom in the country. “Recapitulation of Existing Literature” presents an overview of the studies conducted in this regard, both Indian and abroad. Focus of the study, objectives and further utility of the study and limitations and organization of the study, further, adds to the aesthetic value of the present chapter.
THE PROBLEM

The proposed research work studies Venture Capital as a catalyst in the growth of Indian Economy. Through an empirical survey of existing literature and experiences of venture capital investors and investee companies, it seeks to analyse the recent phenomenon of Indian venture capital as an organized industry in relation to the pace and extent of growth of Indian economy in the post independence era. It examines Indian venture capital industry in the present global context of developed and developing countries such as the UK, the US, Japan, China, Israel, Korea and few other countries in Europe and Asia. The study aims at analysing and subsequently suggesting ways of developing venture capital market in India.

Even after more than 50 years of independence, the growth of Indian economy has not taken the desired shape. The economy architects first focussed on the agricultural development and then the industrial development. The development of other nations, who also got independence in the same period, is in a much comfortable state. The global competitive reports (published by World Economic Forum and the World Competitive Yearbook, 1999) indicate a very poor ranking of Indian competitiveness. A comparison of competitive rankings of few developed countries since 1993 as indicated in Exhibit 1.1, Exhibit 1.2 and Exhibit 1.3, with those of some of the major Asian economies including India shows that throughout 1993-99, USA continued to top the list, followed by Singapore and Hong Kong. Perhaps reflecting the impact of Asian financial crisis, Hong Kong, of late, seems to be drifting away. Similarly, Japan was rated as a highly competitive economy at the beginning of the decade. It’s ranking since then has declined as the decade progressed and reached as low as 18 in 1998 and then recovered to 16 in 1999. Almost similar is the trend in the case of Germany, France, and UK where there has not been a stable and consistent
performance during the period. On the other hand, Taiwan and Malaysia had rather excellent positions in the beginning of the decade. Their performance, however, deteriorated over time. Taiwan has managed to stay well above the average position throughout except in 1997. Although hit by the Asian financial crisis, Malaysia was only marginally below the world average in 1999. Similarly, Thailand and Korea started rather satisfactorily but went down to reach well below the average position in 1998 and 1999. Indonesia has been in the bottom quartile throughout the period. In fact, it fell to the last but one rank (next only to Russia) in 1999. While broadly reflecting a similar trend over time, these countries were ranked much higher by GCR (1999) with Taiwan occupying the 4th position in 1999, while Malaysia was the 16th.

Exhibit 1.1

Ranks obtained by India, China, Malaysia and Indonesia in select variables

<table>
<thead>
<tr>
<th>Criteria</th>
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Source: WCY: World Competitive Year Book, Various Years
### Exhibit 1.2

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<td>Philippines</td>
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<td>6.5</td>
<td>3.7</td>
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<td>9.7 25.6 4.8</td>
<td>47.4 3.8</td>
<td>4.0</td>
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</tr>
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<td>Jordan</td>
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<td>18.1 4.4</td>
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<td>14.5 10.0 0.4</td>
<td>10.1 1.5</td>
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</tbody>
</table>

- a. Baseline projection assumes that all countries maintain the natural and policy conditions recorded in 1995.
- b. East Asian Standard projection assumes that all countries adopt the same policies as East Asia in 1995.
- c. Inward policies assume openness changes from 1 to 0.5, and that central government saving declines 5% points.

Note: 1995 per person GDP levels are based on 1992 values from Summers and Heston (1994), extrapolated forward with growth rates from IMF(1996).

Source: WCY: World Competitiveness Yearbook, 1999
Both India and China were well below the world average to start with, India's position being lower than China's by 4 points in 1994 (as per exhibit 1.3). While China went on rapidly improving its ranking to reach the middle position in 1998, India, despite some improvements during the mid nineties, deteriorated to reach as low as 41st position in 1998. China's rank fell to 29 in 1999, while India's improved, albeit by only two points. Political instability, coupled with the failure to maintain the economic reforms momentum seems to have accounted for India's inability to wrest competitive advantage from the rest of the world despite having recorded impressive rate of economic growth in 1996 and again in 1997 and 1998.

**Exhibit – 1.3**

**Competitive Rankings of various countries**

<table>
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<tr>
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<td>3.</td>
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<td>5.</td>
<td>Canada</td>
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<td>Switzerland</td>
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<td>4</td>
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<td>9.</td>
<td>Australia</td>
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<td>Japan</td>
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India's weaknesses as reflected above in competitiveness extend to a wide range of variables relating to all the factors representing the economic, cultural, social and infrastructural elements.

The GDP of China in 1997 was $825 billion, which was more than twice that of India's and has been achieved through a sustained growth of more than 7 per cent per annum since last two decades. Exhibit 1.4 presents a birds eye view of comparative VC investment of various countries as percentage of Gross Domestic Product. While talking of Annual GDP growth per person, India with an average growth rate of 2 per cent lags behind Korea, Singapore, Malaysia and Sri Lanka (Exhibit 1.5). India has a stock exchange which is 100 years old, lagging behind China which until very recently had no stock exchange of its own. In the wake of issues like "improper practices by corporate boards", shareholder value in India has yet to reach the position achieved by China and Malaysia. In the area of expertise, India had a reasonable expert growth performance of 11.1 per cent in 80's against 12.2 per cent of Pakistan and 18.5 per cent of Sri Lanka. Share of high technology exports at 10 per cent stood out as an exception as compared to the rest of South Asia. Even after initiation of economic reforms, by all accounts, these programmes in India are far from being complete. First, the fiscal deficit still continues to be high by international norms. It is because of 80 per cent of the financial savings that are being absorbed by the public sector, including Government. This high fiscal deficit can still generate pressures on real interest rate. The above, thus, points for immediate reduction in fiscal deficit. The tax structure in India still remains highly complicated with high rate of taxation in regard to both direct and indirect taxes. In the area of direct taxation, while the personal income tax is now
broadly in line with that elsewhere in the world, corporate taxes are still high. There has not been any significant progress towards VAT as state government is continuing to levy sales tax, which is not uniform. Likewise import duties are still high and need to be brought down considerably.

Exhibit – 1.4

Comparative VC Investment of various countries as percentage of Gross Domestic Product

<table>
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<th>per cent of Gross Domestic Investment</th>
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<td>Hong Kong</td>
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<tr>
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Source: WCY World Competitiveness Yearbook, 1999
### Exhibit - 1.5

**Growth in the Global Economy, 1965-90**

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<th>Region/Economy</th>
<th>Average annual GDP growth per person (PPP adjusted)</th>
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<td>Singapore</td>
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<td>Taipei, China</td>
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<td>2.3</td>
</tr>
<tr>
<td>OECD</td>
<td>2.7</td>
</tr>
<tr>
<td>Middle East</td>
<td>2.5</td>
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<tr>
<td>Sub-Saharan Africa</td>
<td>0.7</td>
</tr>
<tr>
<td>Latin America</td>
<td>0.8</td>
</tr>
</tbody>
</table>

*Source: WCY World Competitiveness Yearbook, 1999*

OECD = Organization for Economic Co-operation and Development

PPP = Purchasing power parity

Foreign Investment regime in India is also highly restricted. Foreign ownership that exceeds 51 per cent equity still requires a long procedure of government approvals. Government's approach to such approvals is not only non-transparent but also arbitrary in some cases. Although vastly improved from what it used to be in late eighties and early nineties, India's ability to attract foreign direct investment is nowhere near to even Indonesia's. This is also despite India's risk-being lower than that of Malaysia, Thailand, Indonesia and Philippines.
## Exhibit – 1.6

### India's Micro Economic Advantages and Disadvantages Relative to Income Level

<table>
<thead>
<tr>
<th>Competitive Advantages</th>
<th>Competitive Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Strategy</td>
<td>Extent of regional sales</td>
</tr>
<tr>
<td>Marketing expertise</td>
<td>Attention to staff training</td>
</tr>
<tr>
<td>Breadth of international markets</td>
<td>Professionalism of senior management recruitment</td>
</tr>
<tr>
<td>Value chain presence</td>
<td></td>
</tr>
<tr>
<td>National Business Environment</td>
<td>Negotiation of cross-border ventures</td>
</tr>
<tr>
<td>Domestic supplier quantity</td>
<td>International direct dial communications</td>
</tr>
<tr>
<td>Adequacy of private sector</td>
<td>Costs of Road, Infrastructure and quality</td>
</tr>
<tr>
<td>Legal resources</td>
<td></td>
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<tr>
<td>Stock market access</td>
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</tr>
</tbody>
</table>

For almost five decades, the small sector in India has been heavily protected through reservation of over 800 product lines. The continuation of such a policy stifles large-scale industrial expansion, especially in those technologies that are viable only if economies of size are guaranteed. Signals towards dereservation have already been given while some product lines from the food-processing sector were liberated from the reserved list in 1997. India's approach to industrialisation through small-scale units is guided more by idealism than by techno-economic realities. Speedy de-reservation of the listed product lines would be a progressive step towards faster and healthy industrialization of the country.
While significant progress has been achieved in regard to opening up of infrastructure to the private sector, full results are yet to come forth. The state governments are unable to settle infrastructure projects with foreign investors, since approvals are required from the Central Government. New legal regimes at the federal level that give state governments greater autonomy to attract foreign direct investment are urgently required for the speedy development of roads, power and other infrastructure sectors in the country.

Although much talked about, effective public sector reform is yet to start in India. "There is no doubt that more than half of the public enterprises of the centre and the states taken together, cast a very heavy burden on the economy. There are large numbers of loss making unliveable public enterprises. Even among public enterprises that are making profits, many are inefficiently run, are overstaffed and are subject to political interference and patronage". The government monopolies in banking, insurance and infrastructure sectors need to be abolished and loss-making state-owned enterprises need to be closed or privatised. It is important that the disinvestment proceeds are not diverted to cover the revenue deficit, they should be used to retire high cost public debts. These funds may also be used to support voluntary retirement schemes of employees of public sector units including the managerial staff, which suffers from acute over-employment.

Rural areas need a better deal. There should be a reliable supply of infrastructure services (roads, water, power, and basic telecom) at commercial prices rather than unreliable and grossly inadequate arrangements given free of charge or at highly subsidised rates. Both sound economic sense and past experience indicate that unless charges are levied on realistic basis, it would not be possible to deliver these essential services satisfactorily. Thus, a nation's competitive advantage is
Venture Capital is more than just providing money. The interaction of the management team and the involved venture capitalist can have a critical impact on its success. Venture Capitalists help the promoter in various ways to nurture the companies, as they are aware of how to attract the brightest and best people, how to foster a climate that enables them to be creative and how to motivate them with a meaningful share of the ownership. In short, the best venture capitalists know how to add value beyond money to their portfolio companies and that is possible only when both suppliers and users of capital work as partners. Specifically, venture capitalists help their investee companies in providing a network, recruiting key management and building a team, developing financial systems, advising on company law and other legal matters, helping for co-investment and arranging for working capital facilities from bankers, providing marketing links and contacts, sharing the business perspective, helping in long term strategic thinking and planning, helping to create an entrepreneurial climate and devising incentive systems to promote team work, involving for the longer period and, providing support and confidence during bad times.

For effective value addition, the involvement of venture capitalists starts from the very early stages of business. However, their roles become increasingly important as the venture develops. For their value addition to be effective, openness, trust and mutual respect between the two partners are necessary. If a peer relationship can be established, the value-added synergy can be a powerful stimulant for success. At the time of negotiating the investment, relationship is adversarial; but when business is being built relationship should be supportive. If either party suspects, such a relationship cannot be perfected, it should be abandoned and thus, complete
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angel investors who will provide the venture with not just funds, but also with strategic management support. Furthermore, the venture creation process will succeed only if it generates high quality ideas that receive the support of investors and management.

India becomes a centre of excellence in selected areas. Most countries have created clusters of ventures around their areas of competence. Clustering allows the sharing of valuable insights across ventures. It increases returns to scale through the growing concentration of suppliers and customers, stimulates the creation of supporting infrastructure such as day care center schools, recreation centers and provides concentrated expertise in support services such as financing, legal advice, and real estate. India should aim to create clusters around segments such as wrapper products, e-businesses and asynchronous IT-enabled services. However, it will first need to improve its venture creation process by ensuring a stream of innovative ideas, supporting start-ups, catalyzing venture growth and camp-ups and strengthening exit options so that innovators can benefit from their success. The above can be achieved by emulating the success of Israel and other countries.

The above information provides some clarity and helps in building up a symbiotic relationship between information technology and venture capital industry like elsewhere in the world. If Indian economy has to take lead in the 21st Century by creating dynamic new industries, attitudes and policies must be changed. The characteristics needed to be fostered are: a culture that prizes entrepreneurs, a population second to none in education, and a government that genuinely supports new technology initiatives and fosters entrepreneurship with enlightened policies.
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Innovative entrepreneurship is India's best chance of realizing national competitive advantage in the 21st Century and Venture Capital is a vital element of the entrepreneurship equation. Technology and knowledge-based ideas will be the growth drivers in the global economy in 21st Century. India's recent success story in the area of information technology has shown that there is tremendous potential for the growth of knowledge-based industries. It is unlikely that a country such as India can successfully exploit its core competence in the area of Information Technology without a strong local venture capital community. Hence, Venture Capital is an important ingredient in the transition to a knowledge-based economy. This potential is not only confined to information technology, but is equally relevant in several areas such as bio-technology, pharmaceuticals, media and entertainment, agriculture and food processing, telecommunication and other services. Given the inherent strength by way of its human capital, technical skills, cost competitive manpower, research and entrepreneurship, India can unleash a resolution of wealth creation leading to employment generation and rapid economic growth. What is needed is risk finance and venture capital environment that can leverage innovation, promote technology and harness knowledge-based ideas.

Thus, scientific, technology and knowledge-based ideas properly supported by venture capital can be propelled into a powerful engine of economic growth and wealth creation in a sustainable manner.
RECAPITUALISATION OF EXISTING LITERATURE

The present study indeed is not the first study on the venture capital. Various efforts have been made earlier in this context. In this section, an attempt has been made to recapitulate the existing literature with a view of formulating the problem, identifying the important financial and non-financial parameters influencing management of venture company funds and consequently, focusing to set meaningful objectives of the proposed research.

Huntsman and Hoban\(^1\) (1980) in their study examined 110 investments by three venture capital firms over the period 1960-1975. They showed that venture capital returns depend on outliers. While the average return over the period was 18.9 per cent; eliminating the top 10 per cent of investments resulted in an average return of \(-0.28\) per cent. In other words, venture capital success is highly dependent on finding a few outstanding investments, and diversification is vital. They provide no formal tests of the superiority or inferiority of their returns with respect to a formal model of returns.

A comparison between publicly traded funds and mutual funds has been acknowledged by Martin and Petty\(^2\) (1983). They found that the venture capital funds were riskier on average than their mutual fund counterparts but that they were not dominated on account of exhibiting higher returns on average.

Tyebjee and Bruno\(^3\) (1984) suggested a venture capital investment process model. They considered a investment activity of any venture capitalist as a sequential process involving five steps: deal origination, screening, evaluation, deal structuring and post-investment activities.
Tyebjee and Bruno\(^4\) (1984) also investigated the factors that influence the investment evaluation of venture capital funds in the United States. The deals that formed the basis of their study had been initially screened in accordance with their expected return and risk and on 23 criteria by using a four-point scale (from low=1 to very high=4). The authors clustered the evaluation factors into five categories: market attractiveness, product differentiation, managerial capabilities, environment threat resistance and cash-out potential. In their conclusions they declared that the perceived risk was influenced by the managerial capabilities and the resistance to environmental threat, while the expected return was strongly influenced by the market attractiveness, followed by a highly differentiated product whereas cash-out potential was observed as not having any impact on the perceived risk and the expected return of a venture.

In another study administered by Macmillan, Siegal and Narasimha\(^5\) (1985), he identified 27 criteria grouped into six categories: entrepreneur’s personality, entrepreneur’s experience, product characteristics, market characteristics, financial considerations and composition of the venture team for the venture investment evaluation. His analysis revealed that out of ten criteria most frequently rated as essential, six were related to the entrepreneur’s personality and experience. The author analyzed the criteria and obtained six categories pertaining to risk: competitive risk, bailout risk, investment risk, management risk, implementation risk and leadership risk. In a subsequent study, he found two most consistent criteria: competitive threat arising from the present or anticipated competition during the first two years of operations and demonstrated market acceptance of the product.
In confirmation to the contributions made by the above-mentioned conventional thinkers, Goslin and Barge (1986) enunciated in their study that in the venture capital funds assessment of a venture investment, the quality of management was a critical factor, as the entrepreneur constitutes and leads the management team.

Fried and Hisrich (1988) examined the activities of venture capitalists in the United States, particularly their investment decision-making process. They suggested a six-stage model of the investment decision making process, starting with the investment proposal origination, the venture capital firm-specific screening, generic screening, first-phase evaluation, second-phase evaluation and closing (including deal structuring and negotiation).

An analysis of performance of publicly traded venture capital firms has been carried out by Brophy and Gunther (1988). They constructed a portfolio of such funds and found that, although the individual funds had high total risk, their systematic risk was low, and so a portfolio of such funds had low risk. On a return versus total risk basis, they emphasised that the portfolio of venture capital funds dominated mutual funds with maximum growth goals.

Chiampou and Kallet (1989) in their study examined private venture capital funds, breaking them into two groups. One group consisted of funds more than six years old and the other group contained the newer funds. They found that the investment returns of the thirty-five mature funds over the period 1978-87 averaged 24.4 per cent per annum against a standard deviation of returns of 51.2 per cent. The younger firms performed much more poorly, averaging only 5.4 per cent over their shorter lives. However, the results for the younger funds probably reflect two biases in
the sample. First, venture capital returns for the broad sample were lower in the middle years of the 1980s than in the earlier part of the sample, and the newer firms returns heavily reflected that period. Second, it is difficult to measure the value of relatively recent investments since their values are unlikely to have been realized through merger or public offering or other events. Their values will often be reflected at cost rather than at market value. The older firms will have more investments whose values have been marked to market.

Gorman and Sahlman\textsuperscript{10} (1989) came up with a research work focused on post-investment activities of venture capitalists. They established that venture capitalists spent roughly half of their time monitoring an average of nine portfolio companies. They spend an average of 110 hours per year working with each portfolio firm, and their most frequent activity is assisting the firm in raising additional funds. Typical respondents said that they had replaced three chief executive officers in portfolio companies during their careers as venture capitalists. This finding is consistent with the broad view that key activities of venture capitalists are identifying and recruiting members to the management team of portfolio companies. Those same venture capitalists identified weak management as the dominant cause of failure among their portfolio companies, so it is natural that considerable emphasis would be placed on management capabilities.

Taylor, L.’s\textsuperscript{11} (1989) study of United States venture capital industry comes out, that in the United States, commencing in the 1950s, prosperity, congressionally legislated investment incentives, and the evaluation of high technology enterprises fastened the formation and development of venture capital companies. The 1978 enactment of capital gains, income tax rates and the
emergence of an exuberant group of venture capital managers created a growth industry venture
capital search, investment and development.

Eldridge, D. and Wood, JR.\(^{12}\) (1990) in his report, identified various external factors, which affect
the prospering of Venture Capital Subsidiary in the short term, as Fiscal regime, increasing ability
in the investing public to rely on financial statements, the growing or existing stock market as
economic policy matter are best addressed by the government. He suggested the government to
pay attention to financial gains tax, financial statement reliability, improving/tightening the
regulatory framework and a growing stock market as measures for attracting DFI in the country.

Cottrell, R. L.\(^{13}\) (1990) in his article stressed that India cannot hope to develop a private sector
venture capital industry in isolation from the evaluation of wider, liberated markets for equity
investment. There are many widely held misconceptions about the scope and nature of venture
capital as it has so successfully developed in the west. It was successful because favourable
conditions for risk capital investment in general have been created on account of large private
pools of investible funds and the scope to spread risks across a wide range of opportunities. Indian
attempts to create a private sector venture capital capability 'within a vaccum' have limited chance
of success. Only as part of the development of more far reaching policies could it evolve.

In Sahlman's\(^{14}\) (1990) study of investor-investee relationships, a myriad of agency conflicts in
venture capital have been explained. He visualized why conflicts exist, and discussed the
mechanisms to deal with the same. There are conflicts between the investors and the venture
capitalists as well as conflicts between managers of portfolio firms and venture capitalists. He
demonstrates that there is a similarity in the mechanisms for addressing such conflicts, and relates agency costs in a venture capital context to agency issues in other settings. One feature of contracts between entrepreneurs and venture capitalists is that venture capitalists receive a payoff that is typically tied to performance in several ways. First, venture capitalists will have an equity interest (perhaps the dominant equity interest) and will benefit from value creation. Further, it is common that the degree of dilution of venture capitalists' ownership interests is tied directly to performance, so that they receive a larger fraction of a more successful venture. Entrepreneurs commonly receive a relatively modest salary so that their success is tied to the success of the venture. It is also common for venture capitalists to retain sufficient control to be able to fire or demote an ineffective manager. The manager would typically suffer some loss of equity interest in such an event in addition to suffering a loss in the value of human capital:

In confirmation to earlier studies, Megginson and Weiss\textsuperscript{15} (1991) acknowledged the importance of reputation and certification role of a venture capitalist for the success or otherwise of initial public offerings. Their findings are consistent with a recognized role for the venture capitalists as monitors. They used a matched sample of initial public offerings with and without venture backing. They found significantly less under pricing in those issues with venture capital banking, which is similar to other studies, emphasizing that the quality of the underwriter or auditor can influence initial public offerings pricing.

Ray, D. M. and Turpin, D. V.\textsuperscript{16} (1991) in their study explain that in the early 1970s Japan experienced the emergence of a new generation of entrepreneurs as well as the use of a new type of small high-technology business engaged in the development and application of innovative
products and technologies, such as microelectronics, software, industrial robots, precision machinery, office and medical equipment. These companies came to be known as becha bijinesu “Venture Business”. Comparing the market sentiments of Americans and Japanese, he laid down that Venture Capital may be more plentiful in the United States but it may be less accessible because the US venture capitalists have more stringent and more extensive criteria for evaluating a prospective investment. In contrast, the Japanese venture capitalists do not seem to have so many essential requirements and are less likely to view prospective clients in terms of what Macmillan and associates call “Fatal Flaws”. Furthermore, the Japanese venture capitalists use a wide range of information resources and specialists in evaluating prospective deals.

Sagari and Guidotti\(^\text{17}\) (1991) have listed four exit routes available with the venture capitalists as initial public offerings, acquisition by another company, repurchase of the venture capitalist’s shares by the investee company and secondary purchase of venture investor’s shares by a third party.

In a study geared to the comparison between Japanese and US venture capital industry, Hurry, D., Miller, A. T. and Bowman, E. H.\(^\text{18}\) (1992) disclosed the strategic logic of Japanese high technology venture capital, the existence of an implicit call option, or ‘Shadow option’, or new technology. This option is exercised by further investment in product development, manufacturing and distribution. The process is described with reference to a comparative study of Japanese and United States venture capital firms. Similarities and differences between the two groups are reported and a conceptual model of Japanese Option strategy is formulated. Their implications provide understanding of Japanese strategy.
Ray and Turpin's\(^{19}\) (1993) empirical study was a landmark in analyzing the investment evaluation criteria used by venture capital funds, respectively, in Singapore and Japan. In both Singapore and Japan, the entrepreneur's personality and experience were found to be the most important aspects of evaluation, and financial considerations as the least important in venture investment evaluation. The top six factors included: managerial capability, market attractiveness, superiority of product and technology, financing ability, availability of raw materials and production capability. The authors also found that financing ability was emphasized more than production capability and superiority and technology at the time of the current evaluation of a deal. Two reasons were attributed for the focus on financing ability: conservatism on the part of the venture capitalists and their lack of technical background to fully evaluate the product and technology contents of the ventures.

The study organized by Helman\(^{20}\) (1993) with an initiative to study the inclination of venture capitalists towards short-term performance objectives, signified that an unintended consequence of this focus could be one of myopia, i.e., the entrepreneur could lose sight of the big picture by focusing too narrowly on meeting short-term performance objectives that are essential as intermediate steps towards a long term goal.

Gompers\(^{21}\) (1993) in his study further develops the notion of staging and shows how it can deal with agency costs and create a strategic option. Gompers provides empirical evidence on staging from a database of 2145 rounds of venture capital financing for 795 firms. His findings state that early stage investments typically receive relatively small amounts of capital, that the rate of

\[ \text{rate} = 1.24 \]
capital consumption increases as a venture matures, and that greater industry sales growth is
associated with capital commitments of longer durations. Gompers measures the intensity of
monitoring by the length of the period between successive capital commitments since the decision
to continue or abandon a project is the ultimate measure of control.

In a study administered by Lerner22 (1994), he establishes that experienced venture capitalists can
time the initial public offerings market. In particular, Lerner demonstrates that venture capitalists
tend to bring their portfolio firms public at times when the market valuation of those firms is
particularly high, whereas privately financed firms tend to go public at times when market
valuations are lower. These results suggest that the venture capitalist provides a valuable service
in assisting the entrepreneur in timing the market. They also suggest that more experienced
venture capitalists have greater ability and greater incentives to time the market as compared to
their less experienced counterparts.

Admati and Pfleiderer23 (1994) have focused on the investment and continuation decisions when
capital is provided in stages. They identified the main problem as the over-investment problem i.e.
an entrepreneur who can attract outside funds may continue to invest in the project even when it is
no longer valuable based on the entrepreneur’s inside information. Even if the information would
show that a project has a negative net present value, as long as it has some probability of being
successful, the entrepreneur’s option, like position suggests, is to continue as long as others will
provide the financing. In principle, an external investor, such as a venture capitalist, can enter the
picture, invest, monitor, and become equally informed. However, having become an insider, the
venture capitalists may suffer the same problem as the entrepreneur: Having invested and having

1.25
learned that a project is not favourable, but has a probability of success, the venture capitalist may have an incentive to attract new outside funds as well. Thus neither entrepreneurs nor venture capitalists can be assumed to provide unbiased views concerning the prospects of the investment. How can the issue be resolved? The authors demonstrate that a contract in which venture capitalists continue to maintain the same fraction of equity in subsequent financing rounds as they had in the earlier round will resolve the conflict. This solution neutralizes the venture capitalist's incentive to mislead. They also show that their contract is robust in the sense that minor changes in the set of possible outcomes will not render the contract sub-optimal.

Fried, V. H. and Hisrich, R. D. (1994) directed their research efforts towards developing a model of the venture capital investment decision-making process. They identified a generic criteria that venture capitalists used a six stage process model that proposed origination, venture capital firm-specific screen, generic screen, first phase evaluation, second phase evaluation and closing phase-evaluation. Different activities were identified in each stage. The authors opined that the venture capitalists provide both supply-side and demand-side benefits to the market.

Lerner, J.'s (1994) investigation about the rationales behind the syndication of Venture Capital investments was based on a sample of private biotechnology firms. Three rationales were identified in this regard. Experienced venture capitalists syndicate investments to both their peers and to less experienced capital providers. When experienced venture capitalists invest for the first time in later rounds, the firm is usually doing well. Syndication often insures that the ownership stake of the venture capitalists stays constant in later venture rounds.
Sachilit, W. K.'s (1994) empirical study set with an initiative to appraise the current situation brought out the fact that it is becoming tougher today to realize the traditional returns expected by venture capitalists. When Intel, currently a $5 billion company, was started in 1968, the initial investment was only $500,000 but returns were insignificant but in mid 1980s, Convex computer of Rochardsen Texas, a typical of Hi-Tech startup, by investing $21 million with no guarantee of success was fortunate to have gone public in 1986, despite high risk involved with such a venture. It was found that despite a very strong initial public offerings market, public offering brought some of the early investors only three times the original investment.

Fried and Hisrich's (1994) investigation of activities undertaken by venture capitalists revealed that on an average venture capitalists spend three weeks of full-time effort in evaluating and closing the deal and that nearly 100 days elapse during the process. They examined the investment decision-making process in order to identify the activities venture capitalists undertake to avoid the adverse selection problem. They argue that an intensive screening and evaluation process allows the venture capitalists to gather substantial amounts of information prior to investing and that this information reduces the adverse selection problem.

The study set about by Lerner (1994) to identify alternative ways in which venture capitalists reduce the adverse selection problem brings out that they tend to syndicate their investments, i.e., venture capitalists tend to invest with other venture capitalists. Lerner investigated more than six hundred rounds of investment in biotechnology firms. He found that syndication is common from the first investment round of investing; a fact that he argues is a part of the screening process. He
comments that venture capitalists are more comfortable with a deal when other venture capitalists of similar experience are willing to invest as well.

Gompers²⁹ (1994) conducted a survey with a view to analyze the pattern of returns in the venture capital industry, explaining why venture returns have fallen broadly since the early 1980s. He pointed out that returns were relatively high, generally greater than 20 per cent on an annual basis, in the first half of the 1980s. The early success of venture capital, a hot initial public offerings market, and financial deregulation attracted capital in record amounts from pension fund investment managers. The larger quantity of capital placed pressure on the industry to find deals, and so the valuation of venture capital deals tended to rise. Also, many relatively inexperienced venture capitalists entered the market. The increase of institutional investors in the market, according to him, put pressure on the venture capital funds to demonstrate earlier the investment results that would be reflected in the performance of the pension fund investment managers. This pressure tended to cause investment in relatively later-stage investments, which could be harvested more quickly but which, involving less risk, would be expected to produce lower average returns. The analysis of venture capital performance indicated that venture capitalists take on high risks that appear to be rewarded on average. Those risks tend to be unsystematic, so that portfolios constructed by investing in a variety of venture capital funds will have much lower risk than will investment in a single fund, he suggested. The evidence regarding the performance of those investments is mixed, so it remains to be seen whether venture capital is a superior form of investment, the author commented.
Gompers\textsuperscript{30} (1994) further established that relatively less experienced or less reputed venture capitalists have incentives to make a portfolio firm public prematurely. A related paper by Gifford investigates the same phenomenon from a theoretical perspective. He points out that one area of concern is the timing of a public offering. Instead of abandonment of a viable venture, however, the venture capitalists encourage a premature public offering in order to achieve the visibility associated with that offering and use that visibility in marketing the next limited partnership.

Since the value of the portfolio held by the venture capitalist is not normally updated to its current market value in the absence of transactions, an initial public offering may permit the venture capitalist to mark-to-market an investment that previously was carried at a lower book value. This opportunity may be especially pertinent if the venture capitalists market new funds to pension fund managers who are concerned with reporting their own investment performance. He suggests that venture capitalists without a substantial track record would be especially prone to premature offerings. His empirical results support these hypotheses. Relatively inexperienced venture capitalists tend to bring portfolio companies public earlier in the life of the firm than do established venture capitalists. They also tend to raise new funds sooner after an initial public offering than do more experienced venture capitalists. Finally, the initial public offerings tend to be more underpriced than are offerings by the more experienced venture capitalists. This finding also coincides with Lerner’s finding concerning the timing of initial public offerings: Venture capitalists with their own agendas may be less concerned about the optimization of timing viewed from a valuation perspective and may be concerned instead with timing as it affects the marketing of their own services. In addition to suggesting that the venture capitalists have incentives to offer bad advice to their entrepreneurs in the matter of initial public offerings timing, a premature initial public offering can also be harmful to the venture capitalist’s investors. That is, Gompers suggests
that the interests of investors in existing funds may be compromised by the desire to find investors
for an additional fund. That situation reflects a potential agency conflict with existing investors as
well as with entrepreneurs.

Gompers\textsuperscript{31} (1994) in another research attempt 'Grandstanding Analysis' gauged the effectiveness
of investor-investee relationships and he recognizes that the relationship between the venture
capitalist and entrepreneur is affected by the relationship between the venture capitalist and the
investors.

With a view of appraising the activities undertaken by venture capitalists with regard to over view
their portfolios, Lerner's\textsuperscript{32} (1995) empirical study is of great importance. He studied the
association between the venture capitalists degree of involvement and the need for monitoring. In
particular, he found that venture capitalist representation on boards of directors increased for
firms in which the CEO had no prior experience in running an entrepreneurial firm. He also
examined the impact of a change in CEO. He refers to CEO replacement as an instance of
"organizational crisis" and as an indication of a need for more intense monitoring. He found that,
on average, venture capital investors added 1.75 board members between financing rounds when
the CEO was replaced, versus an average increase of only 0.24 board members between rounds in
which the CEO was not replaced. Thus, the monitoring activities of venture capitalists appear to
intensify as the need dictates.

Gompers\textsuperscript{33} (1995) made an attempt to investigate the structure of staged venture capital
investments when agency and monitoring costs exist. He visualized that expected agency cost
increases as assets become less tangible, growth options increase and asset specificity rises. Venture capitalists concentrate investments in early stage and high technology companies where informational asymmetries are highest. Decrease in industry ratio of tangible assets to total assets, higher market to book ratios, and greater Rand D intentions lead to more frequent monitoring. Venture capitalists periodically gather information and maintain the option to discontinue funding projects with little probability of going public.

A study geared to the examination of development of venture capital activity in Korea as undertaken by Kim, S. G. (1995) evaluated the effect of inflation and high rates of interest on Korean economy. Technology financing by commercial banks was not forthcoming, as it did not provide any incentive for investment. Banks were reluctant to finance risky projects related to technology development and small enterprises. This type of tight money situation coupled with some contemporary economic factors has influenced the early development of Venture Capital in Korea. The Korean venture capital funds have been basically taking the United States as a benchmark, as that country has an excellent business environment for venture capitalists in terms of firms' technology level, availability of risk taking funds, ability of technology evaluation, and efficient stock markets such as NASDAQ. Fund availability, technological lend, market size and stock markets are still not sufficient for Venture Capital. The Korean venture capital funds, therefore, can only be considered an adhoc type of Venture Capital. New tech venture capital funds are managing their funds mainly in the form of loan, rather than investment and start-up business.
Fried, V. H. and Hisrich, R. D. (1995) emphasized that it was necessary to understand the relationship between venture capital and managers for those seeking to overhaul the corporate governance of large firms. A series of case studies were conducted regarding the role of venture capitalists when serving as a 'lead' investor. The inputs were money, operating services, networks image, moral support, general business knowledge and discipline. The authors identified three kinds of venture capital power – money, personal relationship and formal power.

Sweeting, R. C. and Wang, C. F. (1997) focused their work on handling of post-investment investor-investee relationships. Though their research was limited to only one large venture capital firm, they did observe that it was possible to run it profitably and successfully with a hands-off approach. It was observed that in United Kingdom, Venture capital industry had reached a watershed in its development, with the players in 1980s having to reassess their positions and possibly in some cases, their continuing viability as independent operators. It has been suggested that increasing number of United Kingdom venture capitalists are moving towards a more ‘hands-on’ approach to post-investment relationships with investee in the hope of improving performance and investment out-turns.

Bernard’s (1998) research analysis evaluated the hows and the whys a software entrepreneur should keep in mind before approaching a venture capitalist. He suggested that might be venture capital is right but the time is not right. Timing is everything in this business that needs to be taken care of.

1.32
Gompers and Lerner38 (1998) for venture capital distributions, a legal form of insider trading, provides an ideal arena for examining the share price impact of transactions by informed parties. These sales, which occur after substantial run-ups in share value, generate a substantial price reaction immediately around the event. In the months after distribution, returns apparently continue to be negative. When the short and long run reactions are decomposed, they are consistent with the view that venture capital uses inside information to time stock distributions: Distributions of firms brought public by lower quality underwriters and of less seasoned firms have more negative price reactions. This paper examines the distribution of venture capital investments to the investors in venture capital funds by the funds’ general partners. This is a unique environment where transactions by informed insiders are exempted from antifraud provisions.

The study set about by Ramesh,S.39 (1989) to review the existing venture capital industry in India brings out that structural changes presently taking place in Indian economy are making the environment more conducive for venture capital investment in various sectors of economy. Enterprising people from the northern states of India have to exploit these opportunities to their best advantage. Innovative and dynamic people working in fast growing medium and large-scale enterprises are more suitable for taking such projects. The guidelines by the government should be made more flexible to allow shadow expansion, management buy-out and turn-around cases also under this scheme. This will enhance the opportunities under the scheme.

The study by Ramesh, S. and Maheshwari, S.K.40 (1989) stresses that new ideas and technologies entail risks in developed countries, but venture capital backed such ideas and technologies and
helped entrepreneurs to launch their projects successfully. To nurture growth on sound and professional lines of indigenous technology development, technology transfer and absorption including professional test and evaluation methods and equipment, vigorous technology assessment, quality assurance system, technology licensing, escort system required for successful commercialisation as also support services for technocrat entrepreneurs. The world paves the way for the systematic development of technology venture financing in India.

Iyer, K. (1989) in his study underlines the tremendous potential that the Venture Capital Industry is having in India and that the country very badly needs such capital in adequate measure to nourish its substantial pool of potential technocratic entrepreneurs. However, it has been rightly stressed that the activity as Venture Capital Industry in India can be built up only on the basis of sound expertise knowledge and track record so as to be able to attract investment funds from the general public as in the U.S. and Europe.

Bhattacharya, S.'s (1989) research work formulated the requirements of successful venture capital financing in India in the light of experience in the United States and some of the Southeast Asian countries. He identified that origin of venture capital activity could be traced to the rise of merchant banks in the United Kingdom. Institutionalization of venture capital financing took place much later around 1950s in the US with setting up, in 1946 at American Research and Development at MIT with an explicit objective of promoting new technologies developed in universities. Venture Capital financing travelled to Japan with a large measure of success. Institutionalization in South Korea took place in 1974. In Taiwan legislation were passed in 1983 offering attractive incentives for investors in venture capital funds. In 1981, the National Iron and
Steel Mills launched into a corporate venture investment programme. In Dec. 1987 Hong-Kong Venture Capital Association was formed with 20 companies as full members. In 1987 in Thailanc Business Venture Promotion Company was promoted. In 1984, Malaysia Bhd fund was set up under SEAVI programme. Thus an attempt has been made to evaluate venture capital activity in Indian marketplace as compared to their Asian and US counterparts.

A study geared to the examination of role of risk financing in entrepreneurial activities, Kulkarni, B.K.43 (1989) comments that it is often realised that new technocrat entrepreneurs who have broad commercial proposition in the form of new product or service are not able to start their enterprise owing to inadequacy of risk capital. Venture Capital Funds is characterized by high risk of failure at the same time. In case they succeed there is a promise of high return to the entrepreneurs as well as the venture capital financers.

In a study directed by Gupta and Sapienza44 (1992), it was revealed that the specialization of venture capitalists makes it prudent for the venture capital investor to diversify across venture capitalists to eliminate the diversifiable risk inherent in specialization.

Kama, M. N. and Chandra, S. S.45 (1993) in their research endeavour to deal with the development of Venture Capital financing. They discussed the role of Venture Capital in financing the high-tech projects. The paper attempts to trace the development of its growth in India and abroad. It also describes the features of some leading venture capital funds and suggests for the healthy growth of the venture capital financing industry in India.
In his developmental approach to venture capital financing, Mishra, A.K. (1993) claims that this concept, which began in U.S.A., spread throughout the world by mid seventies. In India, it came later when the entrepreneurs confronted financial constraints on account of difficulties in raising funds. The government decided to promote the venture capital for boosting industrial development. It announced guidelines and over the counter market and made it essential for government and venture capital companies to review and resolve the issues that could come in the way of the growth of their industry on secured and professional lines.

Sabarinathan, G. (1993) in his study attempts to provide a background to the practice of Venture Capital in some mature American Industry in recognition with the breadth and depth of its experience and the attempt of many other countries, including India, to adapt the American model to their local context. Along side their background to corresponding Indian approach practice/experience is outlined. In most economies that have a venture capital industry of a sort, there is a good deal of brou-lala about the rule of venture capital. Many among those economies don’t have a venture capital industry. The sheer magnitude of the venture capital industry though in relation to the size of the economy is not significant. It would therefore not be proper to conclude that the importance of venture capital to the economy is not on account of the volume of capital it provides.

Gupta, S.L. (1993) conducted a research with an eye to explore the need and vast scope for venture capital financing in order to augment India’s technical progress. The paper also examines the improper application of the concept of Venture Capital in India. It makes suggestions for tapping the full potential of Venture Capital financing in India, after highlighting the existing
fiscal and institutional limitations on the promotion of venture capital. It is evident that there is a need for venture capital financing in India. There are vast opportunities for investing in connection with new ideas, new products and new processes. India has already started experimenting with the concept of venture capital financing for accelerating her technological development. The success of the experiment, however, will depend on the right kind of fiscal and institutional environment. However, venture capital financers do not participate in pilot efforts, much less in Research and Development efforts and as a consequence their exposure to risk is less. So the actual venture capital financing is not in accordance with the basic concept of venture capital. Therefore, concerted efforts should be made to tap the full potential of this concept that can provide a significant impetus to the country's industrial and technological development.

Ganesan, K.⁴⁹ (1994) undertook a study to discuss the theory, characteristics, and development of Venture Capital firms in India, their requirements and importance of venture capital financing. Various handicaps have been identified and suggestions have been offered to ensure success by creating a perfect mix of innovative technology, commercial viability high-risk rapid growth potential, low cost and first generation technocrats lacking financial support.

Balachandran, P.³⁰ (1994) has urged the providing of Venture Capital to promoters in the country, considering the requirements and potentialities. As number and activities of Venture Capital funds are quite inadequate, one may plan the setting up of more venture capital funds in the years ahead. Nalini Prava Tripathy⁵¹ has identified that the Indian capital market has been undergoing various changes and has emerged as a major source of finance for the corporate sector. Several new institutions have appeared in the financial scene and venture capital companies have joined to
expand the range of financial services. Venture capital financing is needed to augment India's technical progress. The paper briefly discusses the concept and importance of venture capital and offers some suggestions for tapping full potential of venture capital in India. Venture Capital Finance is an instrument inducing technological development, stimulating creativity and innovation and nurturing entrepreneurship. The following are the suggestions for developing venture capital market:

■ To promote and develop venture capital business, the union government should give fiscal relief in the shape of expected returns from capital gains tax and modify stock market regulations to provide quick exit routes.

■ The government should provide long-term finance for venture capital companies through public financial institutions, establish an unlisted security market and encourage stock option scheme as an incentive for venture capitalists.

■ There is poor awareness about the availability of venture capital finance from private and public sector institutions. There is no direct advertisement/publicity. The above should be corrected.

■ Venture capital finance involves risk but high risk involves high returns both for entrepreneur and financiers. If this is accepted as reality, there will be a better market.

The financial and non-financial oriented incentives were found to have significantly influenced the performance of venture capitalists by Bansal, L.K. He further states that despite the restrictive guidelines, venture capital activities may prove to be a boon for potential first generation entrepreneurs. Viewing the fact that financial institutions and commercial banks are already providing funds to industry, some incentives may be incorporated in the guidelines. To
make venture capitalists adventurous, they should be given a free hand and a proper perception should be created in their minds.

Kumar, N.³³ (1995) in his study observes that Venture Capital Industry in India is one of the fast emerging financial services industry. It is long-term risk capital to finance high technology projects involving high risk. Government has allowed overseas venture capital investments in India. The Ministry of Finance in 1995, allowed offshore investors who may invest in approved domestic Venture Capital Funds/Venture Capital Companies.

In a study organized by Mukhopadhayay, D.⁵⁴, (1995) he acknowledges that venture capital industry is at the take off stage in the country. It covers history, operation and management of venture capital funds and suggests a set of policy measures required for their effective functioning in India. Venture Capital can play catalytic role to rehabilitate the sick units and promote the development of entrepreneurship that remains unexploited among the young and energetic technocrats and other professionally qualified talents. Hi-tech industries including healthcare, publishing, tourism involving high risk and promise of substantially attractive rate of returns can be the favourite choice of the venture capital funds as the desired avenue of investment. To bring about a commercially sound growth pattern in the venture capital industry, the concept and contemporary relevance of the subjects need to be properly understood by the professionals, financial institutions and regulatory bodies like – Central Board of Direct Taxes (CBDT), Securities Exchange Board of India (SEBI). A favourable environment for nurturing venture capital funds in the country is felt essential.
Deo, M.'s (1996) research efforts directed towards examination of importance of venture capital industry brings out that venture capital is a long-term equity investment in business that displays potentials for significant growth and return. In a short span of less than a decade, venture capital financing has made considerable strides in the Indian business scenario. Basic features of venture capital financing, eligible activities, stages of financing, problems and prospects in Indian scenario have all been discussed in this study.

In Indian market place inception of an orderly study of Indian venture capital industry can be ascribed to Mishra, P.C. and Mahaptra, P.C. (1996). Venture Capital as financing of opportunities based on technological innovations in contrast to conventional security based lending. No doubt it is a late entrant in India in the field of Industrial Financing and is in its infancy stage, it has tremendous potential for growth. It will provide stimulus to the development of indigenous technology and a new generation of entrepreneurs in the country. Till date no effective and concerted efforts have been made to popularize the concept of venture capital in our country. IVCA (Indian Venture Capital Association) must play a key role to popularize the concept of Venture Capital. In view of present liberalized economic environment and talents in the country, Venture Capital financing has a bright future ahead.

Pandey, I.M. and Jang, A. (1996) visualized status of venture capital activity in Taiwan. They studied the differences in the perceptions of the venture capitalists and investee company vis-a-vis the extent and quality of the management assistance provided by Taiwanese venture capitalists. Venture capital formally introduced in 1984 has grown rapidly since then. The study also shows that the Taiwanese venture capitalists actively solicit deals. They generally prefer financing
ventures at the development stage and start up. The initial screening of ventures is based on the nature of the industry and the five most important criteria for the evaluation of the venture are return on investment, market need for product, the venture teams technical skills, the potential market growth and the liquidity of the investment. The venture companies in Taiwan depend on the venture capitalists only for about one-tenth of their fund requirement and mostly for financing the development stage. Their choice of the venture capital firms is based on the venture capitalists' reputation and image, help in identifying consultants, flexibility in obtaining funds and assistance in going public. The venture capitalists in Taiwan provide management assistance to the investee companies and they consider their involvement in the ventures as a significant contribution.

Batra, G. S.'s 58 (1996) empirical work substantiates that India is one of the foremost countries of the world with regard to number and size of institutions that produce and market financial service. Some important innovations in financial service, according to him, have recently taken place, or are in process. These are: Leasing, Venture Capital, Merchant Banking, Mutual Funds and Factoring. Venture Capital is the response of invisible funds to capitalize on an opportunity to earn very high returns as compared to conventional security backed lending, by enabling high risk but high promise projects to realize their full potential. In a free market economy venture capital funds are expected to flourish, many more companies will be floated and competition would become keener. Service orientation and offering fine terms will make all the difference between getting an account and not getting it. The author, however, concluded that in Indian context future of venture Capital is bright.
Pramanik, A.K. (1998) in his research endeavours that lack of financing is inhibiting the process of industrial development in India, so the Indian Capital Market has emerged as a major source of finance—several new institutions have appeared in the financial scene and Venture Capital Companies have joined to expand the range of financial services. The government of India, at first, in 1988 issued guidelines for setting up venture capital companies and venture capital funds. Subsequently SEBI has been constituted in order to regulate the venture players in the capital and investment market. He suggested that venture capital companies/Joint Capital funds should try to popularise the concept of venture financing through publicity, as there is poor awareness about the availability of venture capital financing. He further expressed his expectations that venture capital activity running at full stream can speed up the process of Industrial development in the country.

Joshi, A. (1998) came out with the conclusion that world basks in the glory of the likes of Bill Gates, Netscapes, and Federal Express. Many in India wonder if such success stories could be replicated here. India does have a vast reservoir of technically skilled manpower. But then it does not have vibrant venture capital industry. But why go to a Venture Capital fund? The difference between a banker and a venture capitalist is that the former is a manager of other people’s money while the latter is basically an investor. Venture capitalists operate their funds as mutual funds manager. However, venture capitalists are specialists who lend management support and provide entrepreneurs with many other facilities.

In a study undertaken by Pandey, I.M., Gupta, J.P. and Wickramtailae, R.M.D. (1998), it was brought to light that one common feature with regard to the investment evaluation criteria of venture capital funds in the United States, Japan, Singapore and India, as revealed in various
studies, is that all of them focus their top attention on the entrepreneur’s personality and experience. However, in terms of the specific traits of the entrepreneur’s personality and experience, the practice in India—a developing country, differs from that of the United States, Singapore and Japan—developed countries. For example, amongst the five criteria most frequently rated as essential in the United States, Singapore and Japan, the entrepreneur’s characteristics include sustained intense efforts, familiarity with target market and ability to evaluate and handle risk well. None of these appears in the top five criteria in India. The top five criteria in India, on the other hand, include integrity, urge to grow, commercial orientation, long-term vision and well-thought strategy to remain ahead of competition. A good amount of empirical work exists on the venture capital investment process in the United States and other developed countries. There seems to be a gap in this regard in the context of the developing countries. Notwithstanding this, and empirical study of India, a developing country, provides evidence somewhat different from that found in the developed countries. Is it true for other developing countries? A number of questions need answers in the case of developing countries: How are venture capitalists financed? How about their flow of deals? What are their investment policies? How do they evaluate proposed deals? How are deals structured? Are the practices of the venture capitalists in developing countries different from those of developed countries? The study was carried out to answer these questions in the context of Thailand—an emerging market in a developing Asian country.

Pandey, I.M. (1998) further acknowledges that the growth in the level of venture capital investment in the emerging small economies of Taiwan, Sir Lanka, and Thailand has been nothing short of astounding. This paper describes the development of venture capital in these countries
and analyzes the criteria requested for a venture capital firm to invest in a venture. To carry out this empirical study, a questionnaire was devised asking venture capital funds in these three countries to rate the important criteria when investing in a venture. The surveys were conducted in all venture capital firms over the period 1994-95. The criteria involve diverse areas such as the entrepreneur’s capability, the product, finance items, environmental conditions, and the market situation. Analysis of the data at both the category and individual levels of criteria revealed that importance differed according to the country where a venture capital fund was investing: venture capital funds in Taiwan focus more on expected financial returns as well as potential market growth and size, whereas in venture capital funds in Sri Lanka relatively more emphasis is put on financial indicators and management team characteristics; and in Thailand, the venture capital funds the quality of the venture management team is considered as the most critical evaluation criteria. Potential areas for further research on venture capital funds in emerging markets are proposed.

Pandey, I.M. (1998) in his study establishes that the investment decisions of venture capitalists in India—a developing country—are governed by the quality of its entrepreneurs. He listed top five criteria, most frequently rated as essential, out of which four relate to the entrepreneur’s personality, viz., integrity, urge to grow, long-term vision and well thought strategy to remain ahead of competition. In terms of the general conclusion that characteristics of the entrepreneur are paramount in the evaluation process, this study confirms empirical results in the context of the United States, Singapore and Japan. However, with regard to specific traits of the entrepreneurs it differs from the findings in the United States, Singapore and Japan. By analysing ten pairs of two critical criteria, it is found that if a proposed venture is attractive with regard to product, market
and profitability, it may still be rejected if the entrepreneur lacks most desired traits. On the other hand, a marginal venture may be accepted if it is supported by an entrepreneur who has the desired personality. The authors gave a broad categorization of Indian venture capitalists as purposeful risk managers—those who appraise all aspects of the risk of a venture; and parachutists—those who keep options open particularly the option to exit in case such a need arises. None of the venture capitalists could be classified as determined eclectic—one who is prepared to consider any proposal. It was found that, in the United States, venture capitalists are well distributed over all three categories; in Singapore, they describe themselves as purposeful risk managers and in Japan, eclectics.

Pandey, I.M.64 (1998) in another attempt investigates the process of developing venture capital in a developing country i.e. India. The detailed case analysis of TDICI reveals that the steps involved in the process of developing Venture Capital activity in India are Impetus, Internal context, External Context and Sustainability.

Taneja, S.65 (1999) in his paper emphasizing the need for risk financing arrangements claims that there is a constant need for such institutions so as to mobilise the savings and channelise them into enterprises with innovative business ideas that lack proven track record. Venture Capital companies, a recent phenomenon have occurred in India which besides providing funds is also an input of the skills needed to set up a firm, design its marketing strategy, organise and manage it.

Panchali, J.N.66 (1999) empirical work proposed changes relating to venture capital and their implications for Venture Capital financing activities. The aspects that require to be addressed
have also been identified. The bill proposes clarifications and insertions at all the three stages. At entry level, it specifies the sectors of economy that are eligible for the tax benefits; at value addition level, it clarifies the treatment of sweat equity shares that intends to motivate the promoters and finally, for exit it clarifies tax treatment of buy back of shares on the venture capital undertaking and its shareholders. On the whole, these changes augur well for the Venture Capital industry.

Yadav, R.A.\textsuperscript{67} (1999) in his paper identified various environmental factors that tend to affect the process of venture flows. He analyzed the process of venture capital flows, identifies the environmental factors and venture capital flows in five European countries namely U.K, Germany, France, Italy and Spain over a period of nine years. The results clearly indicated a high degree of relationship between venture capital flows and Stock Market indices, initial public offerings, interest rates and technology in all the five European countries.

Kumar, S.M.\textsuperscript{68} (1999) remarks that the initiatives taken during last two years by the Central Government and its agencies like SEBI and CBDT augur well for both quantitative and qualitative take-off for the venture capital/private equity/off-shore funds investing in unlisted stocks. Now venture funds available from multiple sources, favourable regulation and taxation framework set in position and proposal on the avail even unlisted companies to be traded on the OTCEI. The author acknowledged that the Indian venture capital industry has the necessary maturity and strength to venture out and take up challenges for the benefit of small and medium enterprises for innovative projects.
Nemivant, T. R. (1999), appraising the Indian venture capital industry quotes that the Silicon Valley is the best success story for venture capital. The valley was promoted by more than 300 Venture Capital firms, and is an 80 Km stretch, with more than 7000 electronics and software companies lined along the stretch. In India, Venture Capital was not viewed as a source of credit flow into business and as a promoter of entrepreneurship more. So once Indian Venture Capital funds lack what they call funds critical to success, willingness to take risks, ability to take failure, letting out funds easily and management support. But last two years seem to tell a different story. From Rs. 2560 crore in 1997, the total funds have touched Rs. 5000 Crore in 1999. During the period 1990-98, 14 venture capital firms with a total base of Rs. 672.85 crore had invested funds in 622 projects. There was no venture capital market but a single player in 1992. Reasons for revival of the industry are mainly attractive valuations and a couple of successful investments by Venture Capital funds in Information Technology sectors in early 1998. He thus advocated high potential for venture capital activity in India.

Prasad, S. and Gill, N. (1999) focused their work on a new breed of Venture Capitalists rushing in, looking for cool ideas emphasizing the sudden rise in entrepreneurship activities on account of venture capital backing. Neeraj Bhargava quit his job, started an incubator fund called Acquit in a small office, in Mumbai. Rupert Murdoch’s company, e-partners has a 50:50 joint venture with Softbank, Japanese Software Company that has invested in over 116 Internet start-ups called e-ventral. Co-incidentally, Acquit was raising funds at about the same time e-Ventures set up shop in India, when he met people at e-Ventures India and realized that they were working towards the same goal and decided to merge Acquit into e-Venture. Today Bhargava is running e-Ventures India with a former colleague from McKinsey. Sandeep Singhal and Rajesh Joge pawned at
gateway capital. It is just one of the India’s newest angels, a breed which is multiplying rapidly as the market venture capital deepens at the seed and early stage financing. Others include Suresh Rajpal, the former CEO of Hewlett-Packard India, and now the head of e-Capital, a software development company, Harish Mehta, CEO of Onward Novell, Mike Shah, former CEO Digital equipment, Arun Kumar CEO, Highes Software, Prann Ganshi Former Director, Digital Equipment, Gokul Tondon, former Vice President, HCL, Prakash Shah and Venkat Ramaswamy, both ex-ICICI and now partners in Edllweiss Capital. A gold rush-people quitting their high paying jobs to get into funding start-ups, an inherently risky game.

Prakash, S. (1999) in her study asserts that after nearly 15 years of being around, only in the recent months, the Venture Capital industry has come into serious reckoning due to the sudden boom in the Information Technology industry. The long wait may have done well for the industry. She also establishes that if the government can bring in certain fiscal incentives, help in building linkages between Research and Development and the venture capitalists, provide better management education to the venture capital managers, help the investors exit by introducing SPVs, the venture capital can play a developmental role in a developing country like India.

In his paper, Mani, S. (1999) was primarily concerned with an examination of the institutional support that is required for an effective development of locally generated technologies irrespective of whether these technologies are developed by the government laboratories or by private firms. He identified three principal support mechanisms, namely a correct external environment, availability of risk capital, and finally an institutional support that can correct for crucial information failures between generators of technology and its developers. The second
component can, in fact, encompass the last one. Therefore, of the three, the one that is most tangible and can be operationalised is an institutional arrangement for making available risk capital. There is an explicit recognition of this fact manifested itself in the form of the government establishing a venture capital fund industry. Most of the support mechanisms that exist in the country are primarily geared towards local generation of technology rather than towards its development. His analysis of the actual operations of the Indian venture capital industry showed that though they initially started off with precisely the objective of providing an effective financial and information support for domestic technology development, they were increasingly moving away from it. An important assumption that underlies the analysis is that there are a growing number of technologies that are waiting to be commercialised and are not in view of the absence of an effective institutional support. This assumption is increasingly proved correct by a number of international collaborations between Indian laboratories and Western technology transfer institutions for joint development and transfer of Indian technologies abroad.

THE CONCEPTUAL FRAMEWORK

1999, year of the venture capitalists saw so much money being poured into young start-ups in the United States, Europe, and later on catching fire in Asia, it seemed as if the actual history of venture capital had become clouded. Let's see how venture capital came about.

The term 'Venture Capital' is understood in many ways. Historically, the definition of venture capital as coined 50 years ago at Harvard Business School means risk capital for new or very young ventures. Over time however, and especially outside the United States and Canada, it has become an overall name for any type of equity related financing for privately held companies. To
make matters even more confusing some of the United States venture capital firms have begun
delving into ‘transactional’ finance more akin to the investment banking community. This is,
however, a limited phenomenon. Conventional financing is basically security oriented and is
meant for projects based on proven technology. Certain ideas find little outlet due to lack of cash.
Lack of finance deters the new technocrats from starting an enterprise. Venture capital is the
answer to such problems. Venture capital financing serves as intermediaries between investors
and entrepreneurs lacking financial support. Venture capital is not just an injection of funds into a
new company; it is an input of technical and managerial resources also needed to run the
company.

Bygrave, B., a professor of free enterprise at Babson College, Massachusetts, who has researched
the history of venture capitalism, believes that venture capital is really nothing more than a
variation on the kinds of risk capital that go back to the earliest days of the industrial revolution.
That was the time, when a wealthy magnate would invest a chunk of his private money into a
numbing mill that he wasn’t sure was going to be profitable. Risk capital is still the game of an
infinitely small group of wealthy investors and the lucky protégés. “Venture capital is a very rare
event. Only a few thousand companies a year gets venture financing”. “Doriot, who some might
call the inspiration for an entire generation of venture capitalists, had a major influence on a
group. This group from Boston put together the first venture capital fund called American
Research and Development (ARD). Their first cheque went out to three MIT affiliates who were
starting a company called High Voltage Engineering Corporation. They put $200,000 into it, and
later it had a very successful stint on the New York Stock Exchange” recounted Bygrave.
The psychedelic 60s saw even more success of venture capital funds because the United States federal government passed the Small Business Investment Act in 1958. This Act meant that venture capitalists could borrow money from the government for their ventures. It were, however, the changes in 1969 regarding capital gains taxes that almost eliminated the still developing industry in the early seventies. Since venture capitalists make money from the capital gains, they accrue when one of their companies goes public. Tax hikes made venture capital style risks very unappetizing.

According to Rock, A., his firm was the first real venture capital fund. This company, called Davis and Rock, was started in 1961 and shut down in 1968, when Rock left the teetering East Coast venture capital industry to Silicon Valley, where he founded Intel.

Subsequent changes in the venture capital industry, like the Employee Retirement Income Security Act, allowed pension fund managers to handle their funds like a business portfolio. They got the freedom to pursue risky investments that made pension funds one of the largest sources of venture capital today. The venture capital market was wedded to the initial public offerings market after the Apple Benchmark. The market has had its ups and downs but it has never been imperial again the way it was in the early seventies. Venture capital is about acceleration. Venture Capitalists are good at accelerating how fast a new technology hits the market commercially. There's no better proof than the Internet market.

To put it in a nutshell, venture funds were perhaps the most optimal capitalist tools to exploit a post war culture driven by high technology. This laid the foundation for venture capital
technological innovations happen fast, very fast and it needs an accelerated source of funds - to move in and open the road to discoveries. Venture capital is a highly specific historical phenomenon made possible by an influence of scientific and economic circumstances that may never happen again. It's quite like life, isn't it? And it would be wrong to think than venture capital will live forever. So, "Make hay while the sun shines". Even now, the limited partnership fund manager model of the VC fund is on the wane. "Private placements" rather than partners are the rage now in the US and in some Indian VCs. Before proceeding further let us have an insight into the conceptual framework of venture capital.

Venture capital is a child of the modern era but has its fundamentals in the oldest of drives, the entrepreneurial skill. For decades, new ideas and capital remained on a parallel track. It discouraged many entrepreneurs and killed thousands of potentially great ideas. Then came the concept of venture capital.

Venture capital means financial assistance to innovative entrepreneurs and rapidly growing companies which have reasonable potential to develop into profitable ventures but with uncertainties. It is an important source of fund for technology-based industries to develop and succeed. Venture capital means risk capital. It is the term applied to investments in new and untried enterprises that are lacking a stable record of growth. It is in the form of capital committed as shareholdings, for formation and setting up of firms specializing in new ideas or new technologies with a large perceived risk, but with a potential for rapid growth.
The venture capitalists are to make investment in a company that is new, young and involves owner/entrepreneur and uses new technology to produce new goods. Investments are likely to be made in the form of equity although debt financing and convertible instruments are also allowed. The venture capitalists are to involve in the management of their portfolio investment. Venture capital firms are to raise the value of investment by contributing on matters relating to finance, marketing, general management etc. Investments must be restricted to few companies. Investments may be syndicated with other venture capital investors. After 5-7 years, the investors can convert their equity into cash. This appreciation of investment is treated as capital gains. The investor's return is taxed as capital gain rather than ordinary income. Venture capital cannot be raised through traditional markets because the entrepreneurs will try to manufacture untested products.

Ibanez, F. defines venture capital as the early stage financing of new and young companies seeking to grow rapidly. Venture capital is also defined as a minority and temporary equity or quasi-equity investment in a growth oriented small or medium size business managed by a highly motivated entrepreneur. The investment will be often accompanied by management assistance.

Deriot, G. G. set forth some of the principles of venture capital firms. He said that the aim was not to build up venture capital firms, but to create creative men and their companies. He considered capital gains as a reward - not a goal.

Gorman defined the Venture Capital Company as “a financing institution which joins an entrepreneur as a co-prompter in a project and shares the risks and rewards to the enterprises.”
Dixon defined the Venture Capital “as the financing of new, start-up ventures.”

Guan and Cheong defined the Venture Capital as “the expansion of existing operations intended to move into new stages in the production and / or the distribution process.”

According to Murray “Venture capital is the response of investible funds to capitalize on an opportunity to earn very high returns as compared to security backing lending, by enabling high risk but high promise projects to realize their full potential.” There is risk in accepting and speculator returns could be made on successful portfolio investments. They are to find projects that need small initial investment but must have high potential for growth.

Barrett says that ‘one thing you do not need in the high-risk venture capital is pots of money. Limit the number of projects’.

The concept of Venture Capital as has been taken up in the study includes “investment in the form of equity, quasi – equity and/or a conditional loan, made in new, unlisted, high risk or high – tech, firms, stated by technically or professionally qualified entrepreneurs”.

The Venture capitalist thus,

> Expects the enterprise to have a very high growth rate,
> Provides management and business skills to the enterprise,
> Expects medium to long term gains and
> Does not expect any collateral to cover the capital provided.
Venture capital, another name for risk financing arrangement, has been prescribed by authors in various ways. To understand the concept, however, necessitates some insights into conceptual framework of the same.

Venture capitalists will help companies grow, but they eventually seek to exit the investment in three to seven years. An early stage investment may take seven to ten years to mature, while a later stage investment may only take a few years. The venture investment is neither a short term nor a liquid investment but an investment that must be made with careful diligence and expertise.

There are several types of venture capital firms, but most mainstream firms invest their capital through funds organized as limited partnerships in which the venture capital firm serves as the general partner. The most common type of venture firm is an independent venture firm that has no affiliations with any other financial institution. These are called “private independent firms”.

Venture firms may also be affiliates or subsidiaries of a commercial bank, investment banks or insurance companies and make investments on behalf of outside investors or the parent firms clients, still other firms may be subsidiaries of non-financial, industrial corporations making investments on behalf of the parent itself. These latter firms are typically called “direct investors” or “corporate venture investors”.

Other organizations may include government affiliated investment programs that help start up companies either through state, local or federal programs. One common vehicle is the Small Business Investment Company or SBIC program administered by the Small Business Administration, in which a venture capital firm may augment its own funds with federal funds and
leverage its investment in qualified investee companies. While the predominant form of organization is the limited partnership, in recent years the tax code has allowed the formation of either Limited Liability Partnerships, (LLPs) or Limited Liability Companies (LLCs), as alternative forms of organization. However, the limited partnership is still the predominant organizational form. The advantages and disadvantages of each have to do with liability, taxation issues and management responsibility. Like a mutual fund company, a venture capital firm may have more than one fund in existence. A venture firm may raise another fund a few years after closing the first fund in order to continue to invest in companies and to provide more opportunities for existing and new investors. It is not uncommon to see successful firm raise six or seven funds consecutively over the span of ten to fifteen years. Each fund is managed separately and has its own investors or limited partners and its own general partner. These funds investment strategy may be similar to other funds in the firm. However, the firm may have one fund with a specific focus and another with a different focus and yet another with a broadly diversified portfolio.

One form of investing that was popular in the 1980s and is again very popular is corporate venturing. This is usually called “direct investing” in portfolio companies by venture capital programs or subsidiaries of non-financial corporations. These investment vehicles seek to find qualified investment opportunities that are congruent with the parent company’s strategic technology or that provide synergy of cost savings. These corporate venturing programs may be loosely organized programs affiliated with existing business development programs or may be self-contained entities with a strategic charter and mission to make investment congruent with the
parents strategic mission. There are some venture firms that specialize in advising consulting and managing a corporation’s venturing program.

The typical distinction between corporation venturing and other types of venture investment vehicles is that corporate venturing is usually performed with corporate strategic objectives in mind while other venture investment vehicles typically have investment return or financial.

The process that venture firms go through in seeking investment commitments from investors is typically called “fund raising”. This should not be confused with the actual investment in investee or “portfolio” companies by the venture capital firms, which is also sometimes called “fund raising in some circles”. The commitments of capital are raised from the investors during the formation of the fund. A venture firm will set out prospecting for investors with a target fund size. It will distribute a prospectus to potential investors and may take from several weeks to several months to raise the requisite capital. The fund will seek commitments of capital from institutional investors, endowments, foundations and individuals who seek to invest part of their portfolio in opportunities with a higher risk factor and commensurate opportunity for higher returns. Because of the risk, length of investment and illiquidity involved in venture investing and because the minimum commitment requirements are so high venture capital fund investing is generally out of each for the average individual.

Making investments in portfolio companies requires the venture firm to start “calling” its limited partners commitments. The firm will collect or “call” the needed investment capital from the limited partner in a series of branches commonly known as “capital calls. These capital calls from
the limited partners to the venture fund are sometimes called “takedowns” or “paid in capital”. Some years ago, the venture firm would “call” this capital down in three equal installments over a three years period. More recently, venture firms have synchronized their funding cycles and call their capital on an as-needed basis for investment.

Limited partners make these investments in venture funds knowing that the investment will be long term. It may take several years before the first investments starts to return proceeds.

Since venture firms are private firms, there is typically no way to exit before the partnership totally matures or expires. In recent years, a new form of venture firm has evolved called “secondary” partnerships that specialize in purchasing the portfolios of investee company investments of an existing venture firm. This type of partnership provides same liquidity for the original investors.

The decision to invest is a long-term commitment. This investment decision takes considerable investment knowledge and time on the part of the limited partner investor. Same limited partner investors may have neither the resources nor the expertise to manage and invest in many funds and thus, may seek to delegate this decision to an investment advisor or so-called “gatekeeper”. This advisor will pool the assets of its various clients and invest these proceeds as a limited partner into a venture or buyout fund currently raising capital.

The investment by venture funds into investee portfolio companies is called “disbursements”. A company will receive capital in one or more rounds of financing. A venture firm may make these
disbursements by itself or in many cases will co-invest in a company with other venture firms ("co investment" or "syndication"). This syndication provides more capital resources for the investee company. Firms co-invest because the company investment is congruent with the investment strategies of various venture firms and each firm will bring some competitive advantage to the investment. The venture firm will provide capital and management expertise and will usually also take a seat on the board of the company to ensure that the investment has the best chance of being successful. A portfolio company may receive one round or in many cases, several rounds of venture financing in its life as needed.

Depending on the investment focus and strategy of the venture firm, it will seek to exit the investment in the portfolio company within three to five years of the initial investment. While the initial public offering may be the most glamorous and heralded type of exit for the venture capitalist and owners of the company, most successful exits of venture investments occur through a merger or acquisition of the company by either the original founders or another company. Again the expertise of the venture firm in successfully maintaining its investment will dictate the success of the exit for themselves and the owner of the company.

The initial public offering is the most glamorous and visible type of exit for a venture investment. In recent years technology IPOs have been in the limelight during the IPO boom of the last six years. At public offering the venture firm is considered an insider and will receive stock in the company, but the firm is regulated and restricted in how that stock can be sold or liquidated for several years. Once this stock is freely tradable, usually after about two years, the venture fund will distribute this stock or cash to its limited partner investor who may then manage the public
stock as a regular stock holding or may liquidate it upon receipt. Over the last twenty-five years, almost 3000 companies financed by venture funds have gone public.

Mergers and acquisitions represent the most common type of successful exit for venture investments. In the case of a merger or acquisition, the venture firm will receive stock or cash from the acquiring company and the venture investor will distribute the proceeds from the sale to its limited partners.

Each venture fund has a net asset value or the value of an investor's holdings in that fund at any given time. Each company is valued at an agreed upon value between the venture firms when invested in by the venture fund or funds. In subsequent quarters, the venture investor will usually keep this valuation intact until a material event occurs to change the value. Venture investors try to conservatively value their investments using guidelines or standard industry practices and by terms outlined in the prospectus of the fund. The venture investor is usually conservative in the valuation of companies, but it is common to find that early stage fund may have an even more conservative valuation of their companies due to the long lives of their investments when compared to other funds with shorter investment cycles.

As an investment manager, the general partner will typically charge a management fee to cover the costs of managing the committed, capital. The management fee will usually be paid quarterly for the life of the fund or it may be tampered or curtailed in the later stages of a funds life. This is most often negotiated with investor upon formation of the fund in the terms and conditions of the investment.
“Carried interest” is the term used to denote the profit split of proceeds to the general partner. This is the general partners fee for carrying the management responsibility plus all the liability and for providing the needed expertise to successfully manage the investment. There are as many variations of this profit split both in the size and how it is calculated and accrued as there are number of firms.

INVESTMENT ACTIVITY OF THE VENTURE CAPITAL COMPANIES

Basic Stage: VC companies study how to choose different projects and evaluate the individual projects.

Operating Stage: VC companies focus their attention on carefully monitoring management and giving advice for providing new round of financing.

Exit Stage: VC companies find third parties who intend to acquire venture-backed firms, and arrange for the sale of venture-backed firms.

Venture capitalists invest in companies at three stages: viz., Seed money is used to finance the development of a new product or service. It is most difficult to raise as it is uncertain whether the product will ever reach the stage of commercialization or not. Start-up capital refers to venture funding sufficient to generate initial sales and profits. The company can also resort to the second and third financing because of unsound estimate of initial requirement, failure of management to properly utilize initial financial resources or due to unforeseen changes in the operating environment of the company. If a follow-on-stage offering is used to fund an expansion that enables a company to later conduct a public offering, it is referred to as Mezzanine financing. It is generally provided for growth and expansion of the company that
is even breaking. The forms of investment by venture capitalists are: Common stock, Convertible debenture, and Loans with warrants.

OPERATIONALIZATION OF VENTURE CAPITAL FINANCING

Venture investing is a high-risk, high-return proposition. Venture capitalists invest in entrepreneurial companies with proprietary advantages in rapidly expanding markets. For getting a project financed, a business plan is required to be sent to the venture capitalist called “Offering Circular”. The offering circular (Appendix A), also referred to as the private placement memorandum, consists essentially of the issuer’s business plan, financial projection, a thorough discussions of the risks inherent and other disclosures necessary for an investor as to make an intelligent investment decision. It contains brief history of the company, description of products and services, market trends and competitive analysis, business and operating strategy, product development and manufacturing, distribution channels, organization and management resumes historical and projected financial statements such cash flows and financial requirements.

All venture capital funds consider a comprehensive background check on an entrepreneur. They call it ‘due diligence check’ without which no investor would part with his money. The entrepreneur has to be cautious about the focus of the venture capitalist, the record of the fund, kinds of companies they have invested in, rejected proposals, size of investment, knowledge of the venture capitalist and timeliness of the approach (Appendix D).
Apart from understanding the conceptual framework of Venture Capital financing, another aspect to be taken care is how to manage Venture Capital funds once they are set up. Management of venture capital can help the investor and the entrepreneur in following ways:

1. *Attractive Returns For The VC*:

In return for financing one to two years of company's start up venture capitalists expect a ten times return of capital over five years. Venture capitalists hope to acquire extraordinary returns on investments primarily through the appreciation of the underlying value of their equity (i.e. their stake in an entrepreneur's business). Broadly, well-heeled individuals (sometimes referred as angels) can provide speaking venture capital or large financial institutions with sophisticated investing operations, or organizations that fall somewhere in between.

Angels, public venture capital sources, and other funding sources have had a significant impact on business growth during the 1980s.

Generally venture capitalists can work with an entrepreneur during the very early stages of the research and development process. They often evaluate prototypes or examine early demonstrations of phenomena that could offer extraordinary opportunities for development (e.g. super conductive materials). Venture capitalists, however, tend to view themselves as experts in maximizing the application side of research and development, and shy away from projects that requires extensive basic research or entails an extraordinary discovery yet to be achieved.
2. Evaluating Project Risks:

Although venture capitalists play an important role in the commercialization process, they should not be confused with those who control the mission to provide basic research. The focus of venture capitalism is the commercial one. Consequently, venture capitalists want to know where an invention fits in the marketplace, whether the innovation fits in the marketplace, whether the invention offers a dramatic and sustained advantage, and whether there is compelling evidence to warrant building a business based on the invention. These judgements are made on the basis of the risk profile of the project (Appendix A). Usually, venture capitalists use the following four risk related criteria to evaluate both the strength of an innovation and the ability of the entrepreneur to motivate commercialization:

a) The Market Risk -
This criterion helps venture capitalists determine whether the technology addresses a significant problem in the marketplace, what are the competitive alternatives present and whether the market is large enough to yield a significant return on the investment.

b) The Technology Risk -
This criterion enables investors to evaluate the proprietary aspects of the technology, including patent position and ownership further development work to get to the first product, assessment of manufacturability and the potential breadth of technology's application.
c) The Financial Risk -
This criterion helps the venture capitalists determine the amount of capital needed to achieve a sustainable market position, the potential sources of capital required by the project in addition to initial venture capital investments, and the possible investment withdrawals that may occur.

d) The Management Risk -
This criterion enables investors to determine the strengths and weaknesses of the entrepreneur or founding team, whether additional management is needed, effective working relationships can be established, and whether the commercial objectives and expectations of the entrepreneur and the venture capitalist match. Although inventors sometimes overlook these risks, they should all be addressed before a venture capitalist is approached. If these risks are well understood by entrepreneurs, financial backing will be much easier to obtain.

3. The Market Risk: What Problem Is This Product Solving?
When a venture capitalist first looks at a project, the initial question asked is ‘What problem this technology or product solves?’ Technology driven business development, in which technology is in search of an application, presents difficult problems. Introducing new technology and simultaneously creating a new market is often referred as double whammy investing. The high fatality rate of projects with these characteristics is well known to venture capitalists. Of course, there are exceptional successes and those exceptions provide extraordinary returns on investment.

An entrepreneur with a technology that clearly lacks a demonstrated market is in a difficult position for obtaining finance. The absence of an existing market forces the investor to assess
risks through pure speculation, the most tenuous of analysis. In the absence of a demonstrable market all entrepreneurs are strongly advised to thoroughly demonstrate a problem that the technology can address. If a problem can be seen as a market opportunity by the investor, obtaining finance and project success is more probable.

Unfortunately, venture capitalists often recognize that the entrepreneur's analysis and identification of the market is inadequate, in part because an entrepreneur typically becomes enamored of the technology and fails to sufficiently investigate the market. Entrepreneurs, who usually are not seasoned marketing executives, nevertheless must understand the market potential and the competitive threats to the successful commercialization of their inventions.

In assessment of competitive market environment, the venture capitalist must be convinced that an invention can lead to a dominant market share regardless of the size of the market. In general, dominance requires a large market share of a given industry segment.

Overture a venture capitalist receives is the one in which the entrepreneur claims a $10 billion market and perceives the need for only a two per cent market share for success. Such a small share of the large market is not viewed favorably because an undifferentiated i.e. non-niche market with numerous competitors will probably not generate the level of profits needed by small new entrants to sustain long term growth. Market segmentation, competitive analysis, and market sizing are important pieces of analysis that must accompany any entrepreneurs overture to an investor. Without this analysis, no framework exists within which to determine the value of an invention.
4. The Technology Risk: Who Owns The Ideas?

Establishing a proprietary position early in a technology’s history is important because proprietary technology is what the entrepreneur is selling, and the technology determines the value of the business. Whether the entrepreneur approaches a venture capitalist for financing or tries to establish a licensing agreement with a corporation, establishing who owns the technology and who invented is a critical first step in writing a proposal. It requires the expertise of both business and patent attorneys.

Ownership is often an assumed right to an invention when an inventor obtains a patent. Even if the invention or patent carries the inventor’s name, however, some discrepancy regarding ownership of the project may result, if the work was performed under the auspices of another party, whether for profit or nonprofit. Ownership is often self evident for example, when a project has been funded by the inventor. The classic example is that of an inventor working in a garage, developing an idea that has had no prior art or similar concept. More common, however, is the situation in which someone who, in the course of employment, has an idea that may have been stimulated objectively by work in progress for the employer. To defend against future challenges, the entrepreneur must establish a distinction between work that was truly part of employment and work that was independently created. Written agreements that support this distinction must also provide proof of principle (i.e. the origin of the technology) and indicate where or how the funding or the particular resources may have been allocated or used to develop the idea.

Venture capitalists closely examine these factors early in their evaluation process. In some cases ownership becomes dramatically important (e.g. at universities) where grant monies are abundant.
and most basic research is finished before the application of a new technology begins. Venture capitalists want to ensure that the relationship between the university and the entrepreneur is either well understood and documented or the commercial venture well away from the campus.

Ultimately, the entrepreneur’s goal is to ensure that all the necessary steps are taken to segregate the development of new technology from all resources that could potentially claim ownership. If the innovation was not made during the course of employment (when full disclosures were made) and was created using indirect funding sources and a logbook that documents and traces its discovery, showing how and where the development took place, the inventor generally ends up owning the invention. Other aspects of technology risk, such as the technical feasibility, are typically well understood by the inventor and a sophisticated investor. These should also be presented clearly in a proposal for funding.

5) The Financial Risk: How Much Will It Take?

Evaluating the potential for taking an innovation successfully to market requires estimation of the amount of capital needed to secure the desired market position. Obviously, a venture that requires $1 million to establish market position and one that requires $30 million present different challenges to the venture capitalist. First the venture capitalist must assess whether sufficient capital can be raised perhaps in stages before one dollar is committed to the project.

In addition, most venture capitalists not only want to know what market share can be potentially attained by the product, but what return cash flow can be expected and when. The timing and method of return of invested capital (e.g. through an initial public offering or acquisition) are
important considerations for the venture capitalist. For these reasons, the entrepreneur should thoroughly research the market, the probable costs to enter the market, and the likely scenario for providing investors with returns on their investments.

6) The Management Risk: Can The Market Opportunity Be Exploited?

The problems that venture capitalists experience with investments rarely result from a technology that failed or a market opportunity that could not be addressed successfully. People problems, particularly management problems, are the primary cause of failure and distresses. A problem investment scenario typically features an inventor turning entrepreneur who becomes a jealous protector of an idea and harbors unrealistic expatriations about the value of the invention. The inventor typically distrusts business partners and has limited business experience. Most businesses that are attractive to venture capitalists begin as projects that are oriented to markets greater than $1000 million. Companies of this scale lend to be multidisciplinary.

They typically start with one core invention and develop a team approach to build a substantial product or family of products. The entrepreneur’s friends and family can fund either by the entrepreneur or many business with limited market horizons. Local or regional service business is examples of this type. By comparison, business that secure venture capital are generally those in which the entrepreneur’s expectations are to build a company on the $100 million scale, in which the markets are differentiated and sizable, the technology can lead to a significantly dominant market position, and finally, the entrepreneur and investor are well matched. Deciding whether to start a company based on a technology or to license intellectual property rights to someone else can propped the inventor in distinctly different directions. Venture capitalists have long
understood the criteria that guide this decision, and the lessons they have learned can be helpful to the potential entrepreneur.

The most obvious factors influencing the decision to license are the availability of capital and market distribution facilities. For example, in medical devices, inventors who devise innovations face enormous difficulties in forming distribution channels for new products. The cost of distribution, logistical support, and the conservative purchasing practices of medical providers severely constrain distribution by small new companies. Consequently, inventors and even small venture backed companies often are forced to license marketing rights to a major company that demonstrates distribution dominance.

Similarly from an investment perspective, in certain industries venture capitalists have found that capital raised to fund sales and marketing do not increase the value of the company as greatly as capital expended for product development. Consequently, investing in only technology development and selling the innovation before market entry is a growing trend among influential investors.

Other factors that influence the decision of whether to license or whether the licensor owns technologies that are complementary to an innovation and whether the licensor can shorten remaining development time materially. Rapid development is particularly important if an innovation is incrementally advancing the state of the art and a brief window of opportunity exists in the market.
The obstacles to be overcome for successful licensing are finding the companies that have a strategic need for the invention and negotiating favorable licensing agreement terms. The inventor can potentially lose control of commercial strategies. In addition, there is threat of piracy and the loss of financial returns on extensions of the technology into other applications. Further, the inventor might often find that any leverage to negotiate an acceptable financial return for the invention is constrained. Frequently, entrepreneurs seek venture capital after concluding unsatisfactory negotiations with a potential licensor.

FOCUS OF THE STUDY

This study has been conducted to analyse various micro level factors categorized as Pre-investment Strategies, Post-investment Activities, Post-investment Monitoring of Investee company, Investor-Investee Relationships and Future Challenges and Prospects of Indian Venture Capital industry which are taken into consideration by various venture capital companies for management of venture capital funds. Along with an appraisal of macro environment for the Venture Capital industry in India has also been made. This study also tends to find out the perception of the venture capital units regarding challenges to be faced by venture capital industry in the coming few years and their probable strategies to face the threats and exploit opportunities posed by such challenges. A major portion of this study thus relates to the analysis and interpretation of management related activities of venture capital funds in India. In addition to it, the study would also try to identify the reasons for the poor growth of venture capital industry and offer certain suggestions for its better growth.
THE OBJECTIVES OF THE STUDY

The study intends to examine the following aspects of venture capital industry in India:

- To examine the significance and role of venture capital industry in light of the present business scenario of the country;
- To identify the major reasons for the poor growth of venture capital industry in India and to offer certain suggestions for faster growth of venture capital industry in India;
- To analyse various Pre-investment Strategies, Post-investment Activities, Post-investment Monitoring of Investee company, Investor-Investee Relationships and Future Challenges and Prospects of Indian Venture Capital industry as considered by the venture capitalists in managing venture capital funds;
- To recommend alternative strategies to venture capitalists for effective management of venture capital funds in India.

LIMITATIONS OF THE STUDY

Every effort has been made to focus the study around the chosen objectives. An attempt has also been made to conduct the study in a precise and accurate manner but any study at individual level is bound to suffer with certain limitations and constraints. The following is the brief account of some of the noteworthy limitations. The conclusions and suggestions of the study should be considered in the light of the same.

1. The research is the endeavour of individual research scholar who certainly had constraints in terms of financial resources, time and authority.
2. The concept of venture capital in India is growing rapidly and is new so most of the respondents were not equipped with enough experience to respond to the general working of venture capital.
3. The research aims at gaining an insight into working of venture capital funds from the point of view of Venture Capitalists, the providers of finance. It is only one sided dimension of venture capital process as no consideration has been paid to the perception of companies which become the recipient of financial and non-financial contributions made by the venture capitalists.

4. Apart from primary data, secondary data has also been used in the study. Thus study may also suffer from the inherited limitations of the secondary data.

5. The study is conducted for a selected sample size so it has not covered the universe.

THE UTILITY OF THE STUDY

In terms of utility, the study certainly tries to fill in the existing gap in the literature relating to venture capital industry. The findings of the present shall be of interest to the academicians and researchers on one hand, and the corporate sector in general and selected units in particular, on the other.

For the academics, it would highlight the concept of venture capital, its growth and the problem faced by the venture capital industry. It also enlightens the present status of venture capital industry in India and its comparison with rest of the developed or developing countries.

Our efforts should certainly lead us to generate a meaningful set of statistics in the field of venture capital in India. The study also shows the real picture of the venture capital, which is useful for the industry to draw certain assumptions in general and quite particular to the units that were examined. The factors which are important for growth of industry, the importance of investor-investee relations, quality of successful entrepreneur helps to understand the industry clearly.
This will certainly aid the corporate management in general and those of the firms investigated in the study in particular, resolving a series of problems.

**ORGANIZATION OF THE STUDY**

The whole study is divided into six chapters. The chapter first, 'The Overture', introduces the topic with specific emphasis on the nature of the problem, focus of the study, the objectives, review of existing literature, limitations and the utility of the study. An appraisal of the global context for Indian venture capital industry has been made in chapter second. The profile of venture capitalist funds, universe of the study, sources of the data and methods used for the collection of data, pattern of analysis, statistical tools employed and variables involved in the study constitute the major theme of chapter third. Various factors that influence the management of venture capital have been discussed in chapter fourth. Fifth Chapter examines various pre-investment strategies, post-investment activities, post-investment monitoring of investee company, investor-investee relationships and challenges to and future prospects of Indian venture capital industry affecting the management of venture capital funds as per the point of view of the venture capital units selected under the study. Analysis and interpretation part has also been covered in this chapter. Major findings and the recommendations of the study have been summarised in Chapter Sixth.
NOTES


