CHAPTER - TWO

VENTURE CAPITAL INDUSTRY – GLOBAL AND INDIAN CONTEXT

• The Global Scene

• The Indian Scene
The present chapter seeks to examine the worldwide scenario of venture capital industry world over with special focus on India. To do so, the chapter has been divided into two parts. The first part focuses on the foreign status of venture capital industry with specific relation to fourteen major countries where the venture capital industry has exhibited significant growth. The second part analyses in detail the profile of Indian venture capital industry with specific mention to the present state of the industry in terms of the instruments used for financing, region-wise financing pattern, classification of venture capital funds and the manner in which each of the group could be boosted. The major aspects, which have been discussed, include the development of venture capital; industries in which investment has been made and also the reasons for the poor growth of venture capital industry in India.
This portion of the study basically examines the worldwide scenario of the venture capital industry. The brief profile of venture capital industry in selected countries is detailed below:

THE UNITED STATES AND CANADA

The United States firms started venture capital process in early 1960s. Venture capital investment by the United States firms has been in existence for approximately twenty five years, with a peak around the mid to late eighties when over seventy five major corporations had formal venture capital investment programmes, while three times that number were in the market through limited partnerships. Venture capital investments in the United States were enormously lucrative to the investors in early of mid eighties, when venture capital fund recorded an average return of twenty five percent compounded since 1965. The influx of pension fund money into the venture capital market has been both a curse and blessing. Firms found themselves battling to place their newly floated funds with limited number of specialized hi-tech firms. The result was a series of losses in the early 1990s. The result of that was threefold:

❖ Some venture firms shifted to later stage financing.
❖ Some venture firms delved into ‘transactional’ financing.
❖ Some venture firms diversified their portfolios by staffing and investing in new technology areas.

If risk directly correlates to reward, then later stage financing will only be a transitional phase in the venture capital world. Since later stage financing is safer, and therefore, in the long run it cannot support the returns that venture capitalists seek. In addition, venture capitalists have
traditionally sought high percentage ownership in their portfolio companies as well as input into management issues (some call it control). Later stage companies are not expected to give the level of returns what Venture capitalists are used to getting. Plus, financing within established companies tends to be more of transactional or structure based return financing and less strategically oriented. Transactional financing is a simple transition in the venture capital industry. Basically, individuals look for some sort of quick, equity financing transaction that can allow them to earn the high returns they pursue. Thus, profits are made by structuring the transaction in a certain way. Analysis is focused much more on meeting the requirements of the transaction than on evaluating the long-term prospects of the company and strategic objectives.

EUROPE
Europe and Far East have become major players in venture capital arena after the success of the same in America and Canada. Venture Capital industry in most of the European countries is in early stage of development as compared to the United States venture capital Industry and they have invested mainly in American Venture Capital limited partnerships. Now they have begun to form limited partnership of their own to invest in European Companies. According to the European Venture Capital Association (EVCA), more money was raised for venture capital firms in Europe than in United States in 1987 ($5.1 billion vs. $4.9 billion). European Venture Capital Association (EVCA) has grown and now has close to two hundred members throughout the continent making it comparable to National Venture Association of United States. Until few years ago, the major sources of funding were the state government or banks. The entrepreneurial risk taking capacity was low since lifetime employment seemed more valuable than entrepreneurship. The creation of over the counter or secondary stock markets in most European
countries have changed the situation dramatically. The growth of venture capital industry is by and large similar to that of the United States, except for the sources of early stage finance. The major source of funds in Europe is Bank, which contributes approximately about 20 per cent of the capital, followed by the government agencies, insurance companies, corporate investors and pension funds. Other than United Kingdom no other country has sources of funds like United States, i.e., 25 per cent of the capital comes from the pension funds.

The major industries that have been receiving the greater percentage of venture capital in Europe are industrial products, consumer products, computer products and other electronics products. Owing to growing emphasis on development of technology, West Germany, United Kingdom, France and to a lesser degree the Netherlands and Italy, have invested heavily in Research and Development. In a recent development, twelve European corporations formed a Venture Capital Fund. These corporates include Bosch, Fiat, Olivetti, Petrofina, Phillips, Pierlli and Volvo. This network has invested in Venture Capital fund in Europe through a holding company by investing US $30 million in it. Half of the total venture capital investment in Europe is invested in United Kingdom. The Netherlands and France are the next largest players in the industry followed by Belgium and West Germany. The countries in Western Europe have started playing greater roles in this area, with exceptional growth resulting in Italy and Scandinavia. This has increased the start-up activities in Europe. On per capita basis, the number of startups in Western Europe is almost equal to US. The only difference is that US started these 30 years back and Europe has been a new entrant. The Gross National Product of 12 Countries of European Community is over $4 trillion that is approximately equal to US. Thus, there are tremendous opportunities for the growth of Venture Capital industry in economy of Europe.
UNITED KINGDOM

The early stirrings of UK Venture capital industry began in 1930s, but it was only in the early 1980s that it really began to develop and expand. At the foundation of British Venture Capital Association in 1983, there were only 36 members. Six years later, the industry grew to a peak of 124 venture capital firms. Although the venture capital in the United Kingdom is relatively new, yet the industry has grown significantly because of tax incentives and legislation permitting stock option plans. Furthermore, the Venture Capital industry has been aided by a well-developed financial center having over the counter stock markets - the Unlisted Securities Markets (USM) that is affiliated to London Stock Exchange and the Nightingale market. These developments promoted several prominent U.S. Venture Capital firms to open offices in London. UK can import the venture capitalists from US and export the employees of venture-backed companies for training to US, because of no language barrier. The business culture in States and UK is quite similar and allows the exchange of professionals between two countries.

FRANCE

The Venture Capital activity in France came into picture in 1971 with the creation of the Societies Financiers Innovation. Corporate investors in SFIs could write off their investment for tax purpose that coupled with a 15 per cent capital gains tax rate.

Venture capital activity in France began to take off in 1983 with the creation of its over-the-counter market i.e. Secondary Market. Following this i.e. after the creation of the Societies de capital risqué in 1985, the industry really picked up which allowed private and corporate investors
to write-off their investments and applied a 15 per cent capital gains tax rate to SCR's distribution of dividend to their share holders.

GERMANY

Germany is Europe’s richest country with a gross national product of $100 million, and has had a big business orientation that requires a high degree of professional management experience. Entrepreneurship had not been encouraged by industry-dominated banks, which discourages early stage ventures. For this reason the venture capital activity has not been as strong in the country as it could be.

In later 1980s, the situation began to change and now the climate in the country is becoming more appropriate for the development of venture capital industry. Germans have high rate of savings which can be used as venture capital. Moreover, tax laws are beginning to promote equity investment. In addition to this, Germany established a new secondary market (Geregelter Market) in 1987 to allow for exit of venture capital organization.

ISRAEL

Israeli companies owe much of their success to the assistance they receive in all four stages of venture creation. In idea generation, they benefit from two opportunities: The research and development needs of the Israeli defence forces and the arrival in Israel of talented Russian immigrants. Professionals in army Research and Development units gained invaluable experience developing cutting edge technologies for the defence force, which they used to establish ventures
successfully, on returning to civilian life. Russian immigrants contributed by infusing fresh thinking into IT and technology.

Israel's office of the Chief Scientist encourages start-ups in several ways. To kick-start the VC industry the office of the Chief Scientist had set up Yozma funds to create 10 VC funds with $20 million each. The Government provided 40 per cent of these funds. Today, more than 50 VCs (with $1.5 billion funds) are active in Israel. The Office of the Chief Scientist also provided incubators to help nurture technology ideas into commercial successes. These incubators provide administrative support, consulting services and financial assistance. Today, 26 incubators foster roughly 200 independent projects. To help new ventures secure funds, Israel also arranges major venture fairs every year. Its largest fair, Telecom 1998, provided a meeting ground for more than 250 representatives from outside Israel and telecom start-ups in Israel. Start-ups have been encouraged in innovative ways in the West too. The Mayfields Fellow Programme, is a case in point. Mayfield fellows are students who work for one summer in paid assignments at high technology start-ups. They then return to their educational institutions to share their experience. The programme also creates special opportunities for complementary research by scholars.

To help ramp up growth, Israel has set up a Bind Foundation to encourage technological cooperation between Israeli companies and the United States. The Foundation helps Israeli high-tech companies with a new technology to offer and tie up with United States companies to serve the United States market. It has invested over $150 million since its inception 20 years back. As regards to exit options, Israeli companies seek NASDAQ listings of getting acquired by leading multi-national companies such as Alcatel, Siemens, and Intel. Today, Israel has the
largest number of companies after the United States and Canada. Moreover, in 1997-98 companies in Israel worth around $2 billion were acquired by foreign multinational corporates. Venture capitalists became involved in transactional financing as a result of their involvement in business acquisitions. Historically, the venture capitalists had sat at the end of the table representing the company being acquired. Remember, Venture capitalists cash out either through their portfolio company going to public or being acquired. At some point, they began to see opportunities in financing such transactions and in other investment banking type activities.

In the long run, however, venture capitalists will back out of investment banking type activities and focus on what they are best at i.e. risk capital investments. In the 1980s, many of the firms were quite small and focused on specific areas of technology where they had in-depth knowledge. In the 1990s, the successful firms have increased management staff, diversified into more than one area of technology, and outsourced more of their technological analysis to very specialized experts. Being able to line up industry experts ahead of time, and more important, knowing the internal working of a larger, more diversified, and political venture capital firm are going to be critical elements to secure financing in the coming five years.

JAPAN

Japan has a historical story of Venture Capital. Japan is in its second major venture capital boom. Its first boom, from 1935-1975, ended during the collapse of Japanese over the counter market because of the oil price shock in 1974. The 1980s was the era when Japanese Industry demonstrated its dynamic power and competitiveness while the U.S. economy suffered from the after effects of a bubble economy. It picked up again in 1982 and in 1983 Japan's leading
venture capital funds, Japan Associated Finance Company raised $23 billion yen which is equivalent to approximately $100 million. The leading venture capital firm in Japan are subsidiaries of either Japan’s four big securities companies or of the largest Banks with an asset base of approximately $400 billion that is nearly twice the size of Citicorp of United States.

Currently, Japanese corporations are making investment in US venture capital pools. Japanese corporations are investing at the rate of nearly $500 million annually in minority position in US Companies, e.g. In 1987, Mitsubishi invested $500,000 in Suprex Corp. Similarly Nomura Securities recently invested $4.5 million in plant Genetics. In addition to Japanese companies’ direct investment, there have also been several joint ventures of Japanese and United States investors e.g. Mitsui and Vista ventures - a Venture Capital firm based in Connecticut that recently teamed up to launch Orien, a fund that will be invested in high tech products worldwide.

CHINA

In the emerging markets of Asia, venture capital activity has been growing at an impressive rate, especially since the late 1980s. The Asian venture capital pool increased from US $ 9.9 billion in 1988 to US$ 26.2 billion in 1993 implying an annual growth rate of 21.5 per cent. Among these Asian countries China has relatively been one of the fast growing economies with an emerging capital market, where the venture capital activity is now well entrenched. For more than a century United States has looked upon China as a vast market of untapped potential. This perception has at times undermined rational political decision making without reciprocal benefit, such as our decision to restrict exports of oil to Japan prior to World War II in protest of Japan’s invasion of China. At that time, Japan was a much more valuable trading partner and this has also been
confirmed by the Events following World War – II. Although venture type money has been flowing into China that there will be a shakeout seems quite probable. The pervading fear of the government reversing its pro-capitalist stance limits business focus to short term endeavors. Strategic planning is vastly more difficult in an unstable climate. The first signs of an old order backlash would cause venture investors to think twice before they commit anything else. Most opportunities would be limited to conversion of China’s work force to cost effective manufacturing, including high-tech component. Once again, fathomless layers of bureaucracy have soured many Westerns appetite for Chinese deals. This will not change until the old guard gives way to the younger, pro Western generation, which could take up to 30 years.

THE ASIAN TIGERS

In recent years, we have seen tremendous economic growth of the four Asian countries i.e. Hong Kong, Taiwan, Singapore and South Korea. The combined exports of these four countries are about 80 per cent of Japan's total exports. Moreover, there is enormous potential of other Asian countries such as Thailand and to a lesser extent, Malaysia, the Philippines, Indonesia and People's Republic of China. This entire region has gross national product almost equal to that of one-fourth of the world's total gross national product.

A) SOUTH KOREA

Institutionalisation in South Korea took the following course:

- Setting up of Korea technology Advancement Corporation in 1974 for implementing Research and Development projects of public research institutes.
- Setting up Korea technology Development Corporation in 1981.
Setting up Korea Development Investment Corporation and Korea technology Financing Corporation in 1983.

Passing of small and medium business establishment assistance law in 1986 for equity investment by Venture Capitalists.

Development of technology credit guarantee system designed to assist venture business lacking in collateral for securing the borrowings.

Introduction of over the counter market for transaction of promising venture business provided a great fillip.

B) TAIWAN

Legislation was passed in 1983 offering attractive incentives for investors in venture capital funds. Venture capital in Taiwan was introduced in 1984 with the purpose of enhancing the technological content of the products and process for attaining global competitiveness. Venture capital funds, therefore, expect to meet the financing requirements of high tech, small and medium size firm. The positive initiatives taken by the government have helped in development of venture capital in Taiwan. In 1985, a development fund of $800 million for investing in venture capital fund was established. Thus, the focus has largely been on development of technology.

Currently, a venture capital fund in Taiwan can establish a domestic fund to directly invest in technology products in Taiwan and abroad, or invest in other venture capital fund for indirect investments in technology projects. There were 29 authorized venture capital funds in 1994, of
which six were established in 1990. These firms differ in terms of their fund size, although numbers of them have funds ranging between the US $12 million to $15 million.

Although the government encourages and plays an active role in the venture capital industry, the growth rate of the accumulated venture capital has decreased in recent years. The main reason is the tight capital. It is a hard time for the Taiwanese venture capital funds to raise capital because of the flow of domestic capital into mainland China and demands of the six-year National Development Plan.

C) SINGAPORE

In 1981, National Iron and Steel Mills launched a corporate venture investment programme. This was followed by four other funds.

(a) Southeast Asian Investment Programme.
(b) Transtech Ventures
(c) Elders Pica Growth Fund
(d) Economic development Board Venture Capital funds.

DBC Bank is another major player in Singapore Venture Capital financing. Government is giving incentives to promote the locally based venture capital firms. Exemption from corporate tax for such companies is possible for 10 years. For the exit route, a second tier stock market for smaller companies was started in 1987.
D) HONG-KONG

Venture Capital companies have been used as a base for technology transfer to China, which looks at venture capital entirely in technology transfer terms. Also, in Hong-Kong they get a lot of downstream engineering done on a cost-effective basis. This Venture Capital fund is more application oriented. In December 1987, Hong Kong Venture Capital Association was formed.

E) THAILAND

In 1987, six local commercial banks and USID promoted Business Venture Promotion Company by taking a soft loan of US $6 million from USID and equal amount was raised by banks through equity. The apprehension is with regard to existing legislation, which may treat a venture capital fund as an investment dealing company and thus, leading to higher tax returns.

SIMILAR REGIONS

Both Latin America and Africa will see an influx of venture funding but not traditional venture capital. While privatization presents far less opportunities than in former communist countries, creating infrastructure and commerce does present opportunities. Natural resource extraction and medical resource extraction also present opportunities, but not along the lines of traditional venture capital. Of particular concern is the growing instability in Africa, which may limit even these opportunities. War and disease is projected to reduce Africa’s population by 50 per cent within the next 20 years.
SCOPE OF VENTURE CAPITAL:

We believe the markets with the greatest potential for evolving a true venture capital climate are Israel, Australia and India. Israel faces a lack of entrepreneurialism among individuals growing up in settlements, sometimes described as socialist communes. However, Israel has realized the benefit of an entrepreneurial climate and there is a push in that direction. Israel has historically shown great ability to rapidly adapt to new situations. Expect the same to be true for the venture capital industry. Australians have been borrowing technology, ideas and individuals from the United States West coast for some time, and a true venture capital market will evolve. Of particular interest is the relatively large interest presence within Australia. India seems like a log shot, but really is not. India does have an entrepreneurial type past, and has already evolved co-op type banking systems for small business. The venture capitalists within India have become quite active on the net, as have programming and technology-oriented services for western firms. We believe a small but potent venture capital climate will evolve in India.

INDIAN SCENARIO

India is a hotbed of technology companies, many of which are growing at an average annual clip of 50 per cent. During the past decade, the country has transformed itself into leading off shore software development and IT centers, trailing only the United States in software exports.

As Indian government realizes the importance of going global, it is starting to relax the strict regulations that companies must follow to qualify for overseas stock exchanges. India now has three 'Silicon Cities' - New Delhi in the north and Bangalore, Hyderabad in the south. Nearly every United States technology company has established a research and development facility in
these areas or developed outsourcing partnerships with homegrown companies. The main attraction for Americans is the abundance of high quality, low cost talent. The end result for India: $2.7 billion in software is estimated to have been shipped overseas in 1999. In terms of venture capital, the Walden Group and Draper International are the only major United States based firms accounting for opportunities extensively in the region.

As a result, Indian venture capital investments are growing at a rapid clip up 25 per cent to $292 million in 1998 from $233 million in 1997 according to the Indian Venture Capital Association. The number of deals has also increased from 691 in 1997 to 728 in 1998. There were around a 1,000 such deals in 1999, thanks to a push from overseas giants like Softbank, the company that has invested in, among others, E Trade Group and Yahoo. Softbank has come to India only recently via a joint venture with Rupert Murdoch’s copartners. The Bombay based joint venture, dubbed e Ventures, merged with Acquavit, a venture capital firm started by former Mckinsey and Co. partner Neeraj Bhargava.

“Almost 5500 million could come into the country by 2001 if the opportunities are good enough.” says Bhargava. And if we stop to think that what does $200 million mean for IT startups, we will realize that, on an average, a hundred odd companies will get funded in their start up phase over the next two years.

Despite the high costs of financing through venture capital companies, they do offer tremendous potential for obtaining a very large amount of equity financing and usually provide qualified business advice in addition to capitals entrepreneurship, angel investment, venture capital, internet
valuation and incubation and the above all have emerged as the keywords of the ensuing digital economy.

In India, the venture capital creation process has started taking off. All the four stages including idea generation, start-up, growth ramp-up and exit processes are getting encouragement. However, much more needs to be done in all these areas, especially for exit options. Started in mid 80s' by three All India Financial Institution as an in-house experiment, venture capital industry in India has grown manifold. At present there are 25 firms that include about 10 domestic VCs and almost 15 foreign Offshore Private Equity Funds. About 10 new Funds are likely to enter the market with in next 6 months to one year. The aggregate corpus of total venture capital funds has gone up from Rs. 200 Crores to Rs.5000 Crores (more than US$ 1.00 Billion). Domestic funds have largely invested in the equity and equity related instruments in start up and early stage unlisted companies with a deal size varying between Rs. 2 Crores and Rs. 4 Crores. On the other hand, foreign offshore private equity funds have made investment in the growth of medium and large size existing companies with an average investment ranging between Rs. 6 Crores and Rs. 12 Crores.

The Indian Venture Capital Industry has gone through the same stage of evolution that its counterpart in the United States and United Kingdom underwent. Over the past six years difference between ‘Classical Venture Capital’ of early 90s with a focus on technology investing and the overwhelming majority of “Private Equity Transactions” has been blurred by the reality of successful business development. The industry has reached its maturity stage and crossed its learning curve.
During the past two years, spectacular growth in information technology sector has necessitated emergence of information technology industry specific funds. Small industrial development bank of India has set up a National Software Fund besides creating smaller state level funds in each state to help small information technology start-ups. Many large private equity funds have also emerged to meet growing demand of funds in the information technology Sector. Lately, a number of Angel investors have also started appearing on the scene. As regards geographical distribution, Southern States have been the largest recipient of venture capital funds followed by Western states and then by the Northern ones. Eastern States have received negligible amounts of venture investments.

There has been an increase in the pool of funds available for venture capital activity to Rs.29, 884 million in 1998 from Rs. 25,595 in 1997. Investment has gone up to Rs. 12559.85 million in 728 projects as compare to Rs. 10000.46 million in 691 projects in 1997. Average investment per project has increased to Rs. 17.25 million in 1998 from Rs. 14.47 million in 1997. There is an average increase of almost 20 per cent in project size since the previous year. The trend is continued in 1999, with foreign institutional investors investing almost twice the amount invested by all India Financial Institutions in venture capital fund. In 1998, foreign institutional investors and All India Financial Institution contributed Rs. 15178.05 million and Rs. 7727.47 million respectively.
INDIAN VC EXPERIENCE

Today, we find a complete turnaround and it is the offshore funds that are making the maximum investments. Global players, who bring in global expertise, are increasingly participating in financing the venture capital needs. There is a lot more awareness today about what the venture capitalists can do and how they can help in improving, restructuring, and planning and even drafting a business. Gone are the days when the venture capitalists were looked at with skepticism, throughout of as external players not to be trusted and who did not have any role in value addition. The offshore funds having exposure to the foreign market do not find it difficult to invest huge sums of money. That venture capital investment in sunrise industries is essential for nurturing and catalysing its growth. Exhibit 2.1

INVESTMENT MADE BY VC INDUSTRY TILL 1998.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Rs. million</th>
<th>Number of Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial Products and Machinery</td>
<td>2,956.67</td>
<td>219</td>
</tr>
<tr>
<td>Computer Software And Services</td>
<td>2,508.87</td>
<td>100</td>
</tr>
<tr>
<td>Consumer related</td>
<td>1,381.49</td>
<td>52</td>
</tr>
<tr>
<td>Medical</td>
<td>817.48</td>
<td>47</td>
</tr>
<tr>
<td>Computer Hardware And Systems</td>
<td>739.41</td>
<td>30</td>
</tr>
<tr>
<td>Food Processing</td>
<td>718.58</td>
<td>50</td>
</tr>
<tr>
<td>Telecom And Data Communications</td>
<td>471.89</td>
<td>18</td>
</tr>
<tr>
<td>Biotechnology</td>
<td>448.77</td>
<td>27</td>
</tr>
<tr>
<td>Other Electronics</td>
<td>428.06</td>
<td>40</td>
</tr>
<tr>
<td>Energy related</td>
<td>229.58</td>
<td>18</td>
</tr>
<tr>
<td>Others</td>
<td>1,865.09</td>
<td>127</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12,559.85</strong></td>
<td><strong>728</strong></td>
</tr>
</tbody>
</table>

"Only a few of so many projects that are brought before the venture capitalists get the funds. The venture capitalists are looking for a needle in a haystack," say Venlat Subramanyam, Founder Director, Mantra Consultants, Chennai. An interesting facet that has to be taken into account is that advent of Internet, which has generated a plethora of opportunities.

Exhibit 2.2

INSTRUMENTS OF FINANCE

<table>
<thead>
<tr>
<th>Instruments</th>
<th>% to total</th>
<th>Investments in 1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Shares</td>
<td>64.26</td>
<td></td>
</tr>
<tr>
<td>Convertible Debt</td>
<td>19.75</td>
<td></td>
</tr>
<tr>
<td>Preference Shares</td>
<td>7.59</td>
<td></td>
</tr>
<tr>
<td>Non-convertible Debt</td>
<td>7.27</td>
<td></td>
</tr>
<tr>
<td>Other instruments</td>
<td>1.13</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100.00</td>
<td></td>
</tr>
</tbody>
</table>

**Exhibit 2.3**

**FINANCING BY REGION**

<table>
<thead>
<tr>
<th>Regions</th>
<th>Rs. Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>South</td>
<td>4,870.19</td>
</tr>
<tr>
<td>West</td>
<td>4,784.38</td>
</tr>
<tr>
<td>North</td>
<td>1,927.18</td>
</tr>
<tr>
<td>East</td>
<td>398.37</td>
</tr>
<tr>
<td>Outside India</td>
<td>581.75</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12,559.85</strong></td>
</tr>
</tbody>
</table>


Venture Capital Funds in India can be categorised into the following four groups (Pandey, 1996):

- VCFs promoted by the central (federal) government controlled development finance institutions, such as: TDICI by ICICI; Risk Capital and Technology Finance Corporation Limited (RCTPC) by Industrial Finance Corporation of India (IFCI); and Risk Capital Fund by Industrial Development Bank of India (IDBI).

- VCFs promoted by the state government controlled developmental finance Institutions, such as: Gujarat Venture Finance Company Limited (GVCFL) by Gujarat Industrial Investment Corporation (GHC); and Andhra Pradesh Venture Capital Limited (APVCL) by Andhra Pradesh State Finance Corporation (APSFC).
Venture Capital Funds promoted by the public sector banks, such as Cantina by Canara Bank; and SBI Caps by State Bank of India.

Venture Capital Funds promoted by the foreign banks or private sector companies and financial institutions, such as Indus venture Fund, Credit Capital Venture Fund and Grindlay's Indian Development Fund.

TDICI belongs to the first category of venture capital funds. It is the largest venture capital funds in India in terms of amount of venture capital fund under management (Rs.2800 million in 1996). In 1996, the Indian Venture Capital Association (IVCA) had 17 VCFs as its members (14 of these members have reported information about their venture capital activities). We may notice from Table 2.1 a steady increase in the number of projects (ventures) as well as in the amount invested by venture capital funds. The VCFs average investment in each venture has also increased over the years. This steady increase reflects the general trend in the venture capital industry in the country, with investors (VCFs) focusing on small and medium sized ventures. The total venture capital funds available for investment have also increased. In 1996, the bulk of the funding for venture capital funds came from the central (federal) government controlled financial institutions (60 per cent). Other investors included multilateral development agencies, such as the World Bank (17 per cent) the private sector (16 per cent) non-resident Indians (4 per cent) and the nationalised banks (4 per cent). Further, there are state government controlled financial institutions, foreign institutional investors, the public sector, insurance companies, mutual funds, other banks and even members of the public that also contribute to the capital pool of venture capital funds.
As regards the investment by the stages of business development, in 1996 the maximum investment (Rs. 2367 million or 42 per cent) was in the start-up stage ventures, followed by the Inter-stage ventures (Rs. 1862 million or 29 per cent). Turnaround ventures attracted the least amount of investment (Rs. 77 million or 1 per cent). These preferences were also reflected in the number of IVCA members who invested in different stages of business development. All 14 members of IVCA (who have provided full information about their business) invested in start-up ventures. 10 members invested in other early stage and 13 in later stage ventures, six in seed stage and only four in turnaround ventures. Out of the total venture capital investment, the largest part was invested in industrial products and machinery (Rs. 2956 million or 29 per cent) followed by consumer-related products (13 per cent) and food processing (8 per cent) industries. Other preferred industries for venture capital investment are computer software, services and medical equipment. This has been the general pattern of venture capital investment in India over the past few years (Exhibit 2.1).

Started in mid 80s' by three All India Financial Institution as an in-house experiment, Venture Capital industry in India has grown manifold. At present there are 25 firms that include about 10 domestic venture capitalists and almost 15 foreign Offshore Private Equity Funds. About 10 new Funds are likely to enter the market with in next 6 months to one year.

The aggregate corpus of total venture capital funds has gone up from Rs. 200 Crores to Rs. 5000 Crores (more than US$ 1.00 Billion). Domestic funds have largely invested in the equity and equity related instruments in start up and early stage unlisted companies with a deal size varying between Rs. 2 Crores and Rs. 4 Crores. On the other hand, foreign offshore private equity funds
have made investment in the growth of medium and large size existing companies with an average investment ranging between 6 Crores to 12 Crores (INR).

The Indian Venture Capital Industry has gone through the same stage of evolution as its counterpart in the United States and United Kingdom underwent. Over the past six years difference between ‘Classical Venture Capital’ of early 90s with a focus on technology investing and the overwhelming majority of “Private Equity Transactions” has been blurred by the reality of successful business development. The industry has reached its maturity stage and crossed its learning curve. During the past two years spectacular growth in information technology sector has necessitated emergence of information technology industry specific funds. Small industries development bank of India has set up a National Software Fund besides creating smaller state level funds in each state to help small information technology start-ups. Many large Private Equity Funds have also emerged to meet growing demand of funds in the information technology sector. Lately a number of Angel investors have also started appearing on the scene. As regards geographical distribution, Southern States have been the largest recipient of venture capital financing followed by Western states and then by the Northern ones. Eastern States have received negligible amount of venture investments.

The ministry of finance guidelines, the SEBI Regulations and the tax rules, this total lack of clarity has hampered the growth of venture capital funds / venture capital companies in the country. The SEBI has recognised the need to streamline the different sets of regulations and is in the process of drafting its recommendations. Even with respect to offshore funds, there are several cumbersome guidelines and procedures such as FIPB approval required each time an
offshore fund (without investing through a domestic vehicle) next directly in a portfolio company in India.

From the above discussion, we may conclude that promotion of venture capital, as a tool for development of economy would require following pre-requisites.

❖ The success of venture capital industry depends on the rationality of capital markets i.e. stock prices should be driven by performance of companies rather than overall business sentiments.

❖ Awareness among entrepreneurs about venture capital investment and Venture capital firms in the country to enable them to approach investments.

❖ Ambit of tax exemption / concessions for venture capital firm should be broadened. As on date, exemptions available are not attractive enough to lure more investments.

BOOSTING ALL FOUR STAGES OF THE VENTURE CREATION PROCESS

It is evident that all the four stages for venture creation process would have to be boosted in India. Augmenting risk capital will not be sufficient to accelerate new venture creation. There is more money available today than there are viable business ideas. India will also need initiatives at each phase of the new venture process: idea generation, start-up, growth ramp up, and exit.

Idea generation can be encouraged through several mechanisms. Venture fairs can provide meeting grounds for start-ups, investors and acquirers.
India can also support start-ups in two ways. One, providing an incubator development organisation. This organisation would provide business start-up facilities, technical guidance and management support for a limited time to start-ups. Two, providing finishing schools for entrepreneurs. The finishing schools would help entrepreneurs build knowledge in areas such as valuation, talent management, negotiation, and sales and marketing.

India can help companies ramp up growth by providing linkages to the global and non-resident Indians communities and through management programmes. Linkages to the global and non-resident Indian communities would encourage technological and managerial co-operation between Indian and overseas companies, e.g. for taking Indian products and services overseas. Management courses would help entrepreneurs manage growth by providing knowledge and training in managing growth, succession planning and exit options. These include seeking information, securing 'angel' financing, obtaining venture capital; and drawing up business plans. It also organises an annual conference on entrepreneurship bringing together entrepreneurs, venture capitalists, industry leaders and other parties.

Indian entrepreneurs must also be provided with viable exit options. Once their ideas have been built into successful ventures, they should be able to make their money either through a public issue or through a merger or acquisition. Sabeer Bhatia, who sold Hotmail to Microsoft, and Rakesh Matur, who sold Junglee to AOL, are examples of Indian entrepreneurs who were able to do this in the United States. To facilitate exit, listing procedures on Indian exchanges should be made more efficient and less time consuming. An option could be strengthening the OTCEI (Over
The venture creation and dot com phenomenon is happening in India. It is by itself at the startup stage. But an exponential growth is on the anvil and it is only a matter of time before it happens. The opportunity that India presents is becoming evident, as pieces of the puzzle fall in place. With Government of India backing the information technology industry whole heartedly and investors and entrepreneurs realising the potential upside in creating something of value, it won’t be long before all pieces fall in place to present a picture of the Indian Venture Creation and Incubation Engine running at full steam. The one thing, more than any other that has contributed to the United States becoming the world’s sole super power is the tremendous engine that it has unleashed for creating new ventures, employment and wealth. This engine is Venture Capital.

Therefore, in this background, the present research endeavour has been devoted to examine the prevalence of financial and non-financial factors that affect the venture capital funds. Further the prevalence of factors has been studied in two accounts:

First, through gathering information from the existing and published literature.
Second, through collecting and analyzing the information from selected organization with the help of structured Questionnaire.
FUTURE OF VENTURE CAPITAL:
The vision is that by 2008, India will comprise world class information technology software and service companies with global dominance in their core business of software development, clear ascendancy in cross border information technology enabled services, and an unassailable position in software products and e-business. Undoubtedly, the key word is entrepreneurship. It is evident that to fuel the growth of the information technology engine and entrepreneurship in India, angel investment, incubation services and venture capital are essential. The vision for India is that, it should become one of the top five global locations in the creation of technology ventures, leading to investments of over $2 billion in 2008. Ventures generated through new risk capital investment should provide revenues of at least $40 billion by 2008 (Exhibit 2.4). Nasscom is pushing for all four stages of venture capital creation process including - idea generation, start-ups growth ramp-up and exit processes.

Exhibit – 2.4
VC/Angel Investment in high-tech Firms in India

<table>
<thead>
<tr>
<th>Year</th>
<th>Rs. Million</th>
<th>U.S.$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>700</td>
<td>20</td>
</tr>
<tr>
<td>1997</td>
<td>3200</td>
<td>80</td>
</tr>
<tr>
<td>1998</td>
<td>6100</td>
<td>150</td>
</tr>
<tr>
<td>1999</td>
<td>14000</td>
<td>320</td>
</tr>
<tr>
<td>2000*</td>
<td>32000</td>
<td>750</td>
</tr>
<tr>
<td>2001*</td>
<td>50000</td>
<td>1200</td>
</tr>
<tr>
<td>2002*</td>
<td>450000</td>
<td>10000</td>
</tr>
<tr>
<td>2008*</td>
<td>1600000</td>
<td>40000</td>
</tr>
</tbody>
</table>

Exhibit 2.4 indicates the actual and forecasted figures of the involvement of VC funds in Information Technology.
With Government of India backing the information technology industry wholeheartedly and investors and entrepreneurs realising the potential upside in creating something of value, it won't be long before all pieces fall in place to present a picture of the Indian venture creation and incubation engine running at full steam.
NOTES


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