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VENTURE CAPITAL IN INDIA: A REVIEW OF LITERATURE

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ABSTRACT

Venture Capital is one of the most important innovations of the twentieth century in the world's financial sector. It has come to play an important role as a source of capital for those who fail to finance their ideas by means of traditional sources of financing. In comparison to the developed countries the concept of venture capital is quite new for the developing country like India. The Venture Capital Funds can play a very important role in India by supporting the activities of small and medium enterprises not just by providing financial resources but also by their participation in the administration and management of the startup firms. Over the years the venture capital investment in India by domestic and foreign Venture Capital Funds has witnessed increasing trends that is contributing to the entrepreneurial development in India. The underlying paper explores the various aspects of venture capital in India based on the review of literature. Various papers dealing with the venture capital investment in India, pre investment actions of Venture Capital Funds, risk management by the India Venture Capital Funds have been studied in detail to ascertain the various aspects of venture capital investment in the country. The need of the hour is to introduce certain flexibility in the venture capital regulations and provision of various incentives to entrepreneurs so as to stimulate exploration of new ideas in the country.

KEYWORDS
Investment, Limited Partner, Venture Capital, Venture Capital Fund.

JEL CODE
G20, G24.

INTRODUCTION

One of the most important innovations in the financial sector of the world has been the development of the venture capital in the 20th century that has allowed those firms to obtain funds for their operations that could not otherwise obtain the funds from any other source. A number of internationally successful firms like Facebook, Google, Apple were once able to operate because of the capital that these firms received from the Venture Capital funds (Joshi & Subrahmanya, 2014).

Venture capital industry is globally understood as "independently managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high-growth companies" (Dossani & Kenney, 2002; Gompers & Lerner, Spring 2001).

Venture capital is an investment by VCFs out of the funds received from the wealthy individuals and institutional investors in the form of shares or a later stock option in potentially high-risk businesses. The beneficiary companies are usually small or medium-sized firms, requiring seed or early-stage funding for innovation and development of technology or products, with high growth potential. High annual returns ranging from 25-75% are expected on such investments. Venture capital is a long-term investment and involves active participation and help from the investor for the development of the company. Often, the presence of the VC investor/s gives the company commercial and financial clout (Kaushik, 2014).

In the Indian context, the concept of venture capital may be defined as investment in the form of equity, quasi-equity and/or a conditional loan, made in new, unlisted, high-risk or high-tech firms, started by technically or professionally qualified entrepreneurs. The venture capitalist expects the enterprise to have a very high growth rate, provides management and business skills to the enterprise, expects medium to long term gains, and does not expect any collateral to cover the capital provided (Pandey, 1998).

The understanding of concept of VC requires an understanding of certain key terms. These are as follows:

VENTURE CAPITAL FIRMS

Venture Capital Firms refer to the firms established by Venture Capitalists that typically comprise small teams with technology backgrounds (scientists, researchers) or those with business training or deep industry experience. The venture capital firm with the help of venture capitalists identifies novel technologies that have the potential to generate high commercial returns at an early stage (Haritha, V, & Reddy, 2012).

VENTURE CAPITALIST

A venture capitalist is a person or investment firm that makes venture investments, and these venture capitalists are expected to bring managerial and technical expertise as well as capital to their investments (Haritha, V, & Reddy, 2012).

VENTURE CAPITAL FUND

A venture capital fund refers to a pooled investment vehicle established by the venture capitalists in the venture capital firm that primarily invests the financial capital of third party investors in enterprises that are too risky for the standard capital markets or bank loans (Haritha, V, & Reddy, 2012).

VENTURE CAPITAL CYCLE

The venture capital cycle starts with raising a venture fund; proceeds through the investment in, monitoring of, and adding value to firms; continues as the venture capital firm exits successful deals and returns capital to its investors; and renews itself with the venture capitalist raising additional funds (Gompers & Lerner, Spring 2001).

The underlying paper reviews the various researches that have been carried out in the context of Indian Venture Capital Industry. The paper studies various aspects of VC in India like the evolution of venture capital regulation, pre-investment evaluation, risk management by Indian Venture Capitalists, role of VC in India, trends of VC investment etc.

ORIGIN OF VENTURE CAPITAL

The first venture capital firm, American Research and Development (ARD) was established by Karl Crompton, President, MIT; General Georges F. Doriot, Professor, Harvard Business School and local business leaders in 1946. The firm was set up as the publicly traded closed-end fund. The major investment in the shares of the fund was made by the individual investors while the institutional investors were not convinced enough to invest in these funds considering the high risk associated with the unproven style of investment. The firm used to make risky investments in companies, which were involved in development of

technology for World War II. While the returns from different investments made by the firm during the 26 years of its existence varied widely the firm earned more than half of its profits by way of investment in Digital Equipment Company in 1957. ARD made an investment of $70,000 in Digital Equipment which later grew to $355 million. A number of other venture capital firms established on the lines of ARD were also set up as closed-end fund. With this start, the new concept of venture capital financing got spread from United States to all the parts of the world. However the scale of development of venture capital financing in different parts of the world vary considerably depending upon number of factors like availability of new ideas, efficiency of the capital markets etc (Gompers & Lerner, Spring 2001).

DIFFERENCE BETWEEN VENTURE CAPITAL AND PRIVATE EQUITY

While Venture Capital and Private Equity are often used interchangeably there is a difference between the two. Venture Capital Funding primarily refers to the early stage financing of the startup companies. It is mainly associated with the financing of the companies involved in developing, launching and expanding of the new products and services. Venture Capital Financing is more than provision of finance to the startup companies by venture capital funds as along with providing the financial support venture capital funds also provide entrepreneurial support, partnership based valued addition, human resources, financial advice, established network with the customers and overall guidance in company strategy. On the other hand Private Equity funds are a large source of funding for the enterprises that are relatively secured with an established track record requiring significant large funds for expansion and growth (Kohli, 2009). While VC funds typically invest small amounts in early-stage companies private equity funds invest larger sums in relatively mature firms (Sarkar, 2015).

STAGES IN VENTURE CAPITAL FINANCING

While VC evolved as a source of early stage financing it provides finance to the companies at various stages. The various stages of VC funding are as follows:

Pre seed Stage: Here, a relatively small amount of capital is provided to an entrepreneur to conceive and market a potential idea having good future prospects. The funded work also involves product development to some extent.

Seed Money: Financing is provided to complete product development and commence initial marketing formalities.

Early Stage / First Stage: Finance is provided to companies to initiate commercial manufacturing and sales.

Second Stage: In the Second Stage of Financing working capital is provided for the expansion of the company in terms of growing accounts receivable and inventory.

Third Stage: Funds provided for major expansion of a company having increasing sales volume. This stage is met when the firm crosses the breakeven point.

Bridge / Mezzanine Financing or Later Stage Financing: Bridge / Mezzanine Financing or Later Stage Financing is financing a company just before its IPO (Initial Public Offer). Often, bridge finance is structured so that it can be repaid, from the proceeds of a public offering (Salgar, 2012).

ROLE OF VENTURE CAPITAL IN INDIAN ECONOMY

Venture capital is an important source of equity for start-up companies. Venture capital can be visualized as "your ideas and our money" concept of developing business. In order 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 success story in the area of information technology has shown that there is a tremendous potential for growth of knowledge based industries. The recent economic slowdown of IT Sector has provided a chance to Venture capitalist to consider investment opportunities in other sectors such as Manufacturing and Service Industry which will be necessary to have overall economic development and to reduce the economic dependency on a single sector (Haritha, V, & Reddy, 2012).

A flourishing venture capital industry in India can fill the gap between the capital requirements of Manufacture and Service 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 (Haritha, V, & Reddy, 2012).

Venture capital plays a very important role by promoting the development and growth of innovative entrepreneurships. VC investment can play a very important role in the small and medium enterprises not only in the form of the financial support that the SMEs will get from VCFs but will also gain global exposure and can benefit from the participation of the venture capital fund in the administration and management of the enterprise (Kohli, 2009).

The study of venture development and new venture growth reflects the important role that venture capital could play in the developing nations. The rapid economic growth on account of new ventures and new industry development in the developing countries can provide them a breakthrough on the path of progress. Further the focus on the knowledge and IT industry can lay down the path of development for the developing nations. A found financial system that promotes new ventures has become essential for the growth of any nation. It is also necessary for the developing countries to strengthen the domestic venture capital system along with the legal system to boost up the growth of the venture capital industry in the country (Tang & Wei, 2011).

EVOLUTION OF VENTURE CAPITAL IN INDIA

The concept of Venture Capital is newer in India in comparison to the other countries like UK, USA, and Europe etc. where it has been in existence for many years. During the period when venture capital funds did not exist in India individual investors and development financial institutions like IDBI, IFCI discharged the role of venture capitalists. Other than these the entrepreneurs primarily depended on private placements and public offerings for obtaining funds for starting up the ventures.

In 1973 a committee appointed by Government of India on "Development of Small and Medium Enterprises" emphasized the need to foster venture capital as a source of funding new entrepreneurs and technology. After this some public sector funds were set up but the activity of venture capital did not gather momentum as the thrust was on high-technology projects funded on a purely financial rather than a holistic basis. 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. However, these guidelines restricted setting up of VCFs by the banks or the financial institutions only (Kohli, 2009). Thereafter, Government of India issued guidelines in September 1995 for overseas venture capital investment in India. For tax-exemption purposes, guidelines were 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 (RBI) (Dossani & Kenney, 2002).

As a part of its mandate to regulate and to develop the Indian securities markets, SEBI under Sec 12 of SEBI Act 1992 framed SEBI (Venture Capital Funds) Regulations, 1996. With the establishment of the regulatory framework some domestic VCFs were registered with SEBI and some overseas investment came through the Mauritius route (Kohli, 2009). Thus, there were three sets of Regulations dealing with venture capital activity i.e. SEBI (Venture Capital Regulations) 1996, Guidelines for Overseas Venture Capital Investments issued by Department of Economic Affairs in the Ministry of Finance in the year 1995, and CBDT Guidelines for Venture Capital Companies issued in 1995, which were later modified in 1999. Therefore, there was a need to consolidate all these into one single set of regulations to provide for uniformity and hassle free single window clearance (Avisory Committee on Venture Capital, 2003).

A SEBI committee on Venture Capital headed by KB Chandrasekhar, Chairman, Exodus Communications Inc., California, USA was set up in July 1999 to identify the hindrances in the growth of venture capital and for suggesting some measures so as to facilitate the growth of venture capital activity in India. The committee consisted of industry participants, professionals and the representatives from financial institutions and RBI (K.B. Chandrasekhar Committee, 2000). In order to provide a global perspective to the industry the Indian entrepreneurs from the Silicon Valley were also included in the committee. Thereafter, based on recommendations of the K.B. Chandrasekhar Committee Guidelines for Overseas Venture Capital Investment in India were withdrawn by the Government in September 2000, and SEBI was made the nodal regulator for VCFs to provide a uniform, hassle free, single window regulatory framework. SEBI also notified regulations for foreign venture capital investors. On the pattern of foreign institutional investors (FIIs), Foreign Venture Capital Investors (FVCIs) were also to be registered with SEBI.

Later on, an advisory committee was also set up by SEBI in 2003 under the chairmanship of Dr. Ashok Lahiri, who was the Chief Economic Advisor in Ministry of Finance, Government of India for advising SEBI for the development and regulation of venture capital funds industry in India. On the basis of the recommendations of the committee venture capitalists are now permitted to invest in real estate, removing lock-in period for shares of listed venture capital undertakings, and reducing the proportion of funds raised that have to be invested in unlisted companies from 75% to 66.67% (Tripathy, 2007) .
A 'Committee on Technology Innovation and Venture Capital' was also set up in July 2006 by the Planning Commission of India to examine the issues related to technology innovation and policies for venture capital in India (Kohli, 2009).

VC ECOSYSTEM
VC ecosystem refers to the structure of the venture capital firms. In general, the VC ecosystem comprises three players – Limited Partners (LPs) i.e. fund providers, General Partners (GPs) i.e. fund managers and Entrepreneurs (investee companies). The GPs typically raise funds from LPs for a fixed period. The LPs comprise entities such as pension funds, insurance companies, foundations, corporations, angel investors or any other entities that have surplus funds to deploy. The funds thus raised are then invested by the GPs in the investee firms for a fixed period of time. After about 5-8 years post the investment, GPs look for suitable exit options via any of the following exit routes - Initial Public Offer (IPO), Strategic sale (M&A), Secondary sale to another upstream VC fund or in the worst case, bankruptcy. On exit, the funds are then returned to the LPs and the investment cycle begins all over again. The LPs and GPs are thus the critical players in the VC eco-system that determine the quantum of fundraising (Joshi & Subrahmanya, 2014).

TYPES OF VCF'S IN INDIA
Types of VCFs in India can be categorized into the following four groups.
VCFs promoted by the central (federal) government, controlled development finance institutions: TDICI by ICICI; Risk Capital and Technology Finance Corporation Limited (RCTFC) 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: Gujarat Venture Finance Company Limited (GVCFL) by Gujarat Industrial Investment Corporation (GIIC); and Andhra Pradesh Venture Capital Limited (APVCL) by Andhra Pradesh State Finance Corporation (APSFC).
VCFs promoted by the public sector banks: Canfina by Canara Bank; and SBI-Caps by State Bank of India.
VCFs promoted by the foreign banks or private sector companies and financial institutions: Indus Venture Fund, Credit Capital Venture Fund and Grindlay's India Development Fund (Pandey, 1998).

VENTURE CAPITAL REGULATION, 1996
The activities of VCFs are regulated by formal legislation of SEBI (Venture Capital Regulations, 1996 & SEBI Foreign Venture Capital Investors Regulations, 2000), FDI and RBI FEMA provisions (Kohli, 2009).
Venture Capital Regulations, 1996 lays down a number of regulations in six chapters and three schedules with regard to registration of VCFs, investment conditions and restrictions, general obligations and responsibilities of VCFs etc.
According to Section 2(m) of Venture Capital Regulations, 1996 issued by SEBI "venture capital fund" means a fund established in the form of a trust or a company including a body corporate and registered under these regulation which -
(i) Has a dedicated pool of capital;
(ii) Raised in a manner specified in the regulations, and
(iii) Invests in accordance with the regulations
According to Section 2(n) "venture capital undertaking" means a domestic company -
(i) Whose shares are not listed on a recognized stock exchange in India;
(ii) Which is engaged in the business for providing services, production or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf.
As given in the negative list the SEBI registered venture capital funds cannot invest in the unlisted equity shares or equity linked instruments of venture capital undertaking that are engaged in the business of
- Non-banking financial services excluding those Non-Banking Financial Companies which are registered with Reserve Bank of India and have been categorized as Equipment Leasing or Hire Purchase Companies.
- Gold financing excluding those Companies which are engaged in gold financing for jewellery.
- Activities not permitted under industrial policy of Government of India.
- Any other activity which may be specified by the Board in consultation with Government of India from time to time (Securities and Exchange Board of India, 2010).

Registration under SEBI seems to be a bit bureaucratic, but it offers certain benefits. For example, income is passed to investors without tax in case of trusts registered under the Indian Trusts Act and venture capital companies. FVCIs can freely remit funds to India for investments in Indian VCUs and SEBI registered DVCFs. They are also exempt from both the entry and exit pricing regulations that otherwise apply to foreign investors, such as market-related pricing on divestment. Additionally, the sale of shares by VCFs to company insiders (post listing) is exempt from the SEBI takeover code. Further, VCFs automatically obtain Qualified Institutional Buyer (QIB) status, which is useful for participating in new security placements, and they get exemption from the one-year lock-in for divestment post-initial public offering (IPO) for shares purchased prior to the IPO and are not treated as promoters for purposes of IPO (Deva, 2008).
Under Chapter III, the SEBI Regulations establish investment conditions and restrictions. The investment criteria for a venture capital investor require that it shall disclose to the board its investment strategy and can invest its total funds committed in one venture capital fund. But the investor must invest at least 66.67 percent of the investable funds in unlisted equity shares or equity linked instruments of VCU. Moreover, not more than 33.33 percent of the investable funds may be invested for subscription to initial public offers of a venture capital undertaking whose shares are proposed to be listed. And no more than 33.33 percent may be invested in debt or a debt instrument of a venture capital undertaking that the foreign venture capital investor has already made an investment by way of equity. The 33.33 percent investment limit is also applicable to preferential allotment of equity shares of a listed company subject to a lock-in period of one year, the equity shares or equity linked instruments of a financially weak company, or a sick industrial company whose shares are listed and/or special purpose vehicles that are created for the purpose of facilitating or promoting investment. The venture capital investor must also disclose the duration of the life cycle of the fund (Deva, 2008).
In chapter IV of the Venture Capital Regulations, 1996 general responsibilities of the VCF's has been given that prohibits the funds on inviting subscription from the public. However it states that a venture capital fund may receive monies for investment through private placement of its units (Securities and Exchange Board of India, 2010).

VENTURE CAPITAL ENVIRONMENT IN INDIA
In the initial years, venture capital firms in India encountered a number of problems in developing their businesses. From the in-depth case study of TDICI, Pandey (1998) found that the firm went through the initial constraint of not knowing the venture capital business well, and learnt through experience. It faced problems in raising funds and evaluating prospective ventures. It initially focused its investment in the high-technology business, but gradually shifted the focus towards other potentially high-growth, high-profitable businesses, not just high-tech businesses. It is also noticed that TDICI undertook a number of business development initiatives to popularize the venture capital business in India. It introduced a simple organizational structure for facilitating quick decision making, and developed innovative funding and financing mechanisms.

On the basis of the case study it was found that a developing country requires positive policy initiatives providing an impetus for initiating venture capital activity and the catalytic and development role played by one or a few venture capital firms, committed and professionally competent management team that is dedicated to building the venture capital business, creating simple decision-making structure, and providing managers with operating freedom and an environment that is free from bureaucracy for the development of venture capital industry. Further innovative funding and financing mechanisms to conform with the environmental compulsions and development of value-added services and help systems that create specialization to sustain the venture capital activity is also required (Pandey, 1998).

Dossani & Kenney (2002) consider India to have poor prospects for the development of the venture capital industry because of the history of state directed institutional development and economy being in control of bureaucracy resulting into corruption. However they also consider that India has certain strengths in the form of low cost manpower both skilled and unskilled, a number of small businesses, public equity market and a well grown software industry. For venture capital industry to survive in India the country would have to experience a mixture of interactions between the venture capital institutions and environments so as to suit each other (Dossani & Kenney, 2002).

In India the environment needs to continue being changed for the successful establishment of the venture capital industry. To provide a stimulating environment for the development of venture capital industry in India, the unnecessary regulations that do not serve any important purpose will have to be done away with. The World Bank stimulated the process of Venture Capital Fund in India by funding the Venture Capital Funds in the beginning. Even though these funds were not a huge success they initiated the process of venture investing in the country. Further the development in the software industry provided an appropriate environment for the growth of venture capital industry in India. India still remains a difficult environment for the growth of the venture capital industry because of the bureaucracy and regulations. In order to boost the growth of the venture capital industry in India the government must ease some of the regulations and address the issues related to tax and exchange policies. Further the government must try and reduce the risk involved in venture capital investing if funds are to come from the publicly held financial institutions that are managed by highly risk averse managers (Dossani & Kenney, 2002).

India has an enormous potential in the field of knowledge based industries like information technology, pharmaceuticals, bio-technology, telecommunication etc. While India has inherent strength in the form of cost competitive manpower, technical skill, entrepreneurship etc. the provision of much required risk capital will enable the country to utilize the strengths and explore the untapped potential in the various industries that are not able to grow because of the lack of resources (K.B. Chandrasekhar Committee, 2000).

India has also introduced a number of tax reforms in the years to attract the foreign investors. For example The Indian Income Tax Act 1961 (ITA) exempts income, dividend, and capital gains earned from venture capital investment in India. Section 10 of the ITA provides for incomes that are not included in total income for the year. Any income by way of dividends or long-term capital gains of a venture capital fund or a venture capital company from investments made by way of equity shares in a venture capital undertaking is exempt from income tax. India has come a long way in the venture capital industry and has tried to make itself as a preferred investment hub (Deva, 2008).

DRIVERS OF VC FUNDRAISING

Joshi & Subrahmanya (2014) build up a supply demand framework to understand the factors that determine the fundraising ability of the venture capital funds. While LP's, GP's and entrepreneurs are three players in the venture capital ecosystem LP's and GP"s are on the supply side and entrepreneurs on the demand side. By empirically studying the supply side framework it is found that fundraising ability of VCFs from LPs is more influenced by the macro factors that affect the aggregate fundraising of the VCF while the fundraising ability of GP's is more influenced by the micro factors. The macro factors play a very important role in fundraising by a venture capital fund. The aggregate fundraising by VCF's in Indian economy could have increased on account of the slowing down of the US growth rate; however, inflation acts an impediment to the flow of funds in the Indian economy. Further the strong fundamentals of the Indian economy in the last one decade could also have acted instrumental in the fundraising at the aggregate level. Further the past performance and reputation of the GP's affects the fund raising ability of the VCF's at the micro level. Also, historical deal volume and exits play an important role in determining the fund-raising potential of the individual GP players (Joshi & Subrahmanya, 2014).

PRE-INVESTMENT ACTIONS & RISK MANAGEMENT IN INDIAN VCFS

There are basically four key elements in financing of ventures which are studied in depth by the venture capitalists. These are expertise of the management on board that can bring significant credibility to the company, the expected rate of return on the investment and potential for capital gain, realistic financial requirement and future projections regarding scope, scale of operations, performance etc and financial stake of the owner, family members, relatives and friends (Salgar, 2012).

Soni & Priyan (2013) study the pre-investment actions of the Indian VCFs by conducting a survey of members of Indian VCFs. They find that there are a number of reasons for a high rejection rate of the business plans by the VC Firms primarily being the misfit of business plan in the investment policy preference of the venture capital firm, very high risk, non-agreeable valuation terms, very high/low level of investment required, low contribution of the promoter and expectation of a low return.

The most preferred source of deals for the Indian VCFs is the referrals followed by the deals recommended by the prior investees and active search of the deals itself. The Indian VCF's prefer to invest in ventures by purchasing equity, followed by convertible debt. The use of pure debt is rarely preferred by the VCF's. Further, the firms vary widely in terms of ownership stake that they normally take in the business of investee. The average ownership stake by the VCs may range between16% and 44% approximately.

It is found that while the recently established firms adopt a proactive approach i.e. look for deal themselves the already established firms adopt a reactive approach and prefer to wait for the deals to come to them either through entrepreneurs, referrals, prior investee or VC community. The VCF's conduct a detailed evaluation of the proposal once it passes through the initial screening and evaluate all the information surrounding the venture to judge the probability of success or failure. Indian VCF's use a combination of in-house experts and external specialists for conducting due diligence. VCF's do not consider the environmental conditions i.e. tax benefits and regulations in the industry; significant while decision making. Tax benefits are not relevant in evaluating many deals because VCs see their mission as reaping capital gains rather than providing tax shelters for the investors in their fund. A large number of VCF's prefer syndicated deals mostly at the later stages as compared to early stages. The motives behind syndication are found to be large investment, risk sharing, and need to access specific skills for better management etc (Soni & Priyan, 2013).

The VCF's adopt a number of risk management processes and risk mitigation strategies to deal with identifiable risks. Smolarski, Verick, Foxen, & Kut (2005) identify mainly five type of risks in venture capital investment: pre-investment risk (new investments), risk in existing portfolio companies, portfolio risk, macro-oriented risks, and other.

The major problem is of asymmetric information that has two important issues associated with it which are principal management relationship and portfolio management related issue. This asymmetry in information further gives rise to the problems of adverse selection and moral hazard. The three control mechanisms that can be used to overcome these problems are financial contracting, syndication of financing, incremental or staged financing. Financial contracting is one of the very common mechanisms to control the behavior of the entrepreneurs or the outcomes of the start-up firms thus reducing the moral hazard problem. Syndication of investment reduces the risk of adverse selection and moral hazard by way of confirming the risk with the co-investor. Further incremental or staged financing involves funding of start-ups in stages, more often after certain goals have been achieved at each stage which thus reduces the problem of moral hazard. Portfolio risk is another important aspect of managing risk. Portfolio diversification is an essential and well-known means to control risk exposure by reducing unsystematic (firm-specific) risk.

When studied in comparison to the VCFs in UK, a developed country where the concept of venture capital was introduced much before it came to India; it is found that Indian VCFs prefer syndication to a greater extent than the VCFs in UK as information asymmetry is higher in developing countries than in developed countries. The VCF's in both the countries tend to favor prescreening risk assessment methods for the evaluation of new investments. As far as the risk in

existing portfolio companies is concerned U.K. funds consider aligning management's interest with that of the venture capitalist a significantly more important risk in managing their portfolio companies compared to their Indian counterparts. Indian funds actively diversify their portfolios by investing vertically to a greater extent compared to U.K. funds. With regard to macro and other risks it is found that foreign exchange risk and interest rate risk are more important to UK funds whereas Indian funds consider business-cycle risk, interest-rate risk, and inflation risk as more important. This might be because UK funds specialize to a greater extent as compared to the Indian counterparts due to which they have to manage foreign exchange risk more effectively. U.K. fund managers attend more board meetings for large investments each year and meet with management more often for large and small investments compared to Indian funds. On the other hand, Indian funds attend longer board meetings for large and small investments compared to U.K. funds. Diversification through other sectors of the economy appears more relevant for U.K. funds. On the other hand, Indian funds are more likely to use specialization as a risk mitigation tool. Risk management techniques and risk management styles vary according to country of origin. There is a collective trend within groups in evaluating and controlling, but in considering fund-level risk, including portfolio and macro risks, no consistent risk management policies were captured within the two countries (Smolarski, Verick, Foxen, & Kut, 2005).

FLOW OF VENTURE CAPITAL IN INDIA

Venture Capital Industry is in very early stage in India. Due to the economic liberalization in the economy and the increasing global outlook in India there has been growing interest of the domestic and foreign investors in venture capital. While only 8 domestic VCFs were registered with SEBI during 1996-1998, an additional 13 funds were registered in 1999. Indian venture capital industry has tremendous growth potential provided a proper environment and policy support is provided to the venture capital investors (Dossani & Kenney, 2002).

Venture Capital Investment started in India with the establishment of Technology Development and Information Company of India Ltd. (TDICI) in 1988 with ICICI bank and UTI bank as its promoters. Along with this a number of other venture capital funds, like Gujarat Venture Fund Limited and Andhra Pradesh Industrial Development Corporation, were also started in 1990's by State level Financial Institutions. There was an increase in Foreign Venture Capital Funds in 1990s that focused on providing the development capital without focusing on any specific sectors and looked mainly for opportunities. After the success of these Foreign Venture Capital Funds a number of India-centric Foreign Venture Capital Funds emerged over a period of time. The Venture Capital Industry in India got the real boost in late 1990s with the growth of IT companies and the global dot com boom. However with the burst of the bubble in 2000-2001 Venture Capital Funds suffered huge losses and were able to recover gradually by the end of 2004 (Kohli, 2009).

In 2002 SEBI was made the central regulatory authority for all the VC funds operating in India. This marked an important development in streamlining and regulating the policies pertaining to VC operations in India. Today, there are about 205 foreign and 164 domestic GPs operating in India. The foreign GPs have led the rally of growth of VC investments in India. About 80% of the VC funds invested in India are raised abroad. An increasing numbers of foreign VCs have raised India focused funds since 2005. Several MNCs such as Intel, Qualcomm, SAP and Cisco have set up India focused funds. Microsoft, Google and Amazon have set up their own business accelerators to leverage the innovative technologies developed by the Indian startups. The effort of foreign corporate houses has been supplemented by the Indian industrial conglomerates as well. Many domestic firms such as Reliance, TATA, Aditya Birla group, TVS, Godrej, Patni and Wipro have set up their own VC funds. VCs have funded approximately 2500 companies since 2004. In fact about one-third of the top 500 companies operating in India today are VC funded (Joshi & Subrahmanya, 2014).

Venture capital has become a very important medium of foreign investment into India over a period of time. Venture Capital has seen a phenomenal growth in the recent years which is likely to continue in the future also (Tripathy, 2007).

FOREIGN VENTURE CAPITAL INVESTMENT IN INDIA

Since the opening of the markets in India there have been three major modes of investment for foreign investors which are (i) Foreign Direct Investment regulated by Foreign Investment Promotion Board (FIPB), (ii) Offshore company (usually in Mauritius) operating in India monitored by FIPB in collaboration with the Reserve Bank of India (RBI), and (iii) Direct Investment in Venture Capital Funds, the regulation of Foreign Venture Capital Funds being undertaken by FIPB and Securities and Exchange Board of India (SEBI) (Deva, 2008).

The SEBI (Venture Capital Funds) Regulations were formulated in 1996 to regulate the domestic venture capital funds (DVCF) and to require registration of such funds. It was only in 2000 that legislation was passed specifically dealing with foreign venture capital in India. The SEBI (Foreign Venture Capital Investors) Regulations of 2000 define a "foreign venture capital investor" (FVCI) as an investor that: (1) is incorporated and established outside India; (2) is registered under these regulations; and (3) proposes to make investments in accordance with the SEBI regulations (Deva, 2008).

The flow of venture capital has a positive effect in the economy since it supports the growth the local industries and creates employment. However foreign investors consider a number of factors like legal, social, political, economic and regulatory framework of the country before investing in a particular country. They are more likely to invest in a country that has least procedural and regulatory networks (Deva, 2008).

For purposes of receiving benefits under the SEBI Regulations, an overseas investor must be registered as an FVCI. Before registration, the board would consider certain conditions for eligibility, such as the applicant's track record, professional competence, financial soundness, experience, and general reputation of fairness and integrity. The board would also consider whether the applicant is an investment company, a trust, partnership, pension fund, mutual fund, endowment fund, university fund, charitable institution, or any other entity incorporated outside India; or whether an asset management company, investment manager or Management Company, or any other investment vehicle incorporated outside India. The board would also inquire as to whether the applicant has previously been denied a certificate by the board and whether the applicant is a fit and proper person.

India has been making continuous efforts to create a conducive investment climate in a country by making amendments in the law and regulations governing the venture capital industry in India. Indian venture capital market is driven by a number of other variables like strong growth in the knowledge based industries that are global in nature and are not affected by the domestic issues. Large English speaking population along with the world class professionals and engineers have also enhanced the prospects venture capital investment in India by foreign investors. Further the growth in some of the sectors like Information Technology and Media has also been a motivator for the foreign investors to invest in Indian Companies. However there are certain shortcomings that need to be addressed for making India a better place for venture capital investment. This includes the need for maintaining a balance between the market and the regulatory framework, the need to increase the investment in the fields of education and research, the need to have competent manpower in the regulatory institutions, need to improve corporate governance and financial discipline etc. The improvement in all these aspects would make India a more desirable market from the perspective of venture capital investment (Deva, 2008).

VENTURE CAPITAL INVESTMENT TREND IN INDIA

The Venture Capital industry in India picked up in 1996-97 and reached new heights in 2000 because of the success of India in addressing the Y2K problem and the boost in the IT, Telecom and Internet sectors which allowed global business interactions to become much easier. However the VC activity declined drastically in 2001-2003 when NASDAQ lost 60% of its value in second quarter of 2000. And other public markets declined substantially. Consequently, during 2001-2003, the VCs started investing less money to minimize the risks as a result of which the number of early-stage deals fell sharply from 142 in 2000 to 36 in 2001. The investment in IT related companies also fell drastically. This scenario could change in 2004 only with a renewed investor interest and activity since the Indian economy was growing at a very high rate. Further the Venture Capitalists started focusing on the sectors other than IT because the growth of the Indian economy was no longer limited to the growth of IT sector only. The investment further spread to bio-technology, pharmaceuticals, healthcare, medical tourism, real estate, entertainment and media etc (Aggarwal, 2006).

The following is the industry wise cumulative investment details of SEBI Registered Venture Capital Funds (VCF) and Foreign Venture Capital Investors as on September 30, 2014.

TABLE 1: INDUSTRY WISE CUMULATIVE INVESTMENT DETAILS OF SEBI REGISTERED VENTURE CAPITAL FUNDS (VCF) AND FOREIGN VENTURE CAPITAL INVESTORS (FVCI)

Particulars	as on September 30, 2014 (Rs. in Crore)		
Sectors of Economy	**VCF**	**FVCI**	**Total**
Information Technology	1072	4433	5360
Telecommunication	1299	6480	7096
Pharmaceuticals	376	463	778
Biotechnology	223	141	327
Media/Entertainment	1078	1107	1616
Services Sector	2924	2755	4206
Industrial Products	1241	1319	2243
Real estate	9000	1183	9567
Others	17634	27061	37712
Total	**34847**	**44943**	**68904**
	*excludes Rs.10886 crore of FVCI investments through VCFs		

1. The above report is compiled on the basis of quarterly information submitted to SEBI by registered Venture Capital Funds and Foreign Venture Capital Investors.
2. Due to change in reporting format with effect from the quarter ended 31st March 2010, the investment details for the March '10 and December '09 quarter are not strictly comparable (Securities and Exchange Board of India, 2014).

Table 1 show that there has been huge venture capital investment in the areas of Information Technology, Media/Entertainment, Real Estate and Telecommunications by VCFs and FVCIs.

In the early stages, venture capital investments were mainly in the manufacturing sector. However, with changing trends and increased liberalization, companies in consumer services and consumer retail space emerged as top contenders for VC funding, attracting almost 50% of total VC investments. Other key industries included IT and IT-related services, software development, telecommunications, electronics, biotechnology and pharmaceuticals, banking and finance/insurance, public sector disinvestment, media and entertainment, and education (Kaushik, 2014).

There was a sharp increase in the investment made by the VCFs in the year 2014 both in terms of volume and value as funds sought to invest in fast-growing e-commerce and online service firms. In 2014, VC funds invested $2.1 billion across 1,108 deals marking an increase of 47.7% from 2013 when VC funds invested $1.4 billion across 246 deals, according to data compiled by VCCEdge, the financial research arm of VCCircle.com. In the past year travel bookings, home furnishings, car booking companies have been very successful in raising a significant amount of capital. While there has been huge investment by the VCFs in the previous year the exit by these funds from existing investments still remains a concern primarily on account of weak capital markets in the recent years. However exits by way of mergers and secondary markets have now gained some momentum (Sarkar, 2015).

A completely new field that is attracting venture capital is agriculture. This has been fuelled by the realization that food security is a vital, long-term necessity. Studies suggest that in future, for every Rs 100 increase in GDP, Rs 41 will be spent on food. At the recently held Global AgInvesting Conference, data released indicated that agro businesses would provide better returns of about 11%, compared to 3-5% yield from bonds and equities. Agriculture could well become the new Mecca for venture capital investments. Leading VC firms such as Venture Dairy, Anterra Capital (a spin-off of Rabobank's proprietary venture capital investment team), SAEF (Small Enterprise Assistance Funds) and Rabo Equity Advisors' India Agribusiness Fund have already entered this market (Kaushik, 2014).

Since 1988, ICICI has played a prominent role in promoting venture capital investments in India and currently manages funds over $2 billion. In fact, India recorded a 13% increase in the amount invested against the global rise of 2%. At $45.8 million, India posted an all-time-high median value at the profitable stage in 2013, the highest value ever seen in any market across all of the development stages since 2007.

Early-stage funding has gone down and more funds have been diverted to later, more profitable stages or spread out in multilevel funding, indicating that investors are cautious about high risks. However, top players such as Sequoia Capital, Rabobank, Google Venture, Seed Venture Fund and World Bank's IFC are investing in India. IFC is the leading investor, with $1.4 billion.

Most VC investors, both local and global, have leveraged the Mauritius Treaty route to invest in India because tax is only payable in the country of the investor's residence. The SEBI (Securities and Exchange Board of India) can work towards further simplifying the investment procedures and offer attractive IPO and M&A exit ratios.

Another trigger to invest in India is that both China and India are the top two growing global economies. The new pro-business Indian government has also inspired confidence and foreign investment worth Rs 17,000 crore has already been made. So the prospects look rosy for the growth of venture capital in India (Kaushik, 2014).

A COMPARISON OF VENTURE CAPITAL INDUSTRY IN INDIA AND CHINA

The development of VC and new venture growth of India and China have a number of similarities and differences. Even though the amount of VC investment in India and China is small in comparison to the amount invested in countries like USA and countries in Europe there has been a growing VC investment in both the countries since 2006. While both the countries concentrate on IT, healthcare and services, little attention has been paid to new and high technology based industry. In terms of geographical distribution of VC investment the IT hubs of the two countries i.e. Bangalore of India and Beijing of China have been the major attraction for VCFs. The investment is further more concentrated in the economic and financing centers' of the two countries. There has also been some growing investment in interior cities like Pune and Hunan of India and China respectively. Further foreign capital is a major source of VC investment in both the countries. While VC industry is in the initial stage in both the countries the amount of VC investment is much higher in China than India (Tang & Wei, 2011).

GROWTH AND FUTURE OF VENTURE CAPITAL IN INDIA

The K.B. Chandrasekhar Committee identified five critical success factors for the growth of the venture capital industry in India.

- The regulatory, legal and tax environment of the country should provide a flexible environment to the VCFs for the growth of the industry.
- Resource raising, investment, exist processes should be made as flexible as possible.
- The venture capital industry should be institutionalized and should protect the interest of investors and investees.
- The Indian VCFs should have global exposure and investment opportunities.
- The development of infrastructure should be given importance for faster conversion of Research & development and technological innovation into business ideas.

Along with this FVCI should be able to able to enter easily into the Indian markets since these provide the capital in a highly risky area and management expertise on account of the experience that they have gained over a number of years (Haritha, V, & Reddy, 2012).

The number of players offering growth capital and the number of investors is rising rapidly. The successful IPOs of entrepreneur-driven Indian IT companies have had a very positive effect in attracting investors. The Indian government initiatives in formulating policies regarding sweat equity, stock options, tax breaks for venture capital along with overseas listings have all contributed to the enthusiasm among investors and entrepreneurs, as has the creation of the dot.com phenomenon. A viable venture capital industry depends upon a continuing flow of investment opportunities capable of growing sufficiently rapidly to the point at which they can be sold yielding a significant annual return on investment. If such opportunities do not exist, then the emergence of venture capital is unlikely.

Therefore there is a strong potential for growth of Venture Capital industry in India. All that is required are the comprehensive efforts on the part of the government and business entrepreneurs. This combined effort can create a stimulating environment for the growth of venture capital industry in India (Haritha, V, & Reddy, 2012).

ISSUES IN THE GROWTH OF VENTURE CAPITAL IN INDIA

According to Dr. Dossani a member of the committee on Technology Innovation and Venture Capital formed by the Planning Commission in India in September 2005 there are some deficiencies that restrict the growth of the venture capital industry in India. According to him the entrepreneurs in India even though possess the cost and management skills but lack the talent to convert early stage ideas into viable business. They also lack proper networking and their networks are limited to some personal connections and networks with brokers. There is a shortage of complimentary capital like debt capital and the equity markets are underdeveloped for the listing of the early stage firms. Moreover there are not many firms providing early stage funding (Deva, 2008).

There are certain issues that must be taken into consideration for the success of the venture capital industry in India. The profitability of the start-up companies should not be the only focus of the entrepreneurs in India since such an approach could be counterproductive. This approach may hinder the development of the start up and may deter it from achieving its true potential. The VCs should provide continuous funding in small amounts to the start-up firms and should be more involved in their management and decision making. The entrepreneurs in India generally lack expertise in marketing, sales and business development areas. Hence, finding the appropriate marketing, sales and business development people is one area where Indian start-ups need help. Indian entrepreneurs are hesitant in giving control and usually prefer to take funding from family and friends to start business firms. Indian start-ups lack financial transparency and often have limited experience in implementing effective financial processes. This usually makes the task of the VC much more difficult not only during the due-diligence phase, but also in helping the start-up grow rapidly. Therefore it is believed that simply directing the Indian entrepreneurs to implement processes during monthly or quarterly board meetings may prove to be futile because many entrepreneurs might not know how to execute on the instructions.

One of the most worrisome aspects of the VCs' new-found zeal to invest in India is that most VCs want to continue to invest in Indian start-ups in areas they are most familiar with, i.e., in IT, telecom and Internet products and services. The other really worrisome aspect is that many US-based VCs believe that they can help the growth of Indian start-ups, and provide good returns to their own shareholders by making decisions based on periodical visits to India, sending one of the senior partners in the VC firm to India to set up a subsidiary that can help its portfolio companies, hiring a junior partner in India. However, none of this approach might work due to lack of cross-border experience (Aggarwal, 2006).

In addition to the challenge of raising funds in tough market situations, the biggest challenge for a venture capitalist in India is to find the right set of passionate resources for each of their portfolio companies to support their growth at early stages. The reason many companies fail at early stages is not only because they are not able to mobilize funds at initial stages, but because they are not able to attract the right talent to work with them and to guide them. Those VCs who are able to bring the right resources along with their funding are the ones that will succeed in the long Term (Next Big What, 2013).

SCOPE FOR FUTURE RESEARCH

One of the major problems in VC research is that data is available only for the firms that were able to receive VC funding and not for those who did not get VC funding. More research needs to be done on the early history of the VC-backed companies before they received the venture capital. Also it will be interesting to know how VCFs work, make decisions, attract, motivate and retain talent etc. An insight into the relationship between GPs and LPs will enable a better understanding of the fundraising by the VCFs (Rin, Hellmann, & Puri, 2011).

SUMMARY

Venture Capital has come to play a very important role in India. With the formation of Venture Capital Regulations, 1996 by SEBI and some flexibility offered by the Government of India to VCF's there has been a positive trend in the Venture Capital Industry. While more and more FVCI are attracted towards India DVCFs are also playing an important role in providing venture capital investments and promoting innovative entrepreneurships. After initially concentrating mainly on the IT and manufacturing sector VCFs have now started investing in other promising sectors in India like health, bio-technology, pharmaceuticals, e-commerce etc.

Over the years there has been growing investment by the FVCI in India. What is required is a provision of a more flexible regulatory framework that makes it easier for such investors to invest in the country. Further certain issues with regard to the lack of expertise of the Indian entrepreneurs in converting their ideas into business plans, their lack of knowledge in the fields of marketing and finance, their sole focus on profit making that can act as counterproductive to the growth of firms needs attention so as to stimulate the growth of the Venture Capital Industry in India.

When compared to China India has a very less amount of Venture Capital investment in the country. However the strong fundamentals of the country have been able to attract more and more investors over a period of time in diversified sectors. The need of the hour is that Government should come forward with some incentives and introduce flexibility in the regulations to attract more and more venture capital investors.

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