APPENDIX 2

Venture Capital Industry in India

Historical Evolution

The development of the organised venture capital industry in India, as is in existence today, was slow and belaboured, circumscribed by resource constraints resulting from the overall framework of the socialistic economic paradigms. Although funding for new businesses was available from banks and government-owned development financial institutions, it was provided as collateral-based money on project-financing basis, which made it difficult for most new entrepreneurs, especially those who were technology and services based, to raise money for their ideas and businesses. Most entrepreneurs had to rely on their own financial resources, and those of their families and well wishers or private financiers to realise their entrepreneurial dreams.

Early Beginnings

In 1972, a committee on Development of Small and Medium Enterprises highlighted the need to foster venture capital as a source of funding new entrepreneurs and technology. This resulted in a few incremental steps being taken over the next decade-and-a-half to facilitate venture capital funds into needy technology oriented small and medium Enterprises (SMEs), namely:

- Risk Capital Foundation, sponsored by IFCI, was set-up in 1975 to promote and support new technologies and businesses.
- Seed Capital Scheme and the National Equity Scheme was set up by IDBI in 1976.

- Programme for Advancement of Commercial Technology (PACT) Scheme was introduced by ICICI in 1985.

These schemes provided some succour to a limited number of SMEs but the activity of venture capital industry did not gather momentum as the funding was based on investment evaluation processes that remained largely collateral based, rather than being holistic, and the policy framework remained unaltered, without the instruments to inject dynamism in the VC industry. Also, there was no policy in place to encourage and involve the private sector in the venture capital activity.

Setting-up of TDICI and Regional Funds: 1987-1994

For all practical purposes, the organised venture capital industry did not exist in India till almost 1986. The role of venture capitalists till then was played by individual investors and development financial institutions. The idea of venture capital gained momentum after it found mention in the budget of 1986-87. A 5% cess was levied on all know-how imports to create the corpus of the venture fund floated by IDBI in 1987. Later, a study was undertaken by the World Bank to examine the possibility of developing venture capital in the private sector, based on which the Government of India took a policy initiative and announced guidelines for venture capital funds (VCFs) in India in 1988.

Soon many other funds followed. The pioneers of the Indian venture capital industry were largely government-owned banks and financial institutions, with some contribution from the financial services companies in the private sector. The following VC funds were the pioneers which laid the foundations of India's VC industry:

Table 2.1

Venture Capital Funds Set Up during 1987-1994

VC Fund	*Set Up By*	*Year*	*Size million*
1. Venture Capital Fund Scheme	IDBI	1987	Rs. 543.6
2. India Investment Fund	Grindlays 3i Invest. Services Ltd.	1987	US$ 7.5
3. Venture Capital Unit Scheme I	TDICI	1989	Rs. 300

4. Canbank Venture Capital Fund	Canbank Financial Services Ltd.	1989	Rs. 156
			Contd . . .
5. All Industry Fund	Credit Capital Venture Fund (I) Ltd.	1990	Rs. 120.6
6. Second India Investment Fund	Grindlays 3i Invest. Services Ltd.	1990	US$ 13.5
7. Venture Capital Unit Scheme II	TDICI	1990	Rs. 1000
8. APIDC Venture capital Fund 1990	APIDC Venture Capital Ltd.	1990	Rs. 135
9. Gujarat Venture Capital Fund	Gujarat Venture Finance Ltd.	1990	Rs. 240
10. 20th Century Fund	20th Century Venture Capital Corp. Ltd.	1991	Rs. 287
11. Indus Venture Capital Fund I	Indus Venture Management Ltd.	1991	Rs. 210
12. IL&FS Venture Fund	IL&FS Venture Corporation Ltd.	1991	Rs. 500
13. Venture Capital Unit Scheme III	RC&TF Corporation	1991	Rs. 300
14. IFB Venture Capital	IFB Venture Finance Ltd.	1992	Rs 100
15. Information Technology Fund	Credit Capital Venture Fund (I) Ltd.	1993	Rs 100

Source: AVCJ, 1994-95

Entry of Foreign Venture Capital Funds: 1995-1998

Thereafter, the Government of India issued guidelines in September 1995 for overseas investment in venture capital in India. For tax-exemption purposes, guidelines were also issued by the Central Board of Direct Taxes (CBDT) and the investments and flow of foreign currency into and out of India was governed by the Reserve Bank of India's (RBI) requirements. Further, as a part of its mandate to regulate and to develop the Indian capital markets, the Securities and Exchange Board of India (SEBI) framed the SEBI (Venture Capital Funds)

Regulations, 1996. These guidelines were further amended in April 2000 with the objective of fuelling the growth of venture capital activities in India.

Policy Support — 1999 Onwards

With globalisation policies and practices resulting in India getting increasingly linked with the world, the policy framers realised the tremendous potential of venture capital activity and its resultant impact on the country's growth. In his 1999 budget speech, the finance minister of India announced that "for boosting high-tech sectors and supporting first generation entrepreneurs, there is an acute need for higher investment in venture capital activities." He also announced that the guidelines for registration of venture capital activity with the Central Board of Direct Taxes would be harmonized with those for registration with the Securities and Exchange Board of India (SEBI).

The Government of India constituted a SEBI committee headed by K. B. Chandrasekhar to make recommendations to facilitate the growth of VC industry in India. This committee submitted its report in July 2000 with the following salient recommendations, all of which were accepted and implemented:

- SEBI should be the nodal regulator for VC funds in India providing a smooth, single window, problem-free regulatory framework for quick and efficient flow of money into VC funds in India.
- Tax pass-through status should be granted to all regulatory compliant VC funds, similar to that which is provided to mutual funds, ensuring that at the "pool-level" (VC Fund) profits are tax exempt.
- Foreign venture capital investors (FVCI) should also be registered with SEBI. This registration should enable them to have the same facilities as the foreign institutional level of easy investments and disinvestments without any FIBP/RBI approvals.

Status and Trends in 2009

- About 300 VC funds were active in India.
- The VC industry has shown a steep upward curve from investments of about USD 0.5 billion (56 deals) in 2003 to USD 14 billion (439 deals) in 2007. In the year 2008, there was a decline to about USD 11 billion (382 deals).

- Unlike in the early stages of the industry's growth (in 2000) when the investments were largely in the IT sector, by 2009 VC (including PE) investments were being made in all sectors. The reforms policies (media and entertainment, real estate, SEZ, insurance, banking, etc.), infrastructure development (energy, engineering and construction, etc.), and globalisation policies (textiles, etc.) throws open vast opportunities for PE investors to capitalize on.
- VCs have preferred to invest in growth or later stage deals. Also, there emerged an increasing trend of investing in PIPE deals reflecting the higher return expectations of the "limited partners" (investors in VC funds) as a result of the capital markets boom. Roughly, 2 out of every 3 deals were in the growth / later PIPE stage category.
- VCs also prefer to invest higher amounts reflecting a bias towards PE investments rather than classic venture capital-type deals. About 31% of all investments in 2007 fell into the US$10-25 million category.
- Preferred regions for VC investments are Mumbai, Delhi and NCR, followed by Bangalore. Although companies in South India attracted a higher number of investments, in value terms Western India did much better. Among cities, Mumbai-based companies retained the top slot with 108 private equity investments totalling almost US $6 billion in 2007, followed by Delhi/NCR with 63 investments (US $2.7 billion) and Bangalore with 49 investments aggregating US $700 million.
- Citigroup was the most active investor with a portfolio across energy, engineering and construction, manufacturing. Other active investors included: ICICI Ventures, Goldman Sachs and Helion Ventures.

Sources

- Indian Venture Capital Association — www.indiavca.org
- Securities and Exchange Board of India — www.sebi.gov.in
- K.B. Chandrasekhar Report — SEBI Committee Report, downloadable from the SEBI website — www.sebi.gov.in