How to Teach The Big Baby to Walk: *Case of the Indian Venture Capital Industry*

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It is well established fact that venture capitalists play a crucial role in the promotion, creation, and establishment of new business ventures which ultimately have to go public (Barry et al. [1990]; Gompers and Lerner [1997]; Lerner [1994] and Megginson and Weiss [1991]). Any new business venture (usually developed by high potential would be entrepreneurs) when it starts its operation in the beginning are basically assisted by venture capitalists, and at that time the risk and return will be extremely high. But as and when it progresses from early stage to later stage (transition to established company) the risk element and the return associated with it gradually decreases to very low (Subhash [2003]). At this stage the business venture will be in a position to earn sufficient amount of returns to meet the financial obligations. The entrepreneurs will be getting their anticipated returns and at the same time the venture capitalists will be able to take out their stake in these ventures either exiting through initial public offering to a third party or selling back their stake to the entrepreneur. This usually takes at least 7 to 10 years time. During all these years the venture capitalists will be providing financial assistance by way of venture capital as well as non-financial assistance (technically known as 'adding value to the venture') there by making the assisted unit in to a successful business enterprise.

In the year 1946 this concept was formally recognised in the U.S. (as they were the market leader at that time) and it was termed as modern concept of venture capital. Venture capital is a special type of finance available; to new and innovative ventures or ventures having untried technology or ventures having high growth potentiality with high-risk involvement; in the form of mainly equity (sometimes quasi equity or conditional debt) to those entrepreneurs who are having the technical or professional qualifications for starting up the venture and also efficiently managing the venture. These 'would be' entrepreneurs organizes all other required resources with the help of the venture capital raised and makes the potential business idea pass through different stages of business cycle; as all businesses have a 'life cycle' which involves stage of growth and development, which can be broadly categorized into two: early stages and later stages. If the idea passes through these stages successfully, one can see the birth of emerging successful enterprises, which in turn leads to the development of the economy. This happens only if the intangible ideas of entrepreneurs are financed with tangible money by the venture capitalists in the form of venture capital, which Megginson [1999] identifies as *value addition process.* This in turn results in more than a proportionate share of the increase in well-paid and highly skilled jobs, this was identified by Nuechterlein [2003]. Thus Tudini [2004] argues that the only alternative to the self-financing development phase of any business venture is venture capital. Presently almost over 60 players are there in the global venture capital arena. According to Bruton [2002], the modern concept of venture capital started in the United States in the year 1946 and expanded there to Europe during the 1980's and later to Asia to become a worldwide industry. Koh and Koh [2000] suggest that success of Silicon Valley has fueled the the growth of venture capital industry around the world.

BACKGROUND

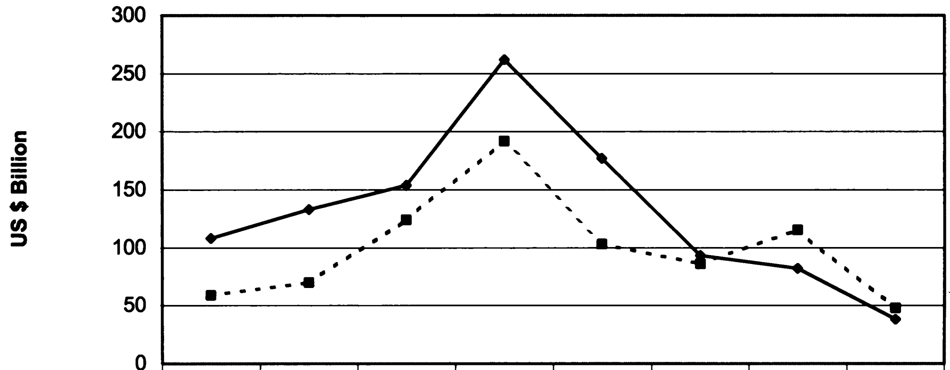
An overview of the studies in the Asia Pacific region during 1991 until the first half of 2005 reveals that altogether 51 studies were carried out, of these 14 were carried out during 1991–2000. But the number of studies increased to 37 during 2001–2005. Except for two studies (one on Singapore and one on Australia), all 49 studies were on the supply-side aspect of venture capital. None of the studies analysed the growth and development of venture capital financing in the Asia Pacific region as a whole or compared it with the other regions around the world. The majority of the studies were carried out in India. During 1991–2000, 6 studies were done and during 2001–2005 almost 10 studies were done. Even then with respect to Asia Pacific region as a whole, in India also growth and development of venture capital industry, and also comparing it with Asia Pacific region and global overview was not carried out. Thus the present study tries to fill the gap that presently exists and make it more relevant.

A general overview of the Indian financial system (Ramesh and Gupta [1995]) reveals the role played by the Indian government during the last 50 year period, was mainly reactive rather than proactive. Analysis of Indian venture capital industry as well as a comparison with other countries shows that though there exists great potential for venture capital financing in India there are various issues to be tackled in order to reap full potentiality of the benefits (Gupta [1991]; Kumar [2001]; Bishnoi [2001]; Many [2003] and Chary [2003]). Issues like lack of potential entrepreneurial talents and also the inertia of risk-taking attitude hinders the development of venture capital in India (Pandy [1996]). Along with these issues, VCF's should be given full support in performing their role (Bishnoi [2001]), and to succeed, VCF's should develop appropriate strategies depending on the local market conditions rather than replicating a readymade strategy uniformly (Wright et al. [2002]). Because thecharacteristics of Indian venture capital model is completely different from the U.S. model and also the Asian model (Verma [1997]), a completely new model needs to be developed for the promotion and development of Indian venture capital industry. It was observed that in India, interaction between venture capital (transferred institution) and the existing institutions modified the existing environment and thus resulted in the success of venture capital industry. In contrast to the U.S. experience, even highly constrained and bureaucratically controlled venture capital operations succeeded in India (Kenny and Dossani [2001]). This is mainly because of the efficient management of the ventures by the VCF's (Sharma [2002]). It was also observed that there exists no basic difference between domestic and foreign VCF's with respect to monitoring their portfolio companies (Pruthi et al. [2003]). The pattern of venture capital investment in India differs with respect to the geographical concentration of industries (Subhash [1999]), certain regions are given more priority over others. Also some of the sectors are getting more importance than others, such as software development (Saha [2003]). But above all timely initiative is to come from government in the form of tax incentives, timely issue of regulatory/legal policies, as well as currency exchange policies (Kenny and Dossani [2001]). Absence of fully developed venture capital market, results in not getting higher investment for those new business ventures and making them prone to failures (Thakur [1999]). The development of venture capital industry during the pre- and post-liberalization period (Subhash and Nair [2004]) reveals that even with such a highly constrained and bureaucratically controlled environment, Indian venture capital industry showed its ability to survive. Thus most of the studies suggested that though Indian venture capital industry is progressing even without having the full support from the government in terms of timely guidelines and promotional activities and also encouraging the entrepreneurial talents, its high time that government should take the initiative in promoting and developing venture capital market in India so as to reap the full potential of venture capital financing, which may lead to a manifold impact on Indian economy in the years to come.

GLOBAL SCENARIO

During the last 60 years (from 1946–2006), the modern concept of venture capital financing has been successfully transplanted (either in its original form or as a variation), to almost all parts of the world. Presently there are over 60 major players in the arena. A brief overview of the global venture capital activity is shown in Exhibit 1.

EXHIBIT 1
Global Venture Capital Scenario



	1997	1998	1999	2000	2001	2002	2003	2004
Raised	108	133	154	262	177	93	82	38
Invested	59	70	124	192	103	86	115	48

Source: Compiled from Global Private Equity Report: 2000, 2001, 2002, 2003, & 2004. PWC & 3i.

With respect to the amount of venture capital raised globally, an upward trend can be seen during 1997–2000, almost a 143% increase (from $108 billion to $262 billion). But afterwards it started declining gradually by almost 32% (from $262 billion to $177 billion) during 2000–01; 47% (from $177 billion to $93 billion) during 2001–02; 12% (from $93 billion to $82 billion) during 2002–03; and 53% (from $82 billion to $38 billion) during 2003–04 first half. The amount of venture capital investment shows a similar trend, increased almost 225% (from $59 billion to $192 billion during 1997–2000) and started showing decreasing trend during 2000–2002. The decrease during 2000–01 was to the extent of 46% (from $192 billion to $103 billion), but during 2001–02 only 16% decrease (from $103 billion to $86 billion) was recorded. But from 2003 onwards the investment activities shows a gradual increase, i.e., 34% increase (from $86 billion to $115 billion). This clearly indicates that though investors are not putting any new money in the venture capital pool, venture capitalists were able to finance more than what is being raised. Only during 2003–04, the global utilization rate is showing an increasing trend, i.e., 140% during 2003 and 126% till first half of 2004.

Another important aspect regards the global venture capital ranking (amount invested) during 1999–2003, which is given in Exhibit 2. U.S. and U.K. are the two players continuously holding the same ranking of first and second positions, respectively. The three players in Asia Pacific region continuously improving their positions are Japan, Australia, and China. Japan now is in the third position, Australia in the sixth position and China in the ninth position. Though South Korea is holding eighth position, it was able to maintain the position during the last four years. India is also improving its position during the last four years (14th position).

But a completely different picture is seen when the compound average growth rate (CAGR) is taken in to consideration, which is given in Exhibit 3. The ranking according to the CAGR shows that India is in the first position and U.S. in the 20th position. This is a complete reversal with respect to U.S. and also for India. When the venture capital investment activity around the world is considered, it can be seen that throughout the Asia Pacific region the investment climate is better than other regions.

The utilization rate with respect to the venture capital fund in Asia Pacific region is much higher than the global rate, which is clear from Exhibit 4. On a global scale during 2003–2004 the utilization rate is 140%, and 126%, respectively. The similar rate for North America is 133% and 96%. Only during 2003, there seems to be an upward trend. The similar rates for Europe are 108% and 188%, which are lower than the global rate during 2004. But for Asia Pacific region the utilization rates for the years 2001 to 2004 (113%, 303%, 533%, and 180%) are much more than the global rates. This clearly shows that this region is capable of attracting more venture capital investment than what was actually raised during the years

EXHIBIT 2
Global Ranking Based on Venture Capital Investment

North America	Europe	Asia Pacific	Middle East & Africa	Central & South America	Rank				
					2003	2002	2001	2000	1999
USA					1	1	1	1	1
	UK				2	2	2	2	2
		Japan			3	6	6	10	12
	France				4	3	5	3	4
	Italy				5	4	7	7	5
		Australia			6	11	14	19	19
	Germany				7	5	3	4	3
		S - Korea			8	8	10	8	15
		China			9	21	13	17	-
	Spain				10	12	17	15	13
	Netherlands				11	7	11	12	7
	Sweden				12	9	9	11	8
Canada					13	10	4	5	6
		India			14	13	15	18	-
			S-Africa		15	16	-	-	18
			Israel		16	14	12	6	10
		Indonesia			17	17	-	-	-
		Singapore			18	20	16	13	17
	Finland				19	18	-	-	-
	Denmark				20	24	20	-	-
		Hong Kong			-	15	8	9	9
	Belgium				-	19	19	-	14
		Taiwan			-	-	18	14	11
				Argentina	-	-	-	16	-
	Switzerland				-	-	-	20	16
	Norway				-	-	-	-	20

Source: Compiled from Global Private Equity Report: 2000, 2001, 2002, 2003, & 2004. PWC & 3i.

2001–2004. The utilization rates for India in 2002 and 2003 were 656% and 331%.

ASIA PACIFIC REGIONAL SCENARIO

The modern concept of venture capital started in Asia Pacific region in the year 1952 in Japan. It took almost six years for this region to adopt after it started in the U.S. in the year 1946. Other two players where venture capital financing started early are Hong Kong (1959) and India (1964). Later on other countries in this region started adopting this form of financing. With respect to the total venture capital pool available in the year 2004 (for the first time Asian venture capital industry cleared the $10 billion mark in total funds under management in the first half of the year 2004), Japan is leading with 27% share, followed by Hong Kong 26.8% and Singapore 10.8%. Other countries in this region hold the remaining 35% share. Share of India is only 3.2%. Exhibit 5 shows the detailed breakdown of venture capital pool during the last 12 years. During the years, Japan's share came down from 68% in 1992 to 27% in 2004, which is almost equal to the share of Hong Kong (it was 8% in 1992, now it is 27% in 2004). Almost 60% decrease took pace in Japan's share and almost 238% increase in Hong Kong's share. The third biggest player is Singapore having 175% increase over the years (from 4% in 1992 to 11% in 2004). Though there are almost 18 players in this region, only

EXHIBIT 3

Global Ranking Based on Compound Average Growth Rate

North America	Europe	Asia Pacific	Middle East & Africa	Rank 2002	2001	2000	1999
		India		1	2	2	-
	Sweden			2	3	1	1
	Denmark			3	1	-	-
		Australia		4	6	20	-
		South Korea		5	18	17	17
		Japan		6	14	19	-
	France			7	13	14	12
	Italy			8	8	7	4
	Spain			9	5	8	9
	Finland			10	-	5	-
			Israel	11	4	3	6
		China		12	7	-	-
Canada				13	11	6	15
	Netherlands			14	15	16	11
	Switzerland			15	-	4	2
	UK			16	20	15	10
	Belgium			17	16	9	5
	Germany			18	9	12	8
	Norway			19	19	-	14
USA				20	17	13	7
		Singapore		-	10	10	13
		Hong Kong		-	12	18	16
		Taiwan		-	-	11	3

Source: Compiled from Global Private Equity Report: 2000, 2001, 2002, 2003, & 2004. PWC & 3i.

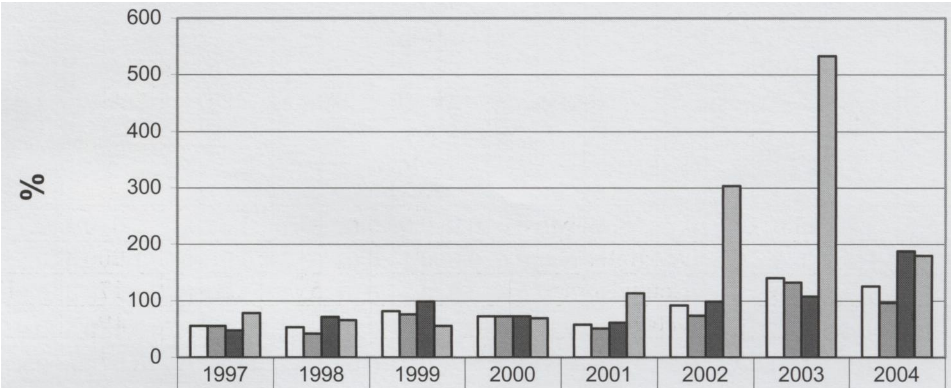
14 are actively participating in venture capital financing. Pakistan, Sri Lanka, Myanmar, and also Bangladesh are the non-active players in this region.

INDIAN SCENARIO

A brief outline of the evolution of Indian venture capital system during the last 4 decades can be summarised as follows: though India had the history of 42 years of venture capital financing activities, the first 27 years (Pre-LPG Era; i.e., Liberalization, Privatization, and Globalization) witnessed only the laying of foundation stone for the venture capital industry and the remaining 15 years (Post-LPG Era) actually made Indian venture capital industry to reach a significant level (Subhash, K.B. [1999]). Exhibit 6 will give more concise information of Indian venture capital industry.

The beginning of modern concept of venture capital in India started when in 1964, Industrial Development Bank of India (IDBI) launched its Own Capital (excludes loan) of Rs. 500 million specially for the promotion of high-risk high-growth ventures promoted by first generation entrepreneurs. For the next 18 years, i.e., during 1964–1981 (the time usually considered to reach maturity) no major development took place, except the setting up of the Committee on Development of Small and Medium Entrepreneurs, which first highlighted the need for venture capital financing in 1972 under the chairmanship of R. S. Bhat, which drew attention to the problems of new entrepreneurs and technologists in setting up industries. The committee recommended the creation of Venture Capital Fund (VCF).

Exhibit 4
Utilisation Rate



	1997	1998	1999	2000	2001	2002	2003	2004
Global	55	53	81	73	58	92	140	126
North America	56	42	76	72	51	74	133	96
Europe	48	71	99	73	61	99	108	188
Asia Pacific	78	66	55	69	113	303	533	180

Source: Calculated based on the information available from Global Private Equity Report: 2000, 2001, 2002, 2003, & 2004. PWC & 3i.

The next major development happened in the year 1985, when the seventh Five Year Plan (1985–1990) emphasized the need for developing a system of funding venture capital. On 20 December 1985, to popularize venture capital financing, the government in its document on Long-Term Fiscal Policy presented in the Parliament, announced the creation of VCF on an experimental basis with an initial capital of Rs.100 million. The main objective of this VCF was to provide financial assistance in the form of equity capital for those entrepreneurs/technocrats having a potential business idea for commercializing indigenous technology and also for adopting technologies which were previously imported from abroad for wider application in the domestic market. This VCF became operational from April 1, 1986, to be fully administered by IDBI. A cess of 5% on all payments made for purchase of technology from abroad was levied under the Research & Development Cess Act, 1986. This also includes all the payments made in the form of royalty, lump sum payment for foreign collaboration, and payment for design & drawings. This levy formed the basis for the VCF to be administered by IDBI. Thus any individual who wish to import any technology from abroad was indirectly contributing towards the creation of VCF in India. In March 1987, ANZ Grindlays 3i Investment Services Ltd launched its first ever venture capital fund in India, the India Investment Fund. This was the first foreign bank to start venture capital financing in India.

The budget speech of 1988–89 gave emphasis on providing a concessional treatment of income tax on capital gains to be made by venture capital companies (VCC's). This was mainly because of the reason of the World Bank's interest in encouraging economic liberalization in India. Three important observations made in a World Bank study were instrumental in getting the required momentum for such a drastic step to be taken by the government: 1) giving more focus to lending rather than equity investment led to institutional lending which was "increasingly inadequate for small and new Indian companies focusing on growth" (World Bank 1989: 6), 2) "the [capital] markets have not been receptive to young growth companies needing new capital, making them an unreliable source for growth capital" (World Bank 1989: 8), and 3) "Bank involvement .... has already had an impact on the plans and strategies of selected research and standards institutes and, with support from IFC, on the institutional structure of venture capital" (Dossani and Kenny [2002]).

In the same year (1988), venture capital cell of Industrial Credit and Investment Corporation of India (ICICI) made the first venture capital assistance in India. Later on ICICI sponsored the creation of Technology Develop-

EXHIBIT 5

Asian Pacific Venture Capital Pool during 1992–2004* (% share)

	Australia	China	Hong Kong	India	Indonesia	Japan	Korea	Malaysia	Myanmar	New Zealand	Pakistan	Philippines	Singapore	Sri Lanka	Taiwan	Thailand	Vietnam	**Total (US $ m)**
1992	5.5	3.7	7.6	0.5	0.2	68.4	7.0	0.6	0.0	0.0	0.02	0.1	3.8	0.1	2.0	0.4	0.1	23,431
1993	5.5	5.4	6.4	0.6	0.4	67.7	6.4	0.6	0.0	0.1	0.01	0.2	3.9	0.1	1.9	0.4	0.5	26,222
1994	5.3	7.7	11.8	0.8	0.7	57.3	6.1	0.6	0.0	0.2	0.01	0.3	5.9	0.2	1.8	0.4	0.8	30,951
1995	6.9	10.3	13.7	0.8	0.7	44.4	7.7	1.3	0.3	0.2	0.02	0.4	9.5	0.2	2.1	0.5	0.9	33,433
1996	8.4	10.7	15.1	2.3	0.9	33.3	9.5	1.3	0.3	0.2	0.02	0.5	11.8	0.2	4.0	0.6	0.8	33,791
1997	8.5	10.9	22.3	3.2	1.3	24.1	5.8	1.3	0.4	0.3	0.02	0.5	13.9	0.2	6.0	0.6	0.9	32,136
1998	6.7	6.8	26.9	2.3	0.7	27.3	6.5	1.0	0.2	0.4	0.03	0.5	11.5	0.1	7.9	0.5	0.6	45,785
1999	5.2	5.4	36.8	2.6	0.5	31.4	7.2	1.0	0.1	0.6	0.08	0.4	11.3	0.1	6.4	0.4	0.5	69,132
2000	5.1	6.4	29.7	3.6	0.2	26.0	7.4	0.7	0	0.6	0.07	0.5	11.4	0.1	7.2	0.7	0.2	81,136
2001	5.5	7.1	30.4	2.9	0.2	25.1	7.3	0.9	0	0.7	0	0.3	11.4	0	7.3	0.7	0.1	85,554
2002	5.5	7.2	29.8	2.9	0.8	25.0	7.4	0.9	0	0.7	0	0.3	11.4	0	7.2	0.7	0.1	89,196
2003	6.1	7.1	27.7	3.2	0.2	26.0	9.3	0.9	0	0.7	0	0.3	11.0	0	6.7	0.7	0.2	97,598
2004*	6.7	7.2	26.8	3.2	0.1	27.0	8.3	0.9	0	0.7	0	0.2	10.8	0	6.5	0.6	0.2	1,01,100
(Rank)	**6**	**5**	**2**	**8**	**14**	**1**	**4**	**9**		**10**		**12**	**3**		**7**	**11**	**13**	

Source: Compiled from 'The 2005 Guide to Venture Capital in Asia, January 2005.'
*: *For the first half of the year only.*

ment and Information Company India Ltd (TDICI) and from July 1, 1988, onwards the venture capital operations of ICICI were taken over by TDICI. Another change that happened in the same year was the conversion of Risk Capital Foundation (RCF) sponsored by Industrial Finance Corporation of India (IFCI) into Risk Capital and Technology Finance Corporation of India Ltd. (RCTFCI). The first ever guidelines for the efficient management and control of venture capital activities in India were issued on 25 November 1988 (Ministry of Finance 1988) by the office of the Controller of Capital Issues (CCI). Thus the government of India took almost 24 years to frame a venture capital guideline; in 24 years generally any industry becomes a matured industry, but here it was still in its infancy, mainly because of the risk-averse financial system and highly bureaucratic economy, where everything was closely controlled by the government.

The first ever guidelines imposed conditions on VCC's/VCF's operating in India with respect to 1) establishment, 2) management, 3) VC assistance, 4) size of fund, 5) capital issue, 6) debt-equity ratio, 7) underwriting/listing, 8) exit mechanism, and 9) eligibility for tax concession; thus requiring all VCC's / VCF's to operate within the framework in order to avail concessional treatment of capital gain. The tax rate applicable was equivalent to the individual tax rate, which was lower than the tax rate applicable to other corporate entities. The exit was not subject to the control of CCI, thus forcing the VCC's/VCF's to exit at a premium. Another restriction dealt with the areas where VC investment was allowed to be made. Further, CCI had to approve every line of business where VCC's/VCF's want to invest. This made the guideline literally difficult (if not impossible) to be complied with. Even then, World Bank decided to give an impetus to Indian venture capital industry by sanctioning $45 million. This was based on the estimate made by the World Bank about the demand (approximately $65 to $133 million per annum for the coming 2 to 3 years).

From 1989 onwards, slowly Indian venture capital industry witnessed the emergence of many VCC's/VCF's.

Exhibit 6
Birds Eye View of Indian Venture Capital Industry (1964–2006)

	Period & Developments	Rs. Million
1	**1964 – 1981 (18 years)** ***Early Stage – I*** * IDBI launches Own Capital * R.S. Bhat Committee recommends creation of VCF	500.00
2	**1982 – 1990 (9 years)** ***Early Stage – II*** * A Cess of 5% on Technology Imports (source for IDBI) * 14 Domestic and 2 Foreign VCF's started operation * IVCA was setup & OTCEI was started in 1990	2,074.53
3	**1991 – 1996 (6 years)** ***Early Stage of LPG*** * 18 Domestic and 16 Offshore VCF's started operation * CCI was replaced by SEBI in 1992 * SEBI guidelines were published in 1996	34,839.61
4	**1997 – 2001 (5 years)** ***Later Stage of LPG*** * 28 Domestic and 12 Offshore VCF's started operation * K. B. Chandrasekhar Committee Report submitted in 2000	83,370.68
5	**2002** and Beyond * Dr. Ashok Lahiri Committee submitted its report in 2003 * Almost more than 77 VCF's are working now in 2005 * Almost more than 300 VC professionals are working now in 2005 * Almost 3,245 US $ million is available now by 2005 * Growth in IT / Pharma / Telecom / Biotech / Services / etc	

Source:
(i) IVCA Venture Activity Reports 1993, 1994, 1995, 1996, and 1997.
(ii) AVCJ report 'The 2005 Guide to Venture Capital in Asia'.
(iii) Author's own compilation.

Venture Capital Unit Scheme (VECAUS–I) sponsored by Unit Trust of India (UTI) was launched and TDICI was appointed as the fund managers. On 21 October 1989, Canbank Venture Fund Limited launched its first VCF with Rs.158.27 million, known as Canbank Venture Capital Fund. This was the first Indian public sector bank to start venture capital activities in India. The State Bank of India (the biggest public sector bank in India) also announced its intention of launching a VCF through its merchant banking subsidiary SBI Capital Market Ltd.

In January 1990, IL & FS Venture Corporation Limited (formerly known as Creditcapital Venture Fund [India]), first private sector financial institution launched its All Industry Fund (AIF) with Rs.300 million and Information Technology Fund (ITF) with Rs.100 million. In March 1990, TDICI launched its Venture Capital Unit Scheme (VECAUS–II) with Rs.1,000 million. In October 1990, Andhra Pradesh Industrial Development Corporation (APIDC) Venture Capital Limited launched its APIDC–Venture Capital Fund 1990 with Rs.135 million. In November 1990, Gujarat Venture Finance Limited (GVFL) launched its Gujarat Venture Capital Fund–1990 (GVCF–1990) with Rs.240 million. In the same year ANZ Grindlays 3i Investment Services Limited launched its Second India Investment Fund with Rs.361 million. With respect to the guidelines, 27 August 1990, one more addition to the guidelines was made (Ministry of Finance 1990), i.e., the words Venture Company/ Venture Capital Company/Venture Capital Fund/Venture Capital Finance Company or such similar name should be included as part of the proposed name of a company. Only then the concessional treatment of capital gain can be availed of.

Another important development took place to assist the VCC's/VCF's in exercising the option of exiting from invested companies, the government took the initiative in creation of Over the Counter Exchange of India (OTCEI) under section 25 of the Indian Companies Act 1956. This initiative was very much welcomed by the venture capital players in India, mainly because they were finding it very difficult to exercise the option of exiting from the assisted ventures. Thus by the end of 1990 OTCEI was set up in India. In the same year ANZ Grindlays 3i Investment Services launched its Second India Investment Fund. By the end of 1990, there were seven domestic and two foreign VCC's/VCF's working in India. In the same year one more significant development took place, i.e., the setting up of Indian Venture Capital Association (IVCA) to look after the promotional and developmental activities of VCC's/VCF's operating in India. The total amount available for venture capital investment by the end of 1990 was Rs.2,074.53 million.

Though India's highly bureaucratized economy, high level of government involvement in almost all aspects of business, avowed pursuit of socialism, a still quite conservative social and business world and a risk-averse system provided little institutional space for the development of venture capital (Dossani and Kenny 2002). The first formal venture capital organizations began in the public sector during 1964–1990. IDBI, ICICI, TDICI, IFCI, RCTFCI, and UTI were all coming under public sector financial institutions. The two banks, Canara Bank's "Canbank Venture Fund Limited" and State Bank of India's "SBI Capital Market Ltd," were also coming under nationalized banks. The government also promoted the biggest initiative in the development of favorable climate for venture capital activities in India, i.e., setting up of OTCEI in 1990. This clearly shows the favorable attitude of the government towards promoting venture capital financing in India. Though it was happening in a slow phase during the last 27 years (1964–1990), all the initiatives were taken by the government only. This was totally in contrast with the U.S. experience, where it was proved that highly constrained and bureaucratically controlled venture capital operations were the least likely to succeed. Thus Indian venture capital industry was successful in making the interaction with the existing institutions in a smooth way and also able to modify the existing environmental factors in such a way that it became totally supportive for venture capital development.

Though from 1964 onwards the significance of venture capital was recognized by the Bhat Committee and recommended for the creation of VCF, no major development took place during the Pre-LPG period (1964–1990). The *first* part of the period (1964–1981), development was minimal. Except the creation of a VCF by the Industrial Development Bank of India (IDBI), no major events took place during the18-year period. But the *second* part (1982–1990) witnessed gradual progress in terms of 1) the initiative from government (imposing a cess of 5% on technology imports as a source for IDBI VCF), 2) formation of 14 domestic and 2 foreign VCF's with an outlay of Rs.2,074.53 million, 3) formation of Indian Venture Capital Association in 1990, and 4) starting of Over the Counter Exchange of India in 1990 to facilitate an easy exit mechanism for VCF's. Thus during a span of 27 years (during which time an industry becomes fully matured), the development of Indian venture capital industry happened slowly, which made the industry look like a big baby in comparison to other major players.

Other than the statistical data published by *Asian Venture Capital Journal* and the Indian Venture Capital Association (IVCA), availability of a comprehensive data set about Indian venture capital industry is difficult. This is mainly because all VCF's and FVCI's working in India are not registered with IVCA or SEBI, and most of the VCF's are practicing the policy "strict confidentiality," making it doubly difficult to gather data. Based on the available data, the growth and development of venture capital in India during 1987–1997 is shown in Exhibit 7.

From 1964 until 1987, only one VCF was functioning under IDBI with an outlay of Rs.1 million. But during 1987 to 1997, gradual development started taking place, in terms of the number of VCF's as well as the volume of funds available. This is not an exhaustive exhibit, but just an indicator.

The development during the three-year period (1988–1990) was more significant than what took place in the previous 24 years (1964–1987). But what happened during the last 15 years (1991–2005) in Indian venture capital industry is much more significant than what took place during the first 27 years (1964–1990). In other words, major developments took place during the Post-LPG period (1991 and beyond).

It is evident from Exhibit 6 that the opening up of Indian economy during 1990–91 led to tremendous growth, both in terms of number of VCF's and also volume of funds available for investment. During the period 1991–96, 18 domestic and 16 offshore VCF's started their operations with an outlay of Rs.34,839.61 million. But during the period 1997–2001, the number of domestic VCF's increased to 28 and 12 offshore VCF's started their operations with an outlay of Rs.83,370.68 million.

Though the government of India was the strong force behind the success of venture capital industry during the last 27 years, one important factor that slowed down the actual investment activity was the extraordinary time delay taken for issuing the guidelines for the efficient management and control of venture capital activities in India.

Exhibit 7

Growth of Venture Capital In India (1987–1997) (Rs. in million)

VCF's	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
IDBI	1	55	109	81	54	96	116	324	346	263	521
RDTFC			9	17	98	72	60	63	188	200	147
TDICI			264	142	113	21	287	991	754	188	500
GVFL					24	9	38	51	65	128	158
ANZ						121	na	48	8	na	nil
IL & FS					20	31	41	19	77	35	5
Canbank				19	14	66	57	40	26	41	52
APIDC				na	na	na	na	1	28	27	77
Indus					na	na	77	27	56	na	32
IFB						3	nil	nil	26	22	22
Pathfinder								161	59	9	nil
20th Century							44	na	na	na	nil
Draper										156	271
IVCL										52	nil
IVCML										145	173
JF Electra										ns	956
Marigold										ns	20
SIDBI										63	32
HSBC Ltd										482	821
Total (A)	1	55	382	259	323	419	720	1725	1633	1811	3787
# of Funds (B)	1	9	70	54	60	78	na	110	159	157	107
Average (A/B)	1.00	6.10	5.46	4.80	5.38	5.37	-	15.68	10.27	11.53	35.39

Source: IVCA Reports 1993, 1994, 1995, 1996, and 1997.

The power of Controller of Capital Issues (CCI) to regulate venture capital was transferred to Securities & Exchange Board of India (SEBI) in the year 1992. But it took almost four years for SEBI to frame and issue the guidelines on 4 December 1996, which is quite a long time for drafting and finalizing the guidelines.

But the time taken by the committee headed by Mr. K. B. Chandrasekhar took only six months (July 1999–January 2000) to finalize and issue the recommendations for the promotion of venture capital activities in India. This may be due to the fact that Mr. Chandrasekhar knows the importance of time management in the present business world, since he was the chairman of Exodus Communications Inc, Silicon Valley, California, where time is valued in terms of money. Though the report is submitted in the year 2000, no major steps were implemented based on the report.

In 2003, again the Advisory Committee on Venture Capital under the Chairmanship of Dr. Ashok Lahiri submitted their report, incorporating more recommendations to the earlier report. Both the reports clearly emphasized the importance of venture capital financing in India and its potential for promoting entrepreneurial talent and also its ability to develop the economy in many ways.

Various recommendations (operational, tax-related, and foreign-exchange control-related issues) of this committee are briefly outlined in Exhibit 8. Once these are incorporated in the existing guidelines, then most of the problems faced by the VCF's in the present situation can be eliminated to a certain extent. But until the end of 2005, no major progress has taken place with either the Chandrasekhar committee or Lahiri committee recommendations. Even then the venture capital industry in India reached a commendable position by 2004.

EXHIBIT 8

Recommendations of Lahiri Committee

1	Operational Issues A Issues common to VCF's and Foreign VCI's: 1. Removal of lock-in period of shares after listing 2. Investment in unlisted companies to be reduced to 66.67% and 33.33% to be allowed to invest in listed companies 3. Permitting hybrid instruments which are optionally convertible into Equity 4. Permission SPV's to invest up to 33.33% of investible funds 5. Permission to invest in NBFC in equipment leasing and hire purchase 6. Permission to invest in Real Estate 7. Permission in Gold Financing, restricted to jewelry alone B Issues Relating to VCF's: 1. Permission to invest in offshore VCU's 2. Permitting flexibility to distribute in-specie C Issues Relating to Foreign VCI's: 1. Permission to allow the custodians to continue even after listing 2. Removal of the limit of 25% ceiling of investible funds in a single VCU
2	Tax-Related Issues: 1. Allow all VCF's formed as trust / company duly registered with SEBI to avail tax exemption [Section 10 (23FB)] 2. VCF's should be continued to enjoy tax exemption even after they receive foreign securities in lieu of domestic securities held by them in a VCU. 3. Suitable illustration should be provided to explain the tax implications of investors once income of VCF's are distributed [Section 10 (23FB)] 4. Procedural matters like (i) Tax Audit U/S 44 AB applicable to VCF's; (ii) filing of returns by VCF's; (iii) treatment of income other than arising out of VCU's; etc
3	Foreign Exchange Control-Related Issues: 1. Wholly owned Indian subsidiaries of Foreign VCI's registered with SEBI may be exempted from the minimum capitalization requirement of an Indian company (minimum now is US $ 5,000,000 = Rs.2.5 crores).

Source: Dr.Ashok Lahiri Advisory Committee Report on Venture Capital (www.sebi.gov.in).

PRESENT STATUS

Although with respect to the CAGR India holds first rank, the ranking with respect to the amount of venture capital raised in relation to the global players is 12th, and in Asia Pacific region it is 8th, it's now time for the government to take adequate measures at appropriate times to promote the Indian venture capital industry as the impact of globalization affects venture capital development in India (Subhash and Nair [2004]). During 1964–1990 (27 years) only 10 VCC's/VCF's started their operations in India with a total amount of Rs.2,574.53 million. But during 1991–2002 (11 years) there was an overwhelming growth in the number of VCC's/VCF's (at least 67 players) and the total amount available for investment was Rs.1,18,210.29 million. This is mainly due to the changing economic scenario in India.

The present position of India in the Asia Pacific region in terms of total venture capital under management for the first half of 2004 is eighth and amounts to

$3,245 million, which accounts for only 3% (AVCJ [2005]). The most recent development, which happened in Indian venture capital industry, is the opening up of the Silicon Valley Bank's (SVB) India office in Bangalore on September 2004 (though the ground work started in the year 1998) and is going to be a significant milestone (Sengupta [2005]). Many Silicon Valley VC's have already opened their offices with SVB. Over the last five years India achieved an enviable position ***(Strength)*** with respect to the potential entrepreneurial talent; world class R&D base; superior technology base; English-speaking, skilled and cost competitive manpower; and favorable investment climate coupled with low cost of production. The Chandrasekhar Committee identified this 8 January 2000 (Chandrasekhar [2000]). But to reap the full potentiality of venture capital in India, ***Weakness*** such as the lack of regulatory and policy support, unfavourable environment and low awareness among investors, and inadequate understanding of global forces should be removed. These were identified in 1998 (Subhash [1998]) and until today these weaknesses exist in the Indian Venture Capital Industry. Presently India has many ***Opportunities***, high-growth potential in IT, biotechnology, pharmaceutical and drugs, agriculture and food processing, and telecom services. Only thing which should be seriously considered is the competition ***(Threats)*** from Taiwan, Hong Kong, Israel, Philippines, China, and even Vietnam. Thus once the ***SWOT*** analysis is properly performed and corrective actions are taken, one can see a tremendous growth in the Indian venture capital scenario resulting in an unprecedented boom in the Indian economy. Though India is presently holding the number one position in terms of CAGR, it may take some more years for the Indian venture capital industry to reach a commanding position in the global arena. Government should take the initiative in simplifying the regulations at the earliest as well as minimizing the bureaucratic hurdles faced by potential and prospective, domestic and foreign VCC's/VCF's (Subhash and Nair [2004]), because these two groups of players are very important in the development of the venture capital industry and they behave differently at every stage of the venture capital financing process, especially with respect to monitoring and exiting (Pruthi, Wright and Lockett [2003]). Even under the present situation, India is an example (Dossani and Kenny [2004]) of how purposive action in an environment replete with resources can have long-term impacts on the national system of innovation (NIS).

Having discussed the global scenario, Asia Pacific regional scenario, as well as the Indian scenario, it is now time for a brief comparison of the development of venture capital industry of selected countries to identify their present status and also the time taken for reaching that position. Exhibit 9 reveals the following information.

Most all the countries holding the top positions either globally or in Asia Pacific region have an edge over technology, which led to the growth and development of industries in those countries. In fact the growth of venture capital is directly related to the growth and development of technology of the host country. Thus in 60 years time, U.S. became the global leader in venture capital industry, followed by U.K. (59 years). These two oldest players in the global venture capital arena have held the same positions for the last seven years.

The youngest player who reached a commendable position is China. In 17 years time it reached ninth position globally and fifth position in Asia Pacific region. The second youngest player is Australia. During 22 years time, it reached sixth position globally as well as in the Asia Pacific region. Other players who reached a higher position in less than 30 years time are Canada, Europe, and Taiwan. It took almost 32 years for South Korea to become eighth globally and fourth in Asia Pacific region. In 34 years Singapore reached 18th globally and third in Asia.

The two big players in Asia Pacific region, Japan (third and first) and Hong Kong (second in Asia), took 44 and 47 years respectively. But India's position is only 14th globally and eighth in Asia Pacific region. This is over a period of 42 years. Considering the size and potentiality of the Indian economy, it looks like a big baby among the other small players who are outperforming India with respect to venture capital financing. If it is possible for other players to reach a commendable position in terms of venture capital raising as well as investing, India can even perform better than others, provided the government takes proper initiatives and provides all the support for a favourable investment climate for the VCF's to operate in India.

The latest statistical information about Indian venture capital industry is given in Exhibit 10 and 11. With respect to private equity deals, almost U.S. $765 million was invested in 15 VCU's by 13 VCF's during 2005. The profile of the VCU's shows that they are from different industrial sectors, high-tech as well as non-high tech. But with respect to venture capital deals, almost all the VCU's belong to IT sector. Almost U.S. $90.43 million was invested in 9 VCU's during 2005, making it almost equal to U.S. $855.43 million during 2005.

EXHIBIT 9
Present Status of Venture Capital in Selected Countries

#	Country	Age of VC Industry (Years)	Present Position (Global - Investment) (Asia - VC Pool)	Period under study
1	USA	60	Global # 1	1946 – 2006
2	UK	59	Global # 2	1947 – 2006
3	Canada	24	Global # 13	1962 – 2006
4	Australia	22	Global # 6 Asia Pacific # 6	1984 – 2006
5	Europe	26	Top 20 players	1980's – 2006
6	Japan	44	Global # 3 Asia Pacific # 1	1952 – 2006
7	Hong Kong	47	Global # above 20 Asia Pacific # 2	1959 – 2006
8	Singapore	34	Global # 18 Asia Pacific # 3	1972 – 2006
9	South Korea	32	Global # 8 Asia Pacific # 4	1974 – 2006
10	China	17	Global # 9 Asia Pacific # 5	1989 – 2006
11	Taiwan	26	Global # above 20 Asia Pacific # 7	1980 – 2006
12	India	42	Global # 14 Asia Pacific # 8	1964 – 2006

Source: authors own compilation from Exhibits 3, 5, and other sources.

SUGGESTIONS FOR FUTURE RESEARCH

Having seen the growth and development of venture capital globally, in Asia Pacific region, and also India in particular; a lot of scope for further research can be identified with respect to Indian venture capital industry. As mentioned earlier in the article the problem/limitation with conducting such studies is mainly due to the non-availability of sufficient data. Unless the VCF's accept the policy of disclosing the information about their business, it becomes more difficult to understand the real picture of venture capital industry in India. So if the VCF's voluntarily becomes members of IVCA as well as registered with SEBI and start providing/publishing annual reports with the authorities, following studies can be successfully undertaken and sufficient and timely suggestions can be provided for the benefit of VCF's for further growth and development.

1. *Economic Impact of Venture Capital in India:* This study may provide a detailed insight into the economic benefits in India due to venture capital financing during the last 5- to 10-year period. This may give the VCF's more bargaining power and government will be forced to take timely action in favor of venture capital financing.
2. *Evolution of Venture Capital Financing in India (from beginning till now):* This study will provide the much-needed statistical data for fully understanding the growth and development of venture capital financing in India. Unless such a study comes out with a full picture, it becomes very difficult for the researchers to understand the historical base of venture capital financing in India.
3. *Geography of Venture Capital Financing in India:* This study will give an idea about the geographical concentration of venture capital financing in India. Like in any other country, in India clustering is taking place. This will provide insight to the policy makers to give priorities to different regions according to their potential.
4. *Evaluation of VCF's in India:* This study will give an insight for taking some preventive measures so that failures becomes less and VCF's will be in a position

EXHIBIT 10
Highlights 2005 (Top 15 Private Equity Deals in India)

#	Investor	Investee	Deal Size ($ mn)	Stake (%)
1	Newbridge Capital	Shriram Holdings	100	49
2	ICICI Bank, IDBI Bank	Ratnagiri Gas & Power	80	23
3	Infinity Capital Venture	Sify	62	32
4	ICICI Venture	Scandent Solutions	60	10
5	ICICI Venture	ACC (refractory business)	59	100
6	Citigroup	Lakshmi Overseas Industries	58	15
7	ICICI Venture	Dr. Reddy's	56	-
8	Silver Peak Investments	Binani Cements	55	25
9	3i Capital	Nimbus Communications	46	33
10	Bisikan Bayu Investments	Apollo Hospitals Enterprises	44	13
11	State Bank of India	Ratnagiri Gas & Power	34	10
12	Merlion India Fund, IL&FS	ABG Shipyard	32	27
13	Amarnath LLC	Indiabulls Finance	30	43
14	IDFC	Gujarat Pipavav	29	NA
15	GA European Investments	NDTV	20	8
			765	

Source: Business world, 16 January 2006, pp. 22–23.

to reap the full benefits. The success stories of VCF's should be studied.

5. *Entrepreneurial Development in India:* This study will give an insight on the interrelation between the venture capitalists and entrepreneurs in India. The potential as well as actual entrepreneurs get an insight to the best possible ways of starting up their business ventures in association with venture capitalists. This will provide an insight into the difficulties faced by entrepreneurs in getting venture capital financing as well as other forms of financing.
6. *Women Entrepreneurs in India:* This study will give an insight into the role played by women in Indian industry, with special focus on attracting venture capital financing. India is one of the few countries where one can see women in all walks of life. In every sector women are playing an equal role.

Thus, once all these studies are carried out, a complete picture will emerge and the concerned group of people will get better bargaining power, which makes them strong in demanding the required support from the government. Thus, the VCF's as well as those who are concerned with venture capital financing in India should take it as a positive step towards their own development, rather than thinking that the information passed on will be used against them. They should change the policy of "strict confidentiality" to "transparency," which will allow researchers full access to information to successfully complete the studies in time to give valuable information back. In this regard, IVCA and also SEBI should take full initiative in making the data available for such studies.

CONCLUSION

As it is evident from the preceding discussion that there is high growth potential for the Indian venture capital industry to compete or even outperform the other big players in the Asia Pacific region as well as other global players, government should take a supporting role in promoting and developing this industry in order to reap the full benefit of venture capital financing. Though withlimited support Indian venture capital reached a level where major foreign players have started coming to India in a major way. Though India has been in the field for the last 42 years, (the time required for completing the life cycle stages of a business from baby to child to adolescent to adult to a matured industry), in comparison to

EXHIBIT 11

Highlights 2005 (Top 9 Venture Capital Deals in India)

#	Investor	Investee	Deal Size ($ mn)
1	Castille Ventures, Artiman Ventures, JumpStartUp, ComVentures	Net Devices	25.00
2	TD Capital Ventures, Mitsui & Co, Entrepia Partners	HelloSoft	16.00
3	Battery Ventures, Intel Capital, IL&FS, Gujarat Deshpande	Tejas Networks	15.00
4	Intel Capital, UOB Venture	MobiApps	10.00
5	Motorola, Charles River Ventures, NeoCarta, WestBridge	July Systems	10.00
6	IFC, Netherlands Development Finance Corporation	Avestha Gengraine	8.00
7	WestBridge, Mobius Technology Ventures	ReaMetrix	3.55
8	WestBridge	Nazara technologies	2.00
9	Bessemer Venture Partners, Latham & Watkins	BA Systems	0.88
			90.43

Source: Business world, 16 January 2006, pp. 22–23.

other big players Indian venture capital industry is considered as a baby (3.2% share in Asia Pacific region and less than 1% on global scale). Hence it is high time that government opens its eyes and looks after the venture capital industry so that the big baby first learns how to stand on its own and starts walking, then slowly and steadily this big baby becomes independent and walks along with (or even overtakes) the other major players.

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