

Expectations and Challenges of VC funds in India

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Unlike in the case of PE funds, Venture Capital funds are expected to identify start up and mostly unlisted companies with long gestation and high risk before taking call on making investments. VCs ability to identify right companies and new sectors very early and monitor them during initial growth phase period until shares are listed at attractive price is key to make desired profits. 2011 to 2013 period was hard for PE and VC funds and their investments shrunk by USD 1 bln to USD 10 bln in 2013. Economic and political uncertainty, depreciation of Rupee, domestic policy inaction, high inflation and high cost of capital made these years among the most difficult to do business in India. Now things are improving after new Government is in place and VCs are hopeful of making profits on investments made during last three years. Following are some of the prominent VCs which made substantial investments in India.

Norwest Venture partners	USD 600 mln
Sequoia Capital	USD 590 mln
Accel Partners	USD 590 mln
Helion Venture partners	USD 290 mln

Some of the Challenges faced by the VC funds.

- 1) Funds should go after companies that will be resilient through ups and downs. Counter cyclical strategies can work in uncertain times and have worked in the past.
- 2) Funds must have operational expertise. If the need arises they can take the steering wheel to manage troubled ones. Funds looking to turn around an investee company have financial strength, they often lack the operational capabilities. The realisation of the absence of operational capability often comes after the deal is won and unable to deliver subsequently. Some of the poorly performing companies fall under textiles and infrastructure sectors.
- 3) During difficult economic period some investments may turn negative and exit become next to impossible. The immediate fallout of the poor financial health of investee firms was the growing mistrust between funds and promoters. Hence funds need to carry out regular due diligence and engage forensic experts where necessary to keep an eye on the numbers put out by promoters led firms, related party transactions and political connections of the promoters. Funds have to initiate follow up action promptly based on forensic reports and take appropriate steps to prevent erosion of its investments value.
- 4) Long gestation period and high risk associated with investments made in the form of shares or debt in start up companies is a quite challenging task for VCs. They should have capability to support and monitor for prolonged period until shares are listed.

5) These days most VCs are investing more than 50% of its corpus in internet based companies eg Taxi for sure, yatra.com. snap deal.com etc. These venture backed businesses are tied to latest technology but right technology talent is in serious shortage. Besides there is a lack of clarity around regulations concerning internet backed ventures which will have an impact on valuation of investee companies.

6) Impact of international regulations

Last year's implementation of Section 1073 of Dodd Frank Act exempted venture capital firms from SEC registration for all the right reasons. Dodd Frank governs consumer payments initiated in the US sent to recipients in other countries to provide more transparency to the consumer. However other regulatory changes and trends are likely to affect working of venture capital firms. While not specifically targeted by the regulations, the impact to venture capital firms may be fewer product options, increased regulatory compliance and changes to confidentiality norms. Applicability of Basel III requirements, strict adherence to KYC & Anti Money laundering (AML) rules, and Foreign Account Tax Companies Act(FATCA) rules.

7) Compliance of local SEBI regulations, FDI rules , FEMA and adherence to CBDT rules for claiming tax exemptions by VCs

Conclusion

In conclusion, VCs have to face lot of challenges before taking call on deciding investments and also required to follow lot of local and global regulations religiously.