Venture Capital Regulations – India

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When Christopher Columbus set out to travel westwards from Europe to reach India, his risky venture did not find support with the King of Portugal and he was denied the funds to support his venture. It was Queen Isabella of Spain who funded his venture, ***the risks were great but the rewards were greater***. The concept of 'venture capital' evolves from here. In modern context it can be said that such ventures which are unconventional and untried and have a high risk high return potential, which are sure not to be financed by the conventional mode of funding are sure to find venture capitalists contributing to the venture.

A venture capital fund (VCF) provides funds to new and promising companies that are typically knowledge based; assume a **high risk element** but promise **sustainable growth** and **higher rewards**. Venture capital fund not just makes an equity participation in a company but also assists in the management and functioning of the company by rendering its expertise to the business; hence are **not passive investors**. These companies are unable to attract finances through the conventional mode of financing as they **do not have sufficient track record** to attract capital investment and **do not have tangible assets** to act as collateral against a loan and have a **high gestation periods** to be able to raise funds from traditional sources of financing

History of venture capital in India:

The venture capital industry in India evolved in the late 1980s with the Government of India legalized venture capital operations in 1988 and has been skimming attention ever since. Technology Development and Information Company of India Ltd. (TDICI), an equal joint venture of ICICI and UTI, was the first organization to begin its venture capital operations in India. TDICI was the investment manager and the funds were registered as UTI's Venture Capital Unit Scheme (VECAUS).

Thereafter in 1996 the regulatory environment of the industry was defined by the SEBI (Venture Capital Fund) Regulations, 1996 followed by the SEBI (Foreign Venture Capital Investor) Regulations, 2000 on the recommendation of Chandrasekhar committee fostering growth in the industry.

How does it work?

- Venture Capital can be formed in**:**
    - Trust
    - Company
    - Body Corporate
- Investors in venture capital funds are:
    - Financial institutions
    - Banks
    - Pension Funds
    - Corporations
    - High Networth individuals; etc
- Venture capitalists raises money from these investors and invests in start-up companies

- Venture capitalists act in the advisory capacity in the company and render their professional expertise to the venture, apart from capital investment
- Typically funds are pooled in for a period of around 10 years and investing it in venture capital undertakings for a period of 3 to 5 years with an expectation of high returns.

SEBI (Venture Capital Funds) Regulations, 1996

- **Definition of VCF** – Section 2(m) of the Regulation, defines VCF as:

  "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;
- **Definition of Venture Capital Undertaking** – Section 2(n) of the Regulations define VCU as:

  "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.
- Application for grant of certificate to be made to the Board in **Form A** along with **non-refundable application fees**. The Board may grant the certificate of incorporation in **Form B**

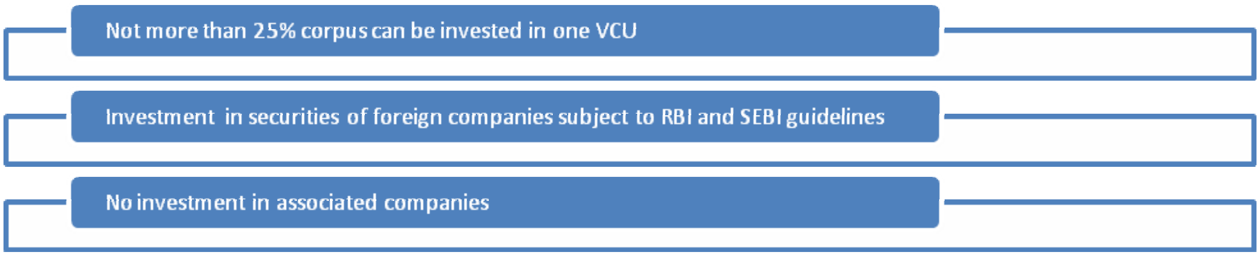
Obligations of Venture Capital fund:

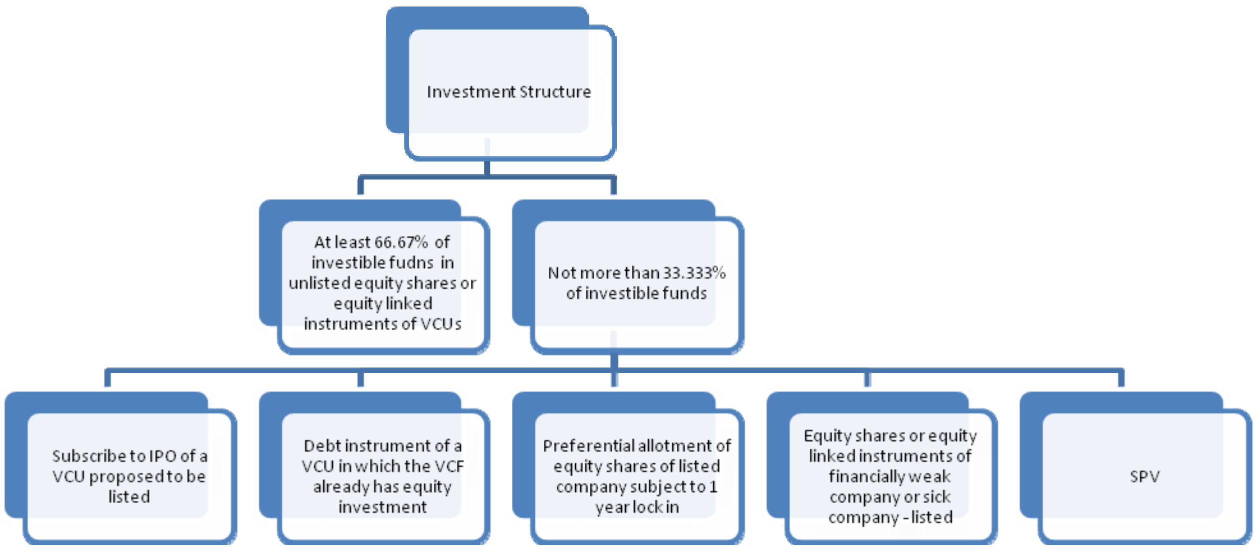
- Venture Capital fund shall not carry out any other activity than that of venture capital fund
- Venture capital shall disclose investment strategy at the time of making investments
- VCF shall disclose the duration of the life cycle of the fund
- VCF shall not get its units listed on any recognized stock exchange till the expiry of three years from the date of issuance of units by VCF
- VCF cannot invite offers from the public for subscribing for its units and shall only receive monies by the way of private placement of the units
- VCF shall enter into the **placement memorandum** and **subscription agreement** which contains terms and conditions subject to which monies is proposed to be raised from the investors. A copy of the placement memorandum and subscription agreement will be placed with the Board along with the actual money collected
- VCF shall maintain its books of accounts, records and documents for a period of 8 years

Minimum Investment in Venture Capital:

- Venture Capital Fund may raise money from Indian, foreign, non-resident Indian, **by way of issue of units**
- Investments **below Rs.5 lakhs** from any investor shall **not** be accepted other than employees, principal officer, directors of venture capital fund or employees of fund manager or asset management company
- Venture capital fund shall invest minimum of Rs.5 crores in each of the schemes launched or fund set up

Investment Restrictions:





Note: As per SEBI (Venture Capital Fund) (Amendment) Regulations, 2010, a VCF can also make investments in the securities listed on the SME exchange

Winding up: Intimation of the winding up of a scheme should be given to the Board

Scheme of VCF can be wound up in the following circumstances:

- In case of trust
  - Period of scheme mentioned in the placement memorandum is over
  - In the opinion of the trustees and in the interest of the investors scheme should be wound up
  - 75% of the investors in the scheme pass a resolution that the scheme should be wound up
- **In case of company**: wound up in accordance with the provisions of the Companies Act, 1956
- **In case of a body corporate**: wound up as per the statute under which it is incorporated

SEBI (Foreign Venture Capital Investor) Regulations, 2000

- **Registration**: Application to be made to the Board in Form A with the application fee. The applicant should be granted the necessary permission by RBI to make investments in India. The certificate of registration is granted in **Form B** by the Board
- **Investment criteria**:
    - Investor shall disclose his investment strategy
    - Can invest all his funds in one venture capital
- **Obligations**:
    - Maintain books of account and records for a period of 8 years
    - The foreign investor shall appoint a custodian for custody of the securities
        - Custodian shall monitor the investment
        - Furnish periodic reports to the Board
        - Furnish information as required/ called for by the Board
    - enter into an agreement with a designated bank for operating the foreign currency account