ISSN 0970-7247

20

THIRD CONCEPT

ın International Journal of Ideas

ı. 14, Nos. 163 September 2000 Rs. 10.00

Editor
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hile the Editor accepts responsibility for the lection of materials to be published, individual ithors are responsible for the facts, figures, d views in their articles. However, the Editor serves the right to edit the articles for reasons space and clarity.

pesetting by : Kamal Laser Graphics

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2000

Venture Capital : The Indian Experience

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The structural reforms in India started in 1980s but got logically consistent shape only since 1991. The package of structural reforms in India consists of three elements, viz. :

* Deregulation and liberalisation of all markets.
* Increasing competitiveness in all spheres of economic activities.
* Living within the means or a strong budget constraints on economic agent.

Measures undertaken under structural reforms in India include decontrol and deregulation of industry or service sector, disinvestment of PSUs, opening the economy for foreign investment and steps to integrate the economy into the world system.

Financial Reforms

The financial reform is an essential adjunct to economic growth. It refers to a general improvement in the functioning and efficiency of the financial system as a whole and the removal of impediments to its Long Term developments.

It is true that reforms undertaken have increased competitiveness within the financial sector by means of freezing interest rates, allowing new financial institutions and instruments and lifting controls on the entry of new domestic and foreign banks. The reforms in financial service have been made by foreign countries well in advance but the process of economic liberalisation in India, as stated earlier, started only from 1991. We have an agenda in financial service to be achieved; unless that is achieved substantially, harmonisation of domestic financial service industry with global financial service industry will not be possible. However, during this interval, we can take a major leap by promoting specialised Financial Service Institutions (FSI) which include Venture Capital Financing (VCF), Lease Financing Factoring, Mutual Funds, Merchant Banking, New Financial Instruments, etc.

The financial assistance is needed for the entire duration to enable the companies to recover from the negative cash flow in the early years. In other words, finance is required to enable them to pass from the start-up phase to the expansion phase. It is only here arises the need of Venture Capital.

Venture Capital : Meaning

Venture Capital is significant innovation in the Twentieth Century. It is considered as a synonym of high risk capital. Venture Capital is risk capital which is used in risky enterprises as equity or debt capital. Venture Capital is popularly used in new sunshine industries or old risk enterprises. "The capital which us used to finance risky ventures is called Venture Capital." It is availed to finance the requirements of early stage of the project, expansion and acquisition of new project, etc. It also provides management support and technical know-how and acts as a partner and adviser to the new entrepreneurs. It is in this context, Venture Capital differs from the conventional bankers, investors and lenders. In a broader sense, Venture Capital refers to the commitment of capital and knowledge for the formation and setting up of firms particularly to those specialising in new ideas or new technologies.

In India, Venture Capital mainly comprises of seed capital, finance for the high technology and funds to turn R&D into commercial production. It is seen as the important means of financing Indian industry, particularly the smaller unlisted companies.

Venture Capital activities have just begin in India and got official recognition only in 1988. But it is well developed in developed countries like USA, UK, etc. Further in foreign countries, Venture Capital gained momentum because of a large

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nun of tax incentives available to Venture Capital firms and investors, well developed avenues for buying and selling shares of the SSI, favourable social climate and Government policy for encouraging entrepreneurial activities. But in India it is still in the infancy stage and requires proper frame work and promotional efforts for the fast growth. Only a few number of Venture Capital firms are functioning in India. They were mainly started by Central and State level financial institutes and commercial banks. Only a very small number of Venture Capital firms are of private sector.

Venture Capital has already made a dent. However a study of all such funds points out that they have been either extreme success or utter flop. The Venture Capital firm by the Gujarat Government has been notable success while that of A.P. Government fared poorly and hence the latter was privatised.

Functioning of Venture Capital in India

Venture Capital in India has the stated objective of financing and development of high technology business. This scope of Venture Capital, though most significant but limited, has been influenced by Government policies and guidelines as the major players in the Venture Capital industry are of public owned development banks and commercial banks. From the past experiences of the functioning of VCF in India, it suffers mainly from the following drawbacks.

1. *Lack of Prioritisation of Thrust Areas:*

   In our country, VCF failed to prioritise high-tech thrust area for venture finance. It is no doubt that prioritisation of thrust area will lead to development of technological speciality and expertise by VCF.

2. *Lack of Regional Focus:*

   VCF extends assistance to whole India not minding regional benefits. VCF was unable to exploit the regional benefits in the various regions of India and it may lead to concentration and specialisation and also to take full advantage of the regional benefits.

3. *Lack of Full Range Financing:*

   It is generally observed that there has been a shift from early state financing to expansion financing. So special stress needs to be laid down on seed capital financing and turnout activities of sick units.

4. *Lack of Focus on Entrepreneurial Development:*

   VCF, in addition to financing high technology should adopt a broader approach to financing and supporting novel ideas of entrepreneurs which may not necessarily be high-tech in nature.

5. *Lack of Encouragement for Private VCF:*

   From 1988 to Sept. 1995, Indian Government did not encourage participation of domestic private sector in VCF. This is one of the reasons for poor contribution by private sectors in VCF. But abroad, there has been a significant contribution by private sectors.

6. *Lack of Autonomy:*

   One of the reasons for poor performance of VCF in India may be that the selection of portfolio by VCF has followed no systematic approach as they have no autonomy.

7. *Lack of Professionals;*

   VCF should be manned by highly ambitious and risk taking people having professional backgrounds, Unfortunately in India, most of these firms are manned by deputationists. Competent professionals are not easily available in India.

8. *Lack of Intermediaries:*

   There are no intermediaries to link R&D taking place in India with VCF. VCF can give proper shape to research activities.

9. *Lack of Attractive Scheme:*

   The existing scheme of financing of VCF should be scrapped and instead the schemes followed by VCF at Frankfurt, New York and Zurich be introduced. In the same way, non-voting rights shares should be introduced in their capitalisation.

Policy Changes for Venture Capital

In the light of the experiences of Venture Capital activities in India during last decade, there is an urgent need to design opt policies for accelerating the pace of growth and function of VCF in India as detailed below:

1. The scope of VCF in India is restricted only to high-tech projects. This restriction in view of globalisation should be changed to horizons like developed countries.
2. There should be an adequate encouragement for the participation of private sectors in VCF like in developed countries. Accordingly Government policies are to be changed.
3. As pointed out by Dr. R. Mehta, Chairman of SEBI (in Economic Times, 16th Nov. 1998), the Government has to free VCF from IT restriction as that of mutual funds, i.e., exemption from tax on dividend income and Long Term capital gains for equity investments.
4. In order to manage VCF more efficiently, it needs professionals with initiative, drive and vision to identify entrepreneurs who have potentially sound ideas and innovative vision. Therefore, management/business schools need to develop special training programmes/special courses for VCF managers.
5. There is an urgent need for Government to find intermediaries to link between R&D and VCF. It is no doubt that VCF can co-ordinate between R&D and Industry by providing financial support for research.
6. An Apex Venture Capital Institution with sufficient powers and capital base to effectively monitor the functioning of various VCFs in our country is to be incorporated.
7. Legal provisions should be made by our Government to issue non-voting shares.
8. The VCFs' scope, within high technology Venture, should be more on development oriented projects including creation of employment, pollution control, import and export, energy savings, etc.

Conclusion

As the reforms on the Indian economy are steadily moving towards various activities of financial service, VCFs are expected to flourish. Many more companies on Venture Capital will emerge and competition would be severe. FIs are reluctant to finance risky project. Hence VCF can grab the opportunities in promoting and financing the risk project. Accordingly guidelines for VCF may be changed to be more flexible. Given the nature and scope of VCF in the present economic and business environment it can be safely concluded that there is a bright prospect in the coming years. □

"Let us become a bit serious, especially in the present atmosphere of liberalised economy, to manage our affairs properly."

— Dr. A. Shandilya