CHAPTER III

AN OVERVIEW OF
VENTURE CAPITAL IN INDIA AND ABROAD

The venture capital industry in India is still at a nascent stage. With a view to promote innovation, enterprise and conversion of scientific technology and knowledge-based ideas into commercial production, it is very important to promote venture capital activity in India. India’s recent success story in the area of information technology has shown that there is a tremendous potential for growth of knowledge-based industries. This potential is not only confined to information technology but is equally relevant in several areas such as bio-technology, pharmaceuticals and drugs, agriculture, food processing, telecommunication, services and the like. Given the inherent strength by way of its skilled and cost-competitive manpower, technology, research and entrepreneurship, with proper environment and policy support, India can achieve rapid economic growth and competitive global strength in a sustainable manner.

A flourishing venture capital industry in India will fill the gap between the capital requirements of technology and knowledge-based startup enterprises, and funding available from traditional institutional lenders such as banks. The gap exists because such startups are necessarily based on intangible assets such as
human capital and on a technology-enabled mission, often with the hope of changing the world.

The Indian Government’s objective to encourage the commercialization of new technologies, the backward integration of existing technologies, and the domestic production of foreign technologies called for thinking in terms of financing a company’s growth, rather than a particular project. In many technology-intensive sectors, capital is required to pay for the development of the product, to study the market and establish distribution networks. These front-ended working capital requirements cannot be readily accommodated by the development banks or the commercial banks, but are critical to the growth of the companies involved. Thus the importance of venture capital as a means of financing technology related risk has been recognized in India only recently.

The Indian tradition of venture capital for industry goes back more than 150 years when many of the managing agency houses acted as capitalists providing both finance and management skill to risky projects. After the abolition of managing agency system, the public sector term-lending institutions met a part of venture capital requirements through seed capital and risk capital for hi-tech industries, which were not able to meet promoter’s contribution. However, all these institutions supported only proven and sound technology while technology development remained confined to government labs and academic institutions. Many hi-tech industries, thus, found it impossible to obtain financial assistance
from banks and other financial institutions due to unproven technology, conservative attitude, risk awareness and rigid security parameters.

**Phases of Venture Capital**

The growth of venture capital in India has followed a gradual sequence of events. The idea of venture capital financing was adopted at the instance of the central government and government-sponsored institutions. The need for venture capital financing was first highlighted in 1972 by the Committee on Development of small and medium entrepreneurs under the chairmanship of R.S. Bhatt (popularly known as the Bhatt Committee) which drew attention to the problems of new entrepreneurs and technologists in setting up industries.

In 1975 venture capital financing was introduced in India by the all-India financial institutions with the inauguration of Risk Capital Foundation (RCF) sponsored by Industrial Finance Corporation of India (IFCI) to supplement ‘promoters’ equity with a view to encouraging technologists and professionals to promote new industries.\textsuperscript{81} In 1976 the seed capital scheme was introduced by Industrial Development Bank of India (IDBI).

A positive role for venture capital was envisaged in the national technology policy statement in 1983, which set guidelines for technological self-reliance in order to encourage the commercialization and exploitation of technologies

\textsuperscript{81}IFCI Brochure, RCF, Proceedings of Inaugural Function held on 10 March, 1995, p.11.
developed in the country. The Policy Statement stressed the development of indigenous technology and the efficient absorption and adaptation of imported technology appropriate to national priorities and resources. Given these objectives, venture capital became a necessary method of financing for enterprises using such technology. In 1984 Industrial Credit and Investment Corporation of India (ICICI) decided to allocate funds for providing assistance in the form of venture capital to economic activities involving both risk and high profit potential.\footnote{ICICI, Annual Report, 1984-85, p.12.}

To popularize venture capital financing, the government announced the creation of a Venture Capital Fund (VCF) in the document on long-term fiscal policy presented to Parliament by the finance minister on 20th December 1985. The venture capital fund was to be created to provide equity capital for pilot projects attempting commercial applications of indigenous technology and for adapting previously imported technology for wider domestic applications.

**The First Phase 1986-1995**

The VCF, which became operational with effect from April 1, 1986, is administered by Industrial Development Bank of India (IDBI). In 1986, ICICI launched a venture capital scheme to encourage new technocrats in the private sector in the emerging fields of high-risk technology. Under the above scheme,
commercial research and development projects involving development of new technology or product, commercial implementation of indigenously developed technology or implementation of an innovative technology imported and transferred from abroad are eligible for venture capital assistance. Further, in August 1986, ICICI undertook the administration of the Programme for Advancement of Commercial Technology (PACT). This was akin to venture capital financing for specific needs of the corporate sector industrial units. IDBI started offering its venture capital fund scheme in March 1987. The origin of modern venture capital in India can be traced to the setting up of a Technology Development Fund (TDF) in the year 1987-88, through the levy of a cess on all technology import payments.

The year 1988 remains significant for the growth of venture capital financing in India. The government’s awakening to the potential of venture capital occurred in conjunction with the World Bank’s interest in encouraging economic liberalisation in India. The government of India announced guidelines for the establishment and functioning of venture capital activities on November 25, 1988. The most important feature of the 1988 guidelines was that venture capital funds received the benefit of a relatively low capital gains tax rate (but no pass through), that is, a rate equivalent to the individual tax rate, which was lower than the corporate tax rate. They were also allowed to exit investments at prices not subject to the control of the Ministry of Finance’s Controller of Capital Issues.
The government also specified that the entrepreneurs should be ‘relatively new, professionally or technically qualified, and with inadequate resources or backing to finance the project”. There were also other bureaucratic fetters including a list of approved investment areas. At least one of the two government sponsored development banks, ICICI and IDBI, were required to vet every venture capital undertaking’s application to a venture capital firm to ensure that it met the requirements. Also, the Controller of Capital Issues of the Ministry of Finance had to approve every line of business in which a venture capital firm wished to invest. In other words, the venture capitalists were to be kept on a very short leash.

Despite these constraints, the World Bank supported the venture capital project, noting that ‘the guidelines reflect a cautious approach designed to maximize the likelihood of venture capital financing for technology-innovation ventures during the initial period of experimentation and thereby demonstrate the viability of venture capital in India. For this reason, during the initial phase, the guidelines focus on promoting venture capital under the leadership of well-established financial institutions.

The World Bank sought to ensure a level of professionalism in the four new venture capital funds, two of which were established by two well-managed state-level financial organizations (Andhra Pradesh and Gujarat), one by a large
nationalized bank (Canara Bank) and one by a development finance organization (ICICI). The World Bank loaned the money to the Indian government that would then on-lend it at commercial rates to these institutions for 16 years, including a 7-year moratorium on interest and principal repayments. The venture capital funds were expected to invest principally in equity or quasi-equity. Some monies were allocated for training personnel through internships in overseas venture capital funds.

The venture capitalists agreed with the World Bank that they would operate under the following operating guidelines:

a) the primary target groups for investment would be private industrial firms with above-average value-added in sectors where India had a comparative advantage, and protected industries would be avoided:

b) the quality and experience of the management was key, along with the prospects of the product;

c) the portfolio return should be targeted to be at least a 20% annual return; and

d) no single firm should receive more than 10% of the funds, and the venture capitalist would not own more than 49% of an investee’s voting stock.
These guidelines also allowed the private sector jointly with banks or financial institutions to operate in the field of venture capital financing. In the year 1988, IFCI-sponsored RCF was converted into the Risk Capital and Technology Finance Corporation of India Ltd. (RCTC). It took over the activities of RCF in addition to the administration of other schemes of financing technology development and managing venture capital fund.

In 1988, the first organization to identify itself as a venture capital operation was Technology Development & Information Company of India Ltd. (TDICI). It was established in Bangalore as a subsidiary of the Industrial Credit & Investment Corporation of India, Ltd. (ICICI), the then India’s second-largest development financial institution. In 1988, the ICICI division was merged into the newly formed TDICI in Bangalore, which was an equal joint venture between ICICI and the state-run mutual fund Unit Trust of India (UTI). The primary reason for creating the joint venture with UTI was to use the tax pass-through, an advantage that was not available to any corporate firm at that time other than UTI (which had received this advantage through a special act of parliament). Hence, while the investment manager for the new funds was TDICI, it was a 50-50 partnership between ICICI and UTI, and the funds were registered as UTI’s Venture Capital Unit Schemes (VECAUS). Vecaus I, established in 1988, had a paid-in capital of 300 million rupees. Founded in 1991, Vecaus II had a paid-in
capital of 1 billion rupees. In October 1994 ICICI and UTI set up a third fund Vecaus I – Right (Vecaus –IR) to invest in expansion stage financing.

Initially TDICI saw itself as an organization funding technology ventures, and did not focus as directly upon commercial objectives. It made investments in interesting technology and not, perhaps, the best business opportunities. There also were organizational failures, the most important of which was allowing relatively junior recruits to filter the deals before the senior professionals saw them. As a result, several high-quality potential investments were missed. By 1994, the difficulties created by the institutional ownership in the management and funding of TDICI began to tell on staff morale, and the performance of the fund’s new investments was relatively poor.

Despite its difficulties, TDICI was the most successful of the early government-related venture capital operations. Moreover, TDICI personnel played an important role in the formalization of the Indian venture capital industry. Also, a number of TDICI alumni became managers in Indian technology firms. So, the legacy of TDICI includes not only evidence that venture capital could be successful in India, despite all the constraints, but also a cadre of experienced personnel that would move into the private sector.

There were other early Funds. In 1990, Gujarat Venture Finance Limited (GVFL) began operations with investments from the World Bank, from the U.K.
Common wealth Development Fund, the Gujarat Industrial Investment Corporation, Industrial Development Bank of India, various banks, state corporations, and private firms. It was sufficiently successful so that in 1995, it launched its second fund. Then in 1997 it raised a third fund to target the information technology sector. From the 1990 fund to the 1995 fund there were less food and agriculture-related firms and a greater emphasis on information technology. The 1997 fund invested exclusively in information technology.

The other two venture funds had only modest success. The Andhra Pradesh state government formed a venture fund subsidiary in its AP Industrial Development Corporation (APIDC). Though located in a relatively strong high-technology region around Hyderabad, APIDC found it difficult to find good investments and received criticism from the World Bank supervision mission in 1992. The final venture fund was the only bank-operated venture capital fund, which was a subsidiary of nationalized Canara Bank, Canbank Venture Capital fund (Canbank). Canbank, which was headquarteried in Bangalore, also performed only modestly. However, all of the firms were able to raise new funds and continue their operations.

This first stage of the venture capital industry in India had difficulties as management needed to develop experience and there were handicaps such as regulations regarding which sectors were eligible for investment, a deficient legal
system, successive scandals in the capital market, economic recession, and the general difficulties in operating in the Indian regulatory environment. And yet, from this first stage, there came a realization that there were viable investment opportunities in India, and a number of venture capitalists had received training.

**The Second Phase, 1995-1999**

The success of Indian entrepreneurs in Silicon Valley that began in the 1980s became far more visible in the 1990s. This attracted the attention of venture capitalists both from India and abroad. The amount of capital under management in India increased after 1995. Particularly important were venture capital funds raised from abroad during this period. Very often, non-resident Indians (NRIs) were important investors in these funds.

The formalization of the Indian venture capital community began in 1993 with the establishment of the Indian Venture Capital Association (IVCA) headquartered in Bangalore. The IVCA had a large agenda and a large task in its efforts to improve the venture capital environment in India. To improve the environment, the IVCA continually lobbied the government. In May 1998 in a letter to the Finance Minister the then Chairman of IVCA, Shri Vishnu Varshney presented the industry’s suggestions on several issues including:

1) The need for a common regulatory framework.
2) The retention of some special tax privileges that the Ministry was planning to withdraw.

3) Permission for pension funds, insurance companies and mutual funds to invest in venture capital funds.

4) Permission for investment by venture capital funds in instruments other than pure equity (such as preference shares),

5) A relaxation of IPO guidelines, and

6) An inclusion of the services industries other than software, which was already included, as eligible investments.

The result of this lobbying effort was mixed: the tax privileges were retained, there was a progressive liberalisation in IPO guidelines, and some financial institutions, such as banks, mutual funds and insurance companies were permitted to invest in venture capital funds. These lobbying efforts to improve the environment for venture capital were continuous and gradually had good results.

The reasons for this constant need to lobby were twofold: First, the government did not understand the benefits of venture capital in economic development terms. This was a result, in large measure, of the lack of recognition of the potential of the Indian-owned portion of the software industry. Moreover, the venture capital industry was tiny with respect to the overall Indian economy. Hence, they were unable to mobilize sufficient political pressure to motivate any
liberalisation. Second, the largest player, TDICI, had few reasons to demand changes in the regulations, because it was unaffected by them. In fact, another important source of lobbying for the Indian venture capital industry was the Indian information technology industry association.

There were internal divisions within the Indian venture capital industry. In 1999 approximately 80% of the total venture capital investments were derived from overseas firms. These foreign firms registered in Mauritius as a strategy to avoid the onerous regulations and taxes imposed by the Indian government – a mechanism that foreign securities firms seeking to invest in India had pioneered. A Mauritius registry allowed tax pass-through, and since they did not have other issues, such as finding funds, they had less incentive to join IVCA or actively lobby the Indian government. IVCA thus was a vehicle for Indian venture capital funds seeking to obtain a level playing field with the foreign funds. At times, in the past, differences within IVCA surfaced, with the overseas funds arguing for more regulation from the Foreign Investment Promotion Board, which has a liberal record, and less from the Ministry of Finance, which has a contradictory record. The domestic funds favored a single regulator, and they ultimately won this debate when the SEBI was formed.

The IVCA continued to experience difficulties, as of December 1998, only 21 venture capital firms were registered with IVCA. Of these firms, eight were in
the public sector and seven had received funds from multilateral funding agencies. Despite these difficulties, an increasing number of Indian firms were able to list on the NASDAQ and on the Indian stock market. If the Indian venture capital industry continues to expand and a regulatory framework that ends the benefit for offshore registration is enacted, then the IVCA will be able to present even more unified positions. This will strengthen it as the voice of the Indian venture capital sector.

The Third Phase 2000 and Above

In the late 1990s, the Indian government became aware of the potential benefits of a healthy venture capital sector. Thus in 1999 a number of new regulations were promulgated. Some of the most significant of these related to liberalizing the regulations regarding the ability of various financial institutions to invest in venture capital. Perhaps, the most important of these went into effect in April 1999 and allowed banks to invest up to 5% of their new funds annually in venture capital. However, as of 2001 they have not made any venture capital investments. This is not surprising since bank managers are rewarded for risk-averse behaviour. Lending to a risky, fast-growing firm could be unwise because the loan principal is at risk while the reward is only interest. This meant that since banks controlled the bulk of discretionary financial savings in the country, there was little internally – generated capital available for venture investing.
The Indian venture capital industry is struggling to emerge and give the general global downturn, the handicaps existing in the Indian environment are threatening. Some of the obstacles can be addressed directly without affecting other aspects of the Indian economy. Others are more deeply rooted in the legal, political, and economic structure and will be much more difficult to overcome without having a significant impact on other parts of the economy. A number of these issues were addressed in a report submitted to SEBI in January 2000 by the K.B. Chandrasekhar committee on venture capital. The committee identified the impediments in the growth of venture capital industry in India and suggested suitable measures including:

1. Harmonization of multiple regulatory requirements into a nodal regulatory system under SEBI,
2. Tax pass through for venture capital fund,
3. Flexibility in investment and exit,
4. Facilitating mobilization of global and domestic resources through hassle-free entry of foreign venture capital investors on the pattern of foreign institutional investors and
5. Increase in the list of sophisticated institutional investors to invest in venture capital funds.
In June 2000, the Ministry of Finance adopted a number of the Committee’s proposals. That is, to simplify the procedure, SEBI would be a single-point nodal agency for registration and regulation of both domestic and overseas venture capital funds. The only criterion was to be the technical qualifications of their promoters, whether domestic or offshore. Such registration would not impose any capital requirements or legal structure. This is very important, because it would allow India to develop a legal structure suitable to its environment, while offering tax pass-through for all firms registered as venture capital firms with SEBI. This was an important achievement of the committee’s report.

A number of suggestions were not accepted even though they would assist in the growth of venture capital. Many were related to the much larger general issues of corporate governance. For example, there was no change in the regulations regarding restrictions on currency non-convertibility, providing employees more flexible stock-option plans, allowing domestic venture capital firms to hold equity in overseas startups, and regulations allowing greater flexibility in voting and dividend rights. Reluctance to adopt these measures is understandable, because they would strike at some of the fundamental issues of corporate governance in India. Thus, they were seen as policy decisions that might set in motion a larger chain of events.
At the end of 2001, the Indian venture capital environment contained several unresolved issues. One important obstacle was the inability to pass through unrealized gains or losses through to the venture capital fund’s investors through a direct distribution of stock or other securities unless the fund was organized as a trust. In the US, these “in-kind distributions” were the most common method of compensating investors. After the budget in 2000-2001, the government responded by the 20 % tax on income of venture capital fund, but allowing domestic venture capital funds tax pass-through status.

At present, several venture capital firms are incorporated in India and they are promoted either by all India Financial Institutions like IDBI, ICICI, IFCI, State level financial institutions, Public Sector banks or promoted by foreign banks/ private sector or financial institutions like Indus Venture Capital Fund and Credit Capital Venture Fund. The brief profiles of important venture capital funds at the national level, state level and private venture capital organizations are given below:

3.1 NATIONAL LEVEL VENTURE CAPITAL ORGANISATIONS

IDBI Venture Fund

Industrial Development Bank of India (IDBI) was established on July 1, 1964 under the Industrial Development Bank of India Act, 1964, enacted by Parliament. IDBI has been providing venture capital as direct assistance to new
and existing industrial units under the Venture Capital Fund Scheme since March 1987. The Venture Capital Fund Scheme is a divisional activity of the IDBI and is operated by its technology development department. The Venture Capital Fund Scheme has a sharp focus on indigenous technology development. IDBI draws funds from the collections made under the Research and Development Cess Act, 1986, prescribing levy and the collection of 5% on all payments made for import of technology. This money is used by IDBI for providing financial assistance to industrial concerns attempting commercial application of indigenous technology or adapting imported technology to wider domestic applications.

**Eligibility Criteria**

All industrial concerns under Section 2(c) of IDBI Act, 1964 are eligible. IDBI considered the following aspects for providing the assistance under its venture capital scheme.

- Venture should normally have innovative content.
- Ventures may not be the first in the technology but would be one of the first few, offering potential for substantial return.
- Ventures, while dealing with traditional products and services in emerging sectors should have a sustainable competitive advantage.
- Potential for long-term capital gain still remains the overriding criterion.
The criterion, has undergone a sea-change. During the early nineties the emphasis was only on technology and there was no mention of the potential for substantial return, competitive advantage or potential for long-term capital gain. Presently the main criteria being high growth prospects, potential for capital appreciation and clear cut exit within a time frame of 3-5 years. The target return is thirty % on equity investment and IDBI prefers startup stage financing.\textsuperscript{83}

**Investment Criteria**

Presently IDBI has no upper limit about the project cost on the ventures to be financed under this scheme. However IDBI’s assistance is restricted to Rs.20 crores and IDBI finances a maximum of 80 % of the project cost. The promoter’s contribution should be at least 20 % and the core promoters are required to bring in a minimum of 10 % of the cost of the project.

IDBI provides venture financing either in the form of equity or in the form of conditional and conventional loan. The IDBI venture fund promotes and provides financial support to new opportunities in the emerging sectors of information technology, media and entertainment, bio-technology, and food-processing, which are considered risky for normal bank finance. IDBI is also setting up a dedicated venture fund for IT sector with a proposed corpus of Rs.50

\textsuperscript{83}IDBI Annual Report 2001-2002.
crores. IDBI is promoting a separate Asset Management subsidiary to manage this fund.

**ICICI Venture Funds Management Company Limited (ICICI Venture)**

ICICI was a pioneer in introducing venture capital in India. ICICI Venture Funds Management Company Limited is India’s largest venture capital firm. Presently ICICI Venture Funds are a wholly-owned subsidiary of ICICI limited and have an affiliation with Trust Company of West (TCW).

**Investment Criteria**

The focus of ICICI Venture Funds Management Company Limited is on the development and financing of indigenous technology. It prefers innovative and high technology projects. Besides financing prototypes, ICICI venture fund also provides finance for setting up and commercialization of pilot plant and seed capital for research and development in a few selected cases. The financing instruments used are equity participation, conditional and normal loans. Conditional loans are interest-free loans with a payment of royalty linked to the commercial success of the venture. In case of a failure, the entrepreneurs are required to payback only a part of the loan. The normal loans have the same terms and interest rate as stipulated by ICICI for loans to its clients.
Presently ICICI Venture Funds seeks to invest in opportunities where it’s networking through ICICI and TCW, creating value for all involved. Its primary objectives is capital appreciation through investment in unlisted companies with significant growth potential with a clear exit strategy in three to five-year period and it selects ventures having potential for capital appreciation. Presently its investments span a broad spectrum of industries and stages. These include startup as well as ventures with one to three years of revenue record that require growth financing and companies close to initial public offerings. The preferred sectors of industry are health care, information technology, light engineering and services.

Small Industries Development Bank of India (SIDBI) Venture Capital Scheme

SIDBI has constituted a venture capital fund with an initial corpus of Rs.10 crores and started operations in 1993. The fund was setup as an assistance avenue for entrepreneurs having innovative ventures, which generally do not qualify for conventional route of term financing. Ventures, involving new and untried processes and technologies, which have scope for commercial application with characteristics of high risk and high reward, are provided assistance from this fund. These include projects relating to development of computer software.

Investment Criteria

The fund invests only in enterprises set up as private or public limited companies. The assistance is provided in the form of equity, conditional
loan or normal term loan or a suitable mix of the same which would be decided on case-to-case basis. No maximum or minimum limit has been fixed in respect of the amount of assistance. SIDBI will normally offload its shareholding in the venture companies at an appropriate time through OTCEI. Normally the promoters are offered the first option to buy back the shares at a mutually agreed price. The conditional loans are structured considering the earning capacity of the investee companies and their ability to payback the same. The promoter’s contribution is also kept flexible. However depending upon the resources available with them the promoters are expected to take a reasonable stake in their venture.

**Eligibility Criteria**

The fund looks for a sound management team comprising professionals endowed with entrepreneurial traits and skills, integrity and ability to innovate with a total commitment to the venture. Only the proposals catering to a rapidly growing market and having a long term competitive advantage in terms of quality, price of product, and growth potential are considered. The venture should have the potential of yielding an above average profitability leading to attractive returns on investment. SIDBI seeks to play a lead investor’s role in the ventures supported by it and maintains an effective involvement with the management of the venture capital undertaking.
SIDBI has also taken initiative for setting up national level venture fund to meet the requirements of software and IT enterprises in small scale sector.

**National Venture Fund for Software and IT Industry (NFSIT)**

NFSIT has been setup by SIDBI, in association with Ministry of Information Technology (MIT), Government of India. It is a close-ended 10 year fund with an initial corpus of Rs.100 crores. NFSIT received the certification as a venture capital fund from the SEBI in September 1999. The main objective of the fund is to meet the total fund requirements of the software and IT companies, particularly small enterprises, to enable them to achieve rapid growth rates and maintain their competitive edge in domestic and international markets. The fund aims at developing international networking to help the assisted ventures to seek further investment from international venture capitalists in subsequent rounds of financing. The fund may also consider funding innovative incubation projects and development of products in the IT sector.

The fund focuses on unlisted small ventures set up as private and public limited companies in InfoTech and software industry like e-commerce, networking, product development, internet portals, data communication, value added communication services etc.

The amount of assistance / investment by the fund depends on the size, nature and stage of the venture, and expected returns. The fund invests in equity
and equity – related instruments depending upon the need and potential of the venture. The fund invests a minimum amount of Rs. 50 lakhs in a venture and is open to sharing its risk with other venture funds. As an exit strategy the fund prefers exit through IPO but is also considers buy back of the shares by the promoters or the company at a mutually agreed price.

**IFCI Venture Capital Fund Limited (IFCI)**

Industrial Finance Corporation of India Venture Capital Fund Limited was originally set up by IFCI in 1975 as a Cooperative Society in the name and style of Risk Capital Foundation (RCF) to provide institutional support to first generation professionals and technocrats for setting up their own ventures in the medium scale sector, under the Risk Capital Scheme. In the year 1988, RCF was converted into a company, namely, Risk Capital and Technology Finance Corporation Ltd (RCTC). After corporatization, RCTC also introduced the Technology Finance and Development Scheme for financing development and commercialization of indigenous technology. In February 2000, the name of RCTC was also changed to IFCI Venture Capital Funds Ltd. (IVCF).

**Eligibility Criteria**

IVCF, based on its wide- ranging experience, has formulated certain parameters for taking investment decisions. These parameters serve as the basis to
effectively evaluate the sustainability and profitability of a project, crucial for ensuring high returns. The quality and depth of the management team, who have the resilience to develop and nurture the business, is one of the most important criteria for committing investment. IVCF believes in backing management teams with industry-specific expertise.

**Investment Criteria**

Presently, IVCF is aggressively investing in emerging knowledge-based industries such as information technology, pharmaceuticals, bio-technology, healthcare, media, telecommunications and the like. IVCF aims at funding projects with innovative content and cutting-edge technologies.

Investment is considered in the form of equity and equity-linked instruments such as optionally and fully convertible debentures and preference shares. IVCF adopts a flexible financing approach while structuring a deal to suit specific financing requirements of individual projects. IVCF looks for a time horizon of 3-5 years for exercising the exit option in a venture. The preferred exit routes are by way of IPOs, strategic sale, buy back by company / promoters.

**Can Bank Venture Capital Fund Limited (CVCF)**

Canara Bank was the first nationalized bank in India to start a venture capital fund. Canara Bank set up Canara bank Venture Capital Fund (CVCF) on
October 21, 1989. The fund was established as a trust fund and Canara Bank Financial Services Limited (CANFINA), a Wholly-owned subsidiary of Canara Bank, managed the fund as a trustee. CVCF is now managed by Canara bank Venture Capital Fund Limited (CVCFL), a wholly–owned subsidiary of Canara Bank, incorporated on February 22, 1995 as an Asset Management Company. CVCFL aims at participating in ventures with technological innovations and high-tech content, promising substantial capital appreciation in the long-term. CVCFL is having two funds; CVCF –I was contributed by Canara Bank, Cantina and World Bank. CVCF-I have already been fully invested and is in the disinvestments mode. CVCF-II is contributed solely by Canara Bank and is in the investment mode.

**Eligibility Criteria**

The fund is looking for technically qualified / experienced promoters with a track record demonstrating good performance in terms of technical, managerial and marketing capabilities. Preference is given to ventures incorporating significant improvement over the technologies operating in the country, leading to energy conservations, reduced material consumption, cost reduction and the like. The project should have significant potential to grow, enabling the company to go public with in 3 to 5 years, so the fund could have a smooth exit.
**Investment Criteria**

Venture finance is provided only to domestic companies whose shares are not listed in a recognized stock exchange in India and is engaged in the area of software, information technology, biotechnology, pharmaceuticals and agricultural-allied sectors as well as production / manufacturing of products using patented technology from the approved research laboratories. Now the fund is strictly investing in venture capital undertaking as defined by SEBI. The fund has a regional preference for Southern and Western regions, although it has no reservations in financing enterprises located in other regions.

CVCF makes investments in all the stages of venture capital. CVCF’s assistance is primarily by way of equity participation. The extent of equity participation has been reduced from 49% to a maximum of 40% and a minimum of 1% of the equity of the company.

**IL and FS Venture Corporation Limited (IVCL)**

IL and FS Venture Capital Limited, a fund management company is subsidiary of Infrastructure Leasing and Financial Services Limited (IL & FS) set up in association with Bank of India and Multilateral Development Agencies. It is the only public listed venture finance management company in India. IVCL, earlier known as Credit Capital Venture Fund (India) Limited, came into the fold
of IL and FS in October 1996. The IL and FS, Bank of India, CDC, ADB, IFC and other public as well as corporate bodies are investors in IVCL.

**Investment Criteria**

IVCL focuses on expansion stage companies in a few identified sectors. The IT and IT enabled Services: Convergence Industries – IT, Communications, Media: Healthcare and Biotechnology; Food processing; and Automotive and Light Engineering have been identified to provide outstanding medium term investment opportunities. Most of the companies operating in the focus sectors chosen by IVCL for investments have their markets outside India. IVCL is presently managing seven domestic venture capital funds some of which are industry specific while some are region specific.

The various funds promoted by IVCL are as under.

- South Asian Regional Apex Fund (SARA Fund)
- Indian Auto Ancillary Fund
- Tamil Nadu InfoTech Fund
- UP Venture Capital Fund
- Orissa Venture Capital Fund
- Auto Ancillary Fund and
- Information Technology Fund.
3.2 STATE – LEVEL VENTURE CAPITAL ORGANISATIONS

Gujarat Venture Capital Finance Limited (GVFL)

GVFL was established on July 14, 1990 by Gujarat Industrial and Investment Corporation (GIIC) Ltd in association with World Bank as a pioneer venture capital firm in India. Currently, GVFL is managing the following four funds.


GVCF –1990 was a closed ended fund of 15 – years duration with a corpus of Rs. 24 crores. The fund provided assistance in the form of equity, conditional loan, income notes, redeemable preference shares and cumulative convertible preference shares. The fund concentrates on investing in technology intensive and innovative projects. It prefers to invest in startup and early stage financing and targets a return of 25 % over a period of 15 years.


GVFL launched its second fund, Gujarat Venture Capital Fund on January 17, 1995 with a corpus of Rs.60 crores. It has a duration of 12 years. The fund, focuses on unlisted companies, is continuing its emphasis on start-up and early stage ventures and first generation entrepreneurs. The fund seeks a target return of 30 % over 12 years. The second fund invests primarily in the equity of the
investee companies and takes a maximum stake of 40 % of the venture’s paid-up capital.

**Gujarat Venture Capital Fund 1997 – Software/SSI Fund**

GVFL launched its third fund, Gujarat venture capital fund 1997 as a close ended fund of 12-year duration with a targeted corpus of Rs.40 crores. It focuses on software and information technology. The fund targets a return of 25 % over a period of 12 years and invests in ventures related only to information technology. SIDBI and World Bank have contributed the entire corpus of the fund and the fund is investing in the existing unlisted companies of start-up ventures. Only ventures, which have a sustainable competitive edge in terms of product, process technology, or market are being considered.

**Gujarat Information Technology Fund (GITF)**

Gujarat Information Technology Fund is one of the IT venture funds set up by SIDBI in different states in association with the state level organizations for promoting ventures related to information technology sector in the State of Gujarat. The fund has a corpus of Rs.18 crores contributed by Gujarat Industrial and Investment Corporation Limited and SIDBI. It is a 12-year close ended fund and is presently in investment phase.
Andhra Pradesh Industrial Development Corporation (APIDC) - Venture Capital Limited

APIDC-Venture Capital Limited (APIDC-VCL) is a joint venture promoted in 1989 by Dynam Venture East (P) Limited holding 51% and APIDC with 49% shares with an authorized capital of Rs.2 crores. APIDC-VCL is managing a trust fund by name APIDC-Venture Capital Fund 1990 with an initial corpus fund of Rs.13.5 crores which has been raised to Rs.30 crores. The fund is a 15 year close ended fund.

The fund invests in all sectors of industry and its area of focus is business with the ability of building strong/unique competitive advantages. The fund primarily invests in equity including redeemable preference shares and to some extent in convertible debt. The fund invests in all stages of investment including seed stage. However, maximum numbers of assisted units pertain to startup stage while later stage accounts for the highest investment.

Uttar Pradesh Venture Capital Fund

Uttar Pradesh venture capital fund is another state specific trust fund. It is a twelve-year close ended fund that was set up in June 1995. The fund invests in startup and later stage financing in ventures being setup within the boundaries of state of Uttar Pradesh. The fund invests in equity shares, preference shares and convertible instruments.
**Industrial Venture Capital Limited**

Industrial Venture Capital limited is a Tamil Nadu-based venture capital company promoted by Tamil Nadu Industrial Investment Corporation Limited in association with a private sector company, Integrated Finance Company Limited, and ICICI limited. The company has set up a venture capital fund by name “Tamil Nadu Venture Fund” in June 1994. As a policy, the fund can provide venture finance both as equity and debt. It prefers to invest at mezzanine stage financing but the present investment is spread over seed, startup and later stages.

**Karnataka Information Technology Venture Capital (KITVEN) Fund**

KITVEN Fund is a Rs.15 crores, 10 year, close-ended Venture Capital Fund conceptualized and funded by Karnataka State Industrial Investment and Development Corporation Limited (KSIIDC), Karnataka State Financial Corporation (KSFC) and Small Industries Development Bank of India (SIDBI). KITVEN Fund is dedicated to investing in companies in the Information Technology Industry operating primarily in Karnataka.

KITVEN Fund’s primary objective is to make available long-term funds to new/unlisted companies in the seed/start-up stages to develop competitive products and cutting-edge technology, manufacture and commercialise the product developed, move up in the value chain, expand and upgrade existing
capabilities to cater to a wider clientele. About 51% of the Fund would be invested in Small Scale Industry (SSI) units.

The preferred business opportunities include Internet Services, Entertainment/Educational Software, Training, Innovative Products catering to the Communications Industry, E-commerce etc. The fund will undertake investment in the range of Rs.25 lacks to Rs.150 crores per investee company. The typical investment horizon would be 5-7 years although lower periods would also be considered. The preferred form of investment is equity.

**Private Venture Capital Organization**
**Indus Venture Management Limited (IVML)**

Indus Venture Management Limited is the oldest private sector venture capital management company in India. T. Thomus, former Chairman of Hindustan Lever Limited and Executive Director of Unilever Plc., promoted it in 1989 in association with Arvind Mafatlal group companies and International Finance Corporation, Washington, an associate of World Bank. IVML in turn established a venture capital trust fund “Indus Venture Capital Fund-1 (IVCF-1)” in October 1991. This was followed by a second fund “Indus East Holding Limited” in 1996.

**Indus Venture Capital Fund – 1 (IVCF-1)**

Indus Venture Capital Fund-1 was set up to invest in equities of eligible enterprises as defined in the venture capital guidelines, 1988. It was a ten-year
close ended trust fund with a corpus of Rs.21 crores. Software and chemicals were the preferred industry sectors for the investment by the fund. The projects, whose products had an export potential were preferred. The ventures that were considered to have a growth potential capable of yielding a return of 20 to 25% per annum over a period a 5 to 7 years were selected for investment. As per the fund’s policy, all financing has been by way of equity investment in the investee companies. The fund’s investments are confined to startup and expansion stage with a marked preference for the startup stage.

**Indus East Holding Limited/ Sutter Hill Investment Mauritius Limited (IEHL)**

Indus East Holding Limited is the second venture fund established by IVML. It is a Mauritius – based offshore fund setup in 1996. IEHL is also a ten-year close ended fund and it has an authorized capital of Rs.212.76 crores. The new fund has identified software, textiles and chemicals as the focus industries. Its investment is open for all stages of an enterprise. The fund does not give any loan and invests only in equity capital of investee companies.

**IFB Venture Capital Finance Limited (IFB VC)**

IFB Venture Capital Finance Limited is a venture capital company promoted by IFB Industries Limited in association with two all India financial institutions namely IDBI and ICICI. The company was established as private
sector public limited company in November 1992. IFB VC has a paid-up capital of Rs.10 crores. It is one of the few venture capital firms that are not a trust fund managed by an asset management company but is structured as venture financing company. It is a Calcutta-based company and invests only in the ventures being setup in eastern and southern states of the country.

The fund is open to all stages of venture financing except turn around stage. The company has made investments primarily in early and later stages of the enterprises. Besides investment in equity shares, the company has also been investing in preference shares. Recently there has been a shift in the company’s portfolio in favour of preference shares. Its investments are in less risky conventional industries like industrial products and food processing.

**Marigold Capital Management Limited**

Marigold Capital Management Limited is private sector fund management company established in July 1996. It is a small company with the paid up capital of Rs.20 lakhs. It is managing a ten year close ended venture capital trust fund called “Marigold Fund” that was set up in April 1997. The fund has an authorized corpus of Rs.20 crores and fully contributed by resident and non-resident Indians.

The fund has identified information technology and consumer goods as the focused areas for its investment. The fund prefers a broad range of investments from startup to later stage financing and enables it to exit from the investment in a
seven-year period. The fund has invested in equity and equity-related instruments like convertible loans with a higher preference for equity shares of the investee company.

**Alliance Venture Capital Advisors Limited**

Alliance Venture Capital Advisors Limited is a 100% subsidiary of Alliance Management and Fiscal Services Limited, a company of Alliance Group of Calcutta. It is an asset management company that manages an offshore venture capital fund “Swiss Technology Venture Capital Fund Limited” (SWISS TEC VCF). SWISS TEC VCF was established in September 1997 with an authorized capital of Rs.100 crores. It is a ten-year close ended fund.

The fund invests in unlisted small and medium enterprises having linkages with Swiss companies. It prefers to invest in early and later stage financing. The fund is very conservative about startup financing and may consider supporting startup investments on a very selective bases. The fund invests only in equity and abstains from debt financing. The fund plans to invest in health care, food processing and packaging-including food and non-food packaging sectors. It also prefers to invest in graphic arts, instrumentation and green technologies.

**Draper International**

Draper International is a California (USA) based Asset Management Company with an office in Bangalore, India. The company was incorporated in
1994. In March 1996 it established an offshore fund “Draper International India LP”. The fund is not registered with SEBI and operates as a Foreign Institutional Investor. It is a close ended trust fund of ten years duration with a corpus of Rs.209 crores.

The fund mainly invests in information technology and related services. Enterprises in startup and their expansion stages are eligible for seeing investments from the fund. Ventures that have a potential of providing cash return of at least 25% in dollar terms are eligible if they can assure an exit in 5 to 7 year period. The fund invests primarily in convertible preference shares rather than in ordinary equity shares. The fund has invested only in startup and expansion stage financing and totally avoided more risky seed stage and less remunerative later stage investments.

**JF Electra Advisors (India) Limited**

JF Electra Advisors (India) Limited is a private sector fund management company with a principal office in Mumbai. The company is promoted by Jardine Fleming and Electra Fleming to manage a Mauritius-based venture capital fund “JF Electra (Mauritius) Limited”. The asset management company and the venture capital fund were established in August 1995.

The fund invests mainly in unlisted companies in India. It invests only in manufacturing businesses that are globally competitive. Business having a focus
on exports from India is preferred. The fund invests in somewhat established ventures where it can exit in three to five years period. The fund is not registered with SEBI and operates as a Foreign Institutional Investor.

**Walden Nikko India Management Company Limited**

Walden International initiated its operations in India in late 1996 to invest in India-based and India-related technology-oriented companies. The first fund, Walden –Nikko India Venture Company Ltd., is managed as a joint venture between Walden International and Nikko Capital of Japan and was established on April 22, 1998. It is an offshore fund started with a corpus of US $7.5 million. Investments are made in all stages of venture capital. The fund is structured as an investing company. It is not registered with SEBI and it operates as a Foreign Institutional Investor.

Investment opportunities in fast-moving consumer goods and services, software, telecommunications and pharmaceuticals are preferred. It focuses on investing in companies that are in seed and expansion stages of their development. It invests in the equity of the investee companies and abstains from providing debt of any sort.
Accenture Technology Ventures

Accenture Technology Ventures is a unique venture capital option launched in December 1999 as the venture capital unit of Accenture. The company’s mission is to help talented entrepreneurs build great companies that can transform entire industries, create new markets and, ultimately, generate superior economic returns. Accenture Technology Ventures plans to invest up to $1.5 billion in global businesses, including the provisioning of services and intellectual property over the next five years.

The investment strategy includes all stages of funding for pre-IPO companies, and focuses on software and information technology investments. Accenture Technology Ventures is one of the few venture capital firms with global presence. It has its own dedicated teams who are active in North America, Europe, Asia Pacific and Japan.

HSBC Private Equity Management Mauritius Limited (HPEMM)

HSBC Private Equity Management Mauritius Limited is an offshore venture capital company registered in Mauritius. The company was registered in Mauritius on April 17, 1995 and established its India office on July 25, 1995. It is promoted by HSBC Private Equity Management Limited, Hong Kong. It is managing a US$60 million fund. The fund presently has a paid-up corpus of
Rs.109.92 crores. The fund is not registered with SEBI and operates as a Foreign Institutional Investor (FII).

HPEMM prefers to invest in established, profitable companies, which require additional capital of US $3 million and above to expand existing operations. HPEMM generally takes minority equity positions in the companies in which it invests but is prepared to take a majority stake particularly in situations involving restructuring or acquisitions.

3.3 VENTURE CAPITAL – THE GLOBAL SCENARIO

Separately The concept of venture capital dates back to Queen Isabella’s backing of Christopher Columbus’ risky exploration of the new world or to Pierre Du Pont’s investment in General Motors. However before World War II, Venture capital was more of a rich man’s whim than an industry. Enterprising lads could then occasionally find a benefactor who recognized their worth and provided them with the capital to launch a business. But it was a process incapable of coping with the burst of new ideas that came bubbling to the surface of the economy when the was ended. Moreover, immensely wealthy individuals, capable of playing the patron role were in short supply in an economic landscape increasingly dominated by giant corporations. There was an urgent need for a new kind of financial service; one that could capitalize on the opportunities presented
by accelerating changes in science and technology, by organizing the process of evaluating and funding promising ideas. Three men standout among those who began to put risk investment on a permanent institutional footing. Among them Lawrence S. Rockefeller and Jock Hay Whitney were prominent among pre-war experimenters and George F. Doroit, French born, Harvard Business school Professor, who taught unconventional ideas about entrepreneurship but simultaneously on their return from war-time service, the three assembled organizations that laid out the conceptual framework for today’s venture capital industry.84

This section unfolds the evolution and growth of the venture capital industry in different parts of the world. The chapter has been divided into three sections, namely;

1. Venture capital in the United States of America

2. Venture capital in Europe

3. Venture capital in the Asia Pacific Region.

The region-wise growth and development of venture capital, the stages of financing, investment size, and disbursement of finance by application, patterns and trends in venture capital financing are analyzed in detail.

Venture Capital in the United States of America

Evolution and Growth

In the United States of America, venture capital has contributed immensely to the growth of the economy. The US Venture capitalists pioneered the venture capital business immediately after World War II, roughly three decades before venture capital grew to a significant size in any other country. Milestones in the development of venture capital with the US include the formation in 1946 of American Research and Development Corporation (ARDC), the first publicly traded company specializing in equity investing in start-up companies, which had some spectacular early successes, particularly on the $70,000 it invested in 1957 for a 77% equity stake in the Digital Equipment Corporation (DEC) that produced a 5000 fold return over 14 years. This was followed by special fund VENROCK that was started by the Rockefeller family to finance new technology companies.

In 1957, the Federal Reserve System conducted a study that concluded that a shortage of entrepreneurial financing was a chief obstacle to the development of what it called ‘entrepreneurial businesses’. To correct this, the Small Business Investment Act in 1958 was passed to establish Small Business Investment Companies (SBICs) as vehicles for small business financing. SBICs are private corporations licensed by the Small Business Administration (SBA) to provide
venture capital to new companies. The purpose of SBIC Act was to establish government-controlled venture capital funds for developing new and early stage business. As a response to this, a number of SBICs were established to ‘leverage’ their private capital by borrowing from the federal government atbelow-market interest rates. Soon commercial banks were allowed to form SBICs and within four years, nearly 600 SBICs were in operation. With tax advantages and potential government lending for leverage, the SBICs were the first vestige of an organized venture capital industry. Even today, when the large venture capital organizations dominate the US venture industry, SBICs, in their new and modified form, are the major source of their growth.

The 1960s saw a tremendous bull Initial Public Offerings (IPO) market that allowed Venture capital firms to demonstrate their ability to create companies and produce huge investment returns. As a result of the perceived potential returns that could be generated, venture capital became a hot market, particularly for wealthy individuals and families. However, it was still considered too risky for institutional investors.

In the 1970’s venture capital suffered a double-whammy. First, after a red-hot IPO market brought over 1,000 venture-backed companies to market in 1968, the public markets went into a seven-year slump. There were lots of disappointed stock market investors, and a lot of disappointed venture capital investors, too.
Then in 1974, the Congress dealt a severe, though unintentional blow to the venture industry, in response to abuses of corporate pension funds. The Congress passed the Employee Retirement Income Security Act (ERISA). ERISA was intended to protect corporate retirees by curtailing the abuse of pension fund moneys. As a result of the poor public market and ERISA legislation, venture capital fund raising hit the bottom in 1975. In that year, the entire industry raised a grand total of $10 million for new investment.

Beginning in 1978, a series of legislative and regulatory changes gradually improved the climate for venture investing. First, the Congress slashed the capital-gains tax rate to 28% from 49.5%. Then, the Labour Department issued a clarification that eliminated ERISA as an obstacle to venture investing. These and other changes in government policies removed impediments to risk-equity investing. At around the same time, there was a number of high-profile IPO’s by venture-backed companies. These included Federal Express Corporation in 1978, and Apple Computer Corporation and Genentech, Inc. in 1981. This rekindled interest in venture capital on the part of wealthy families and institutional investors.

Indeed, in the 1980s, the venture capital industry began its greatest period of growth. The US venture capital funds grew markedly in the 1980s, in part because of six key legislative acts between 1978 and 1981: the Revenue Act of
1978, which reduced the capital gains tax rate; the 1981 Economic Recovery Tax Act, which further reduced the capital gains rate to 20%; 1979 and 1980 legislation that allowed pension funds to invest in private equity; the 1980 Small Business Investment Incentive Act, which reduced the regulatory burden on venture capitalists; and the 1981 Incentive Stock Option Act, which allowed holders of stock options to defer tax liability to the date when the stocks were sold rather than the date when the options were exercised. The US venture capital industry also profited enormously from the boom in personal computers in the 1980s. Between 1980 and 1990, the value of the personal computer industry grew from virtually zero to $100 billion, the largest legal accumulation of wealth in history. More than 70% of these firms were venture-backed. Cisco, Compaq, Cray, Genentech, Lotus, Microsoft, Netscape, Starbucks, and Sun Microsystems were some of the well-known US companies nurtured by venture capital.

However anecdotal evidence and preliminary data suggest that a precipitous drop in venture capital from 1988 to 1991 occurred, simultaneously with a shift in the type of investors.\(^8\) The stock market crash of 1987 dropped the number of Initial Public Offerings (IPO’s) by 50% in 1988 and 1989 compared with 1986. The number of venture-backed IPO’s enjoyed a short rebound in early 1990. But by fall of 1990, the economic uncertainty and the middle-east conflict bought the IPO market to halt. As a result the venture capital industry disbursed

only $1.4 billion in 1991, to hit a ten-year low. The number of firms declined from an all time high of 1740 firms in 1987 to 792 firms in 1991.

In 2011, the venture capital market produced its heaviest deal flow in a decade, with total proceeds that rivaled the levels of 2007 and 2008, despite lingering economic uncertainty and poor capital market conditions in the late summer and early fall. Liquidity performance was also impressive, with a steady stream of VC-backed IPOs and the highest median acquisition price in VC-backed M&A transactions since the peak of the dot-com boom in 2000.

There were 3,209 reported venture capital financings raising total proceeds of $32.6 billion in 2011, compared to 3,033 financings that raised $29.6 billion in 2010. The number of financings in 2011 was the highest since 2001, when 3,381 deals were reported. Deal volumes were fairly level throughout 2011, producing quarterly totals of 754, 835, 817 and 803 transactions. Total proceeds in 2011 were nearly as high as the amounts raised in 2007 and 2008, before the global economic recession that curtailed investment activity. Once all transactions have been reported, financing proceeds in 2011 are likely to represent the largest annual tally since 2001.

The outlook for the venture capital market over the coming year is generally positive. Early results for 2012 bear out this optimism, although economic concerns and the continuing sovereign debt crisis in Europe could dampen expectations.
In the first quarter of 2012, venture capital investing was largely consistent with the comparable period of the prior year and overall trends in the marketplace, while liquidity outcomes improved further from the already positive results of 2011.

**Contribution of Venture Capital**

The arrival of venture capital as an accepted, even prudent vehicle of investment is a significant phenomenon on American financial scene. The venture capitalists and entrepreneurs provide financial, organizational and cultural models needed to transform a formerly risk-averse society to one in which risk-taking is rewarded, individual enterprise is respected, success is applauded and even failure respected.\(^{86}\)

Venture capital backed companies create a greater percentage of high skilled jobs, such as engineers, biotechnicians, computer specialists and scientists, than can be found in the general population of US companies. In addition, venture capital backed companies spend more time on research and development than do Fortune 500 companies. From 1985 to 2000, Fortune 500 companies spent an average of 7.5 % of their equity on research and development while venture capital backed companies spent 18.4 % of their equity on research and development.

Venture capital played a key by investing substantially in communications, computer software and services, and online-specific sectors. Originally venture-backed companies such as Boise-Cascade, Costco, Fischer Scientific, and Mellon Financial Corporation generated patents and innovative business processes in forestry, transportation, biotechnology and financial services sectors respectively. Venture capital also has contributed to improving the quality of life for many Americans by investing in the medical/health sector. Medtronic, the company to develop the first implantable pacemaker, was an originally venture-backed company.

**Venture Capital in Europe**

**Evolution and Growth**

Venture capital did not become a significant source of financing in Europe until the 1980s. As a consequence of the number of initiatives taken by the Commission of the Communities, in 1983, the European Venture Capital Association (EVCA) was set up to provide a professional organization to the European investor. The motivating factor for its creation was the need to help developing venture capital infrastructure in Europe which could help enterprises overcome the various barriers to growth which they faced in Europe’s fragmented markets, cultural barriers, legal/fiscal barriers, marketing information and the like.
Even after the formation of EVCA, venture capital was scarce in Europe until the mid 1990’s. However, this situation began to change in 1997 when European venture capital firms raised $22 billion, more than double the figure for 1996. During the late 1990s, venture capital funding rose by more than 650 % in Germany and nearly 2000 % in Sweden. Venture capital represents a small but important element of the finance needed across Europe for both the formation of new enterprises and the restructuring of existing companies.

Table 3.1 highlights the total amount of investments made by the venture capital companies in Europe for a period of three years between 2008 and 2010.

**TABLE 3.1**

**TOTAL VENTURE CAPITAL INVESTMENT IN EUROPE (2004 – 2006)**

<table>
<thead>
<tr>
<th>Countries</th>
<th>Amount in Euro Million</th>
<th>Number of Deals</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>Denmark</td>
<td>280.41</td>
<td>258.93</td>
</tr>
<tr>
<td>France</td>
<td>2567.41</td>
<td>1527.04</td>
</tr>
<tr>
<td>Germany</td>
<td>3297.99</td>
<td>1966.89</td>
</tr>
<tr>
<td>Ireland</td>
<td>700.98</td>
<td>399.12</td>
</tr>
<tr>
<td>Sweden</td>
<td>1794.92</td>
<td>1138.61</td>
</tr>
<tr>
<td>Switzerland</td>
<td>564.15</td>
<td>385.08</td>
</tr>
<tr>
<td>U.K.</td>
<td>7309.41</td>
<td>3229.38</td>
</tr>
<tr>
<td>Other</td>
<td>4600.25</td>
<td>1901.52</td>
</tr>
<tr>
<td>Total</td>
<td>21115.53</td>
<td>10806.58</td>
</tr>
</tbody>
</table>

The European venture capitalists invested a total amount of about 21,115 Euro million in the year 2008. The amount of venture capital investments in Europe shows a decreasing trend recording the lowest amount of investment in the year 2010 (4,717 Euro million). The declining trend is also visible in the number of deals, which reduced from 3690 in the year 2008 to 1415 in the year 2010. Between 2008 and 2010, the amount invested in venture capital deals decreased, principally due to less venture stage opportunities. Final figures indicate a decrease in the amount of investment and number of deals compared to 2009. The decrease is largely due to the sharp fall in funds raised and invested in the United Kingdom, which is a major player in Europe.

Sources of Venture Capital

The following Table 3.2 shows the sources of venture capital in Europe in 2010.
### TABLE 3.2

**SOURCES OF VENTURE CAPITAL IN EUROPE - 2010**

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount in Euro Million</th>
<th>Percentage to Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>1240.61</td>
<td>26.30</td>
</tr>
<tr>
<td>Pension Funds</td>
<td>768.90</td>
<td>16.30</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>650.97</td>
<td>13.80</td>
</tr>
<tr>
<td>Fund of Funds</td>
<td>617.95</td>
<td>13.10</td>
</tr>
<tr>
<td>Academic Institutions</td>
<td>75.47</td>
<td>1.60</td>
</tr>
<tr>
<td>Capital Markets</td>
<td>4.72</td>
<td>0.10</td>
</tr>
<tr>
<td>Corporate Investors</td>
<td>344.35</td>
<td>7.30</td>
</tr>
<tr>
<td>Private Individuals</td>
<td>283.03</td>
<td>6.00</td>
</tr>
<tr>
<td>Government Agencies</td>
<td>523.60</td>
<td>11.10</td>
</tr>
<tr>
<td>Others</td>
<td>207.55</td>
<td>4.40</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4717.15</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>


Banks represent the largest single source of venture capital raised during the year (26.3%). Pension funds are responsible for 16.3% of the total funds raised during the year while insurance companies account for 13.8%, fund of funds account for 13.1% and Government agencies contribute 11.1%. The role of the capital markets as a source of venture capital is very negligible in Europe (0.1%). The bank lending has a more extensive influence on the venture capital investment across Europe.
Disbursement of Venture Capital by Application

Disbursement of venture capital by application in Europe is shown in Table 3.3.

**TABLE 3.3**

**DISBURSEMENT OF VENTURE CAPITAL BY APPLICATION – 2010**

<table>
<thead>
<tr>
<th>Industry Segment</th>
<th>Amount Invested in Euro Million</th>
<th>Percentage to Total Investment</th>
<th>Number of Deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Biopharmaceuticals</td>
<td>1180.91</td>
<td>25.03</td>
<td>164</td>
</tr>
<tr>
<td>Healthcare Services</td>
<td>33.42</td>
<td>0.71</td>
<td>16</td>
</tr>
<tr>
<td>Medical Devices</td>
<td>261.09</td>
<td>5.53</td>
<td>82</td>
</tr>
<tr>
<td>Medical Instruments</td>
<td>62.77</td>
<td>1.34</td>
<td>28</td>
</tr>
<tr>
<td><strong>Information Technology</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Communication</td>
<td>397.42</td>
<td>8.42</td>
<td>91</td>
</tr>
<tr>
<td>Electronics</td>
<td>239.55</td>
<td>5.08</td>
<td>95</td>
</tr>
<tr>
<td>Information Services</td>
<td>236.60</td>
<td>5.02</td>
<td>125</td>
</tr>
<tr>
<td>Emiconductors</td>
<td>215.99</td>
<td>4.58</td>
<td>37</td>
</tr>
<tr>
<td>Software</td>
<td>1255.47</td>
<td>26.61</td>
<td>469</td>
</tr>
<tr>
<td><strong>Products &amp; Services</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer and Business Products</td>
<td>38.04</td>
<td>0.80</td>
<td>35</td>
</tr>
<tr>
<td>Consumer and Business Services</td>
<td>554.06</td>
<td>11.75</td>
<td>189</td>
</tr>
<tr>
<td>Retailers</td>
<td>54.73</td>
<td>1.16</td>
<td>31</td>
</tr>
<tr>
<td><strong>Others</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>4747.15</td>
<td>100.00</td>
<td>1415</td>
</tr>
</tbody>
</table>


The Information Technology sector attracted the largest share of venture capital investment in Europe. Consumer products and services and Health care are the other sectors that received considerable amount of funding. The data also reveals that the amount invested in the Health care sector increased considerably over a period of three years between 2008 and 2010. The Health care sector attracted almost treble the amount in the year 2010 when comparing the
investment in the year 2008. Interestingly the Consumer products and services show a declining trend. The amount invested in this sector declined from 29.85 % in 2008 to 13.71 % in 2010. The amount of venture capital investment in information technology sector also shows a declining trend though marginally. The investment in this sector decreased from 59.14 % in 2008 to 57.80 % in 2009 and further reduced to 49.71 % in the year 2010.

**Stages in Venture Capital Financing**

In terms of venture capital investment by stages, buyouts are the dominant category and accounted for 61.2 % of the total amount invested in 2010. Expansion financing is the second largest category with 24.8 % of the total investment. The amount invested in seed capital is very negligible (1.1%). The percentages of investment made in start-up capital and replacement capital are respectively 9.5 % and 3.4 %.

Table 3.4 shows the venture capital investments in various stages in Europe in 2010.
TABLE 3.4

VENTURE CAPITAL DISBURSEMENT BY STAGES - 2010

<table>
<thead>
<tr>
<th>Stage of Development</th>
<th>Amount in Euro Million</th>
<th>Percentage to Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seed</td>
<td>51.89</td>
<td>1.10</td>
</tr>
<tr>
<td>Start-up</td>
<td>448.13</td>
<td>9.50</td>
</tr>
<tr>
<td>Expansion</td>
<td>1169.85</td>
<td>24.80</td>
</tr>
<tr>
<td>Replacement Capital</td>
<td>160.38</td>
<td>3.40</td>
</tr>
<tr>
<td>Buyout</td>
<td>2886.90</td>
<td>61.20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4717.15</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>


**Contribution of Venture Capital**

Despite different economic conditions, venture-backed companies have continued to develop steadily and have shown strong performances over the last fifteen years. EVCA together with the European commission has made special efforts to encourage venture capital companies to work together in international syndicates. To overcome the various cultural marketing and ‘people’ barriers in Europe, the venture capital industry has been developing Europe-networks. These are both ‘formal’ networks of venture capital firms, who have located subsidiary offices in major European business centre and adhoc networks of national venture firms who frequently work together in venture capital syndicates. The Price Waterhouse Coopers conducted a study in the year 2010 on behalf of EVCA to evaluate the contribution of venture capital investment in the European economy. The study highlighted the exceptional growth rate of venture-backed companies in
Europe. The average sales revenue of these companies rose by 35 % per yea, twice as fast as the top other European companies. The study also reveals that the venture-backed companies in Europe are young and medium-sized. Almost half of the venture-backed companies are less than five years old and nearly 75 % are less than 10 years old.

The survey also projected the ability of venture-backed companies to generate employment potential. The venture-backed companies increased the staff numbers by an average of 15 % per year over a period of 5 yeas from 1997 and only by 2 % for the other European companies. Venture-backed companies are committed to Research and Development and expand Europe’s technical expertise and resources and strengthen its competitive position in the world market.

The striking feature of the study is that the majority of the venture-backed companies in Europe recognized that venture capital investors provided more than finance. While only 12 % of venture backed companies regarded their venture capital investors as merely a “fund manager”, 52 % considered him to be a “real partner”. According to the managers of investee companies, the three main contributions made by the venture capital investors, other than finance, were providing financial advice (44%) and assistance on corporate strategy (43%) and acting as a sounding board for ideas (41%). Venture capital is no longer an American monopoly. Today the concept is truly a mechanism for the flow of capital and ideas on a global basis. Quite apart from the European developments,
however, are those in Asia where the venture capital concept has taken hold and grown rapidly over the last several years. Venture capital funds raised and invested increased dramatically in Asia Pacific region in the period following the Asian Financial Crisis of 1997. However, more venture capital funds in Asia are directed to economic restructuring of traditional industries. This is particularly true of large venture capital markets like Korea and Japan, but much less so in China/Hong Kong, Taiwan, and Singapore. The role of venture capital financing in Asia, therefore, differs somewhat from the typical part played in the United States, which is to finance start-up and growing firms in high technology industries.

Sources of Venture Capital

The following table shows the various sources of venture capital in Asia pacific region during the year 2010.

**TABLE 3.5**

**SOURCES OF VENTURE CAPITAL IN ASIA PACIFIC REGION – 2010**

<table>
<thead>
<tr>
<th>Sources</th>
<th>Amount in US Million</th>
<th>Percentage to Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporations</td>
<td>30041</td>
<td>37.00</td>
</tr>
<tr>
<td>Private Individuals</td>
<td>2598</td>
<td>3.00</td>
</tr>
<tr>
<td>Government Agencies</td>
<td>7794</td>
<td>9.00</td>
</tr>
<tr>
<td>Banks</td>
<td>16453</td>
<td>19.00</td>
</tr>
<tr>
<td>Pension Funds</td>
<td>11257</td>
<td>13.00</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>16453</td>
<td>19.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>89596</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

The sources of venture capital in the Asian region differ remarkably from the types of investors in Europe. In Asian region during the year 2010, 37% of the funds committed to venture capital came from corporations, 19% each from insurance companies and banks, 13% from pension funds, and 9% from Government agencies while private individual contributed only 3%.

**TABLE 3.6**

**SOURCES OF VENTURE CAPITAL BY REGION - 2010**

<table>
<thead>
<tr>
<th>Sources</th>
<th>US</th>
<th>Europe</th>
<th>Asia Pacific</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>--</td>
<td>26.3</td>
<td>19.0</td>
</tr>
<tr>
<td>Pension Funds</td>
<td>55.4</td>
<td>16.3</td>
<td>13.0</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>5.4</td>
<td>13.8</td>
<td>19.0</td>
</tr>
<tr>
<td>Fund of Funds</td>
<td>--</td>
<td>13.1</td>
<td>--</td>
</tr>
<tr>
<td>Academic Institutions</td>
<td>--</td>
<td>1.6</td>
<td>--</td>
</tr>
<tr>
<td>Capital Markets</td>
<td>--</td>
<td>0.1</td>
<td>--</td>
</tr>
<tr>
<td>Corporate Investors</td>
<td>4.3</td>
<td>7.3</td>
<td>37.0</td>
</tr>
<tr>
<td>Private Individuals</td>
<td>12.2</td>
<td>6.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Government Agencies</td>
<td>--</td>
<td>11.1</td>
<td>9.0</td>
</tr>
<tr>
<td>Endowment/Foundations</td>
<td>11.0</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Foreign Investors</td>
<td>11.7</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Others</td>
<td>--</td>
<td>4.4</td>
<td>--</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>


A comparison of various sources of venture capital investments in US, Europe and Asia reveals that the pension funds is the major source of investment in venture capital in US (55.4%) whereas in Europe the banks play a major role as
a source of venture capital investments. However in Asia Pacific the corporate investors are the leading sources of the venture capital investments followed by banks and insurance companies.