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FINANCIAL SERVICES

Emerging Trends

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PREFACE

The Indian financial system has undergone revolutionary changes in the recent past. The increasing complexity of financing business has drawn many managers into a web of financial services jargon. Since the early seventies, there has been an explosive growth of financial innovations in India. New methods of financing such as Merchant Banking, Leasing, Venture Capital, Factoring, Mutual funds, etc., have emerged as alternative sources of finance. New financial instruments such as Commercial Paper, Zero Interest Bonds, Deep Discount Bonds, Secured Premium Notes, etc., have also gained prominence in the financial market.

The financial services industry assumes strategic perspective in the increasingly turbulent and uncertain business environment in the era of liberalisation.

Considerable deregulation of financial markets has taken place in India favouring unbridled growth of financial services companies. Reforms undertaken have increased competitiveness within the financial sector by means of freeing interest rates, allowing new financial institutions and instruments and lifting controls on the entry of new domestic and foreign banks. As a consequence, the scope and activities of banks and non-banking finance companies have expanded rapidly due to liberalisation drive, more particularly since 1991. The non-banking finance companies have been competing and complementing the services of commercial banks. It has been observed that the growth of non-banking finance companies is more pronounced than banking companies.

Though the financial services industry faced teething troubles the increasing and diverse needs of growing corporate industry encouraged and sustained the steady growth of financial services market. The development of financial services market has also led to globalisation of financial services. The changes that have come about because of deregulation and opening up of Indian economy to the world coupled with Information Technology resulted in severe competition in the financial

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FINANCIAL SERVICES - AN OVERVIEW

R.K.Mishra

We are passing through an era of financial revolution. The financial services industry is an important component of the financial sector. The world is undergoing intensive financial sector reforms. The success of these reforms, and the extent of success of the financial revolution, will depend on the growth and character of the financial services industry in the closing years of this century. The financial services industry has an unlimited growth potential. It works towards substantial value addition and offers tremendous employment opportunities. It thrives on the growth of technology and fosters an environment for its own advancement. Rather, it creates a situation wherein the two become mutually interdependent in the pursuit of their acceptance and growth. The financial services industry is growing at a very fast rate. The gross domestic product (GDP) of such countries, which have a dominant share of the financial services industry, has been found to be generally associated with the tendency to grow faster as compared to the countries associated with the ascendancy of the primary and secondary sectors in their GDP. This clearly suggests that if India has to lift its growth rate of GDP beyond 6% and join the Asian Tigers' Club, which has had a continuous growth of GDP in the range of 10-15%, it has to develop strategies which place a formidable emphasis on the expansion of its financial services industry.

This paper points out to some specific features of the financial services industry, lists a few essential infrastructural conditions to be made available by the Indian economy conducive for its rapid growth

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VENTURE CAPITAL FUNDS - FINANCIAL SECTOR IN INDIA

M.Selvam

The concept of 'venture capital' is an old one abroad, but in India it is relatively young. Venture capital industry received official recognition only in 1988. There is no specific definition of the term venture capital. However, it is nothing but risk capital as the word venture also means "to expose to hazard". The venture capitalist is sharing the risk of the business as well as the reward. He is not a mere financier, he is an active promoter of such venture. He takes part as a big brother from the very inception of the idea, and withdraws only when the project is fully on its legs. Therefore, venture capital funds is active management involvement and financing participation until the project reaches maturity stage.

Venture capital is about risk money. The promoters of business/industries, find it very difficult to raise capital to start industries. To help them, various financial institutions were established in India over the years. These institutions provide financial assistance as per the policies of the state and central Government from time to time. However, these financial institutions have been unwilling to provide risk capital, particularly during initial stage due to various reasons. Therefore, the capital needs of promoters were not fulfilled.

On the other hand, new entrepreneurs were unable to raise equity in the capital market even to the extent of promoter's share; therefore, new entrepreneurs were the sufferers.

In order to solve these problems, some Indian financial institutions came out with many novel schemes like seed capital schemes, risk capital foundation etc. In this background, venture capital Industries were started in India.

In the foreign countries, especially (in the USA), venture capital movement originated somewhere during the fifties. The experience and performance of venture capital units gave sufficient confidence to the Indian capitalists regarding its potentialities. It is true that in olden days, Indian banking sector (whether development or commercial) and financial institutions were extending financial assistance based on many factors like safety, security, liquidity, profitability etc., Under venture capital systems, financial assistance was extended on the basis of mere potentiality of the project.

The need for creating the right environment for the venture capital industry was also felt by Indian policy-makers. The "venture capital guidelines" were formulated by the Government of India in 1988. Institutions approved under the guidelines were Venture Capital Companies (VCCs) and they were eligible for tax concessions/benefits. The guidelines stipulate that venture capital firms should mainly support enterprises which fulfil the following parameters.

i. *Size* : Total investment should not exceed Rs. 10 crores.

ii. *Technology* : New, relatively technology being taken from the pilot to the commercial stages or which incorporates some significant improvement over the existing ones in India; and

iii. *Promoters entrepreneurs* : relatively new, professionally or technically qualified promoters with inadequate resources or backing to finance the project.

Investment in enterprises engaged in trading, broking, investment or financial services, agency or liaison work shall not be permitted. Further, investment in assisted units for their expansion or strengthening, or investment for the revival or sick units, would be permitted as part of venture capital activity, and the above parameters will not apply.

Venture Capital Companies (VCCs)

As cited earlier, venture capital scheme was formulated in 1988. Security Exchange Board of India (SEBI) is presumed to be the authority to regulate & control this segment of financial services, it has the power over all Indian public sector financial institutions. Commercial banks are eligible to start venture capital funds. Joint venture between non-institutional promoters are permitted, provided the equity holding of such promoters does not exceed 20 percent. The venture capital companies should atleast have 60 percent of its funds in venture proposals. Balance may be invested in any new issue of equity, debentures, bonds or other securities.

Functions of Venture Capital Companies

Let us see briefly how VCCs function in practice. Once a project in the bud approach a VCC for financial support, VCC reviews the prospects of the promising project carefully to assess the factors which may contribute to the successful career of the project. VCC has to assess the management of the company, then look at its market potential and finally at the product or service being offered. After a careful review of the management structure of the business and having considered carefully the factors, the VCC decides to recommend an ongoing involvement in the project. VCC, most often, engages a team of analysts to submit a report after scrutinizing of the project. Once a report has been given favourably, VCC, now, has to arrange for the necessary finance. The funds involvement may range between 20 percent and 40 percent.

The future role of VCC is to monitor the performance of the business against the original business plan and to assist continuously in updating and developing the business growth strategy. Finally once the project comes to an offing, VCC liquidates its holdings and encashes the capital gains.

Characteristics

The important characteristics of venture capital finance in India are given below :

1. Venture capitalists, through participation in management, have an active and effective association with the assisted units.
2. They are ready for potential equity participation in assisted companies.
3. Their effective association and participation with a unit provides significant return out of their investment.

4. They also seek investment opportunities in potentially large markets in which major companies are unable to compete successfully.

Purpose of Venture Finance

Indian venture capital institutions have been providing financial assistance for the following major purposes :

1. encouraging commercial application of indigenously developed technology
2. adopting imported technology to wider domestic applications etc.
3. assisting for modification of a process/products which have been imported so as to make it suitable for Indian operating conditions and
4. assisting on cost of studies, surveys, seed marketing, market promotion programmes, etc.

Types of venture capital investment

There are a large number of institutions ready to provide venture capital. They specialise in different sorts of investments; among those the important are summarised below.

a. Seed Capital : Under this, few institutions finance the production of sample products and it involves high risk.

b. Start up capital : In this risk is reduced relatively. At this stage there will be a product and basic business structure in existence.

c. Early stage investment : More institutions are attracted as applicants have established their trading record; therefore, there is a base for investment.

d. Later stage investment : It also attracts a large number of investors. There is more scope for profit; hence, risk is reduced to a great extent at this stage.

Venture capital institutions

As far as India is concerned, practice of venture capital finance is new. The prominent institutions/companies which are providing venture capital are given below; most of them are in public sector, but in recent years private sectors are also coming into the market rapidly.

1. Technology Development and Information Company of India (TDICI) - promoted by ICICI, Bangalore.
2. Risk Capital and Technology Finance Corporation (RCTC) promoted by IFCI, New Delhi.
3. Venture Capital Division of IDBI, Bombay.
4. Small Industries Development Bank of India (SIDBI) Venture Capital Fund Scheme.
5. Gujarat Venture Finance Limited (GVFL), Ahmedabad.
6. Andhra Pradesh Industrial Development Corporation (APIDC) Hyderabad.
7. SBI Capital Market Limited.
8. Can Bank Venture Capital Fund, Bangalore.
9. India Investment Fund Division (Grindlays Bank), New Delhi.
10. Infrastructure leasing & Financial Service (IL&FS) Venture Capital Corporation, Bombay.
11. Credit Capital Venture Fund Limited (CCVF), New Delhi.
12. Twentieth Century Venture Funds.
13. M/s Indus Venture Capital Fund, Bombay.
14. Lloyds Finance-Venture Capital Division
15. Credit Capital Venture Capital Funds (India) Ltd., Promoted by International Finance Corporation (IFC), Washington.

Need to Revise Guidelines of Venture Capital Finance

Indian Government had issued guidelines in 1988 for the first time; they are now found in practice to be extremely restrictive and inadequate. Therefore, it is essential to issue revised guidelines with considerable flexibility in operation for the smooth and effective functioning of venture capital industries in changing conditions; the aspects to be considered while revising them are summarised below.

* Redefine the term new technology
* Increase of tax concessions limit/introduction of new tax concessions.
* Reduction of tax rate on capital gains through venture capital business.

* Provision for documentary evidence/certificate from apex venture capital industry to claim tax and other benefits.
* Establishment of separate apex venture capital institution with sufficient powers to monitor the functioning of various venture capital industry in the country effectively.
* Present investment assistance limit of 10 crores to units must be enhanced.
* Compulsion to issue audited annual report by public venture capital institutions.

The Future of Venture Capital Finance

As discussed earlier, the promoters of new companies, have recently faced difficulties in raising capital from stock markets for their new projects. This makes the role of venture capital more relevant than before. As on today, around 13-15 venture capital companies are in the arena providing venture capital to promoters. Considering the requirements and potentialities for venture capital, numbers and activities are quite inadequate. In USA and U.K. there are 600 and 120 venture capital firms respectively. Hence, VCCs in India to grow interms of size as resource for which venture investment must be made more attractive; this can be done by making VCC more profitable. Further, the Government should provide the necessary legal and financial framework for the development of suitable organisational and financial structure.

In order to realise the full potential of venture capital in India, it is necessary to widen its scope beyond new technology based. The approach and experience of International companies must be taken into account. Accordingly suitable changes must be made here. All investment in unlisted companies including service sector should be regarded as appropriate venture investment. Specific fiscal incentives should be given for new technology based firms rather than restrict venture capital activity to a narrow segment.

Elsewhere, especially in the USA, recently in the U.K. and other countries as well, the limited partnership form has proved very useful in providing tax transparency to venture capital firms. The other alternative is to make the venture funds at par with funds in tax matter. The Government has to consider suitable fiscal incentives for venture funds.

In India, there is very little scope for alternative methods for structuring the deal, but in the Western countries laws permit substantial flexibility in deal structuring. Therefore, the Government policies regarding the venture capital industry are very important. These are all some of the areas where a positive contribution from the government is essential for the future growth of venture capital in India. Considering the performance of the venture capitalists the world over, it is safe to conclude that the Indian VCCs have indeed a bright and strong potential in the years ahead.

Working of Risk Capital Technology Finance Corporation Limited (RCTC)

Venture Capital Schemes, presently, are being offered by IDBI, RCTC etc. Risk Capital and Technology Finance Corporation (RCTC), registered under the Companies Act. 1956, came into existence in Jan, 1988 consequent upon reconstruction of Risk Capital Foundation (RCF). RCF has been sponsored by IFCI in 1975 and set up as a society under the societies Registration Act 1960. RCF has been providing only risk capital assistance but after its reconstitution as RCTC, a new scheme of technology finance and development was introduced. RCTC has been appointed to take up the management of the scheme known as "Venture Capital Scheme II (VECAS-III)"

The Scheme broadly covers the following spheres

* Providing of substantially innovative technologies, products, processes, markets and services including the setting up of pilot and demonstration scale plants, manufacture of prototypes and their evaluation.
* Technological upgradation through in-house R&D recognised research laboratories, universities and centres of higher learning.
* Commercialisation of domestic technologies including steps entailing customer acceptance.
* Setting up in-house R & D activities including augmentation of facilities of in-house R & D centres.
* Newer technologies for energy conservation and control of environmental pollution.

* Meeting the expenditure of national and international consultants and institutions for substantial product, process and technology improvement and innovation; and
* Sponsored commercial R&D programmes.

RCTC extends financial assistance to small and medium, private and public limited, joint sector companies etc., The nature of assistance is decided on case to case basis and could be a combination of equity and debts, subject to a limit of Rs. 2 crores in each project.

Operation of RCTC from 1988-89 to 1994-95

Table-1 shows the financial assistance sanctioned and disbursed by RCTC from 1989-90 to 1993-94. Assistance sanctioned to various schemes by RCTC has not been steadily increasing every year. Similarly in the case of amount disbursed to various schemes also, there has been no constant growth. The fluctuation in the growth rate clearly shows the hesitation and financial attitude of capitalist in venture capital investment, they should be encouraged for higher investment in venture business.

Table-1 : Assistance Sanctioned and Disbursed by RCTC

(Rs. in crores)

Year	*Sanctions*	*Growth rate*	*Disbursement*	*Growth rate*
1988-89	5.7	54.1	4.6	31.4
1989-90	6.1	7.0	5.1	10.9
1990-91	10.9	78.7	7.3	43.1
1991-92	9.7	-11.0	8.4	15.1
1992-93	11.1	14.4	10.1	20.2
1993-94	7.4	-33.3	9.1	-9.9

Source : Computed from Report on Development Banking in India, IDB I, 1993-1994.

Scheme-wise assistance sanctioned by RCTC from 1989-90 to 1993-94 is revealed in Table-II. RCTC provides financial assistance to three major heads like risk capital schemes, technology finance scheme and venture capital unit scheme-III. In the total assistance in all the years, there has been steady growth regarding venture capital scheme-III except in 1993-94. During which there was a decrease by 1.4 crores.