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RBI opens doors to six VC funds after long gap

Venture Funds Avoid Sensitive Sectors, Amend Charters And Capitalise Adequately To Gain Foothold

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AFTER a long lull, the Reserve Bank of India (RBI) has allowed a string of foreign venture capital (VC) funds to invest in the country. While this decision could have been driven partly by fears of a slowdown and drying capital inflows, the shift in mood may also have a lot to do with these funds changing their charter of investments and making upfront commitments to convince RBI.

In the past two months, the central bank has cleared applications from as many as six foreign VC funds. Though many funds are still waiting in the wings, the industry perceives it as a positive development. Advisors to some of the funds say that among other reasons, this could have been achieved only after they changed their charters to insert a specific clause that there will be no investment in the real estate sector. Till now, the funds were only giving an undertaking, which is just a letter to RBI, stating that they will stay away from real estate — a simple declaration which the regulator thought was inadequate. There are other changes that foreign VCs are making to push their case. Significantly, they are refraining from making any mention of sectors which have certain sensitivity in terms of foreign direct investment. For instance, as funds spell out the segments they would be interested to invest in, there is no reference to industries like retail, non-banking finance companies and banking.

Just like properties, where the inflow of foreign money and the resultant asset bubble have worried RBI, these are businesses where foreign investments are closely watched by the central bank as well as the government. Instead, some funds underscore sectors like power, manufacturing and BPO in their 'investment objective' — a move that could go down well with authorities.

Vikram Shroff, senior associate (funds practice) at law firm Nishith Desai Associates, which has been an advisor to several funds, feels there is a change. "Some of the recent foreign venture capital fund applicants have taken into consideration the regulator's concerns and have attempted to include additional provisions in their constitution and certain other documents, which may eventually assist in a speedier approval process," he says.

SIGNS ON MINT ROAD

Excess inflows
feared to create an asset bubble
Many applicants
earlier just gave an assurance to RBI
Some Mauritius
VCs kept little money in their a/cs

Many applications from VC funds still pending with RBI

ACCORDING to Mr Shroff, "While several foreign venture capital investment applications continue to be on hold due to the policy-level considerations, we have started seeing a few applications being cleared in recent times."

Punit Shah, who heads financial services tax practice at PricewaterhouseCoopers, said that RBI is screening and approving the application very carefully to ensure compliance with all relevant parameters. Mr Shah feels that "it's apprpriate that RBI/Sebi notifies the parameters and puts it in public domain." This, he says, will ensure that the entire process is expedited and provide certainty to long-term investors.

Besides this, for the first time, many foreign VCs are properly capitalising their companies before approaching RBI. Till now, many Mauritiusregistered VCs which had a capital of only a few dollars, were putting in investment applications. The reason is that money is taken from investors only when there is an investment opportunity, instead of putting money upfront in an account with a Mauritius bank.

While this could well be the way they do business elsewhere in the world, it didn't quite succeed in India, where the central bank insisted on seeing some minimum capital that would reflect their commitment. Now, foreign VCs are putting in bigger and more acceptable amounts into the Mauritius company which spearheads the fund's entry into India. RBI had cleared close to 10 foreign VCs during 2000-04, followed by a flurry of approvals in the next few years when more than 80 funds were allowed between 2004 and 2007. But as the country grappled with excessive dollar inflows that upturned the exchange rate equation and began to hurt exporters, very few funds got the green signal in the past one year. At present, there are close to 100 registered foreign VC funds in the country, of which only two are from Singapore and Cyprus. Others are from Mauritius due to the natural advantage that a doubletaxation avoidance treaty offers.

Even at this point, close to 40 applications are still pending before RBI. Besides the opportunity to spot stocks, a few of which turn out to be multi-baggers, what attracts foreign VCs is in the flexibility in investment rules. For instance, a VC can buy and sell at any price, unlike other foreign investors who, as per FDI norms, have to stick to a floor price that reflects the fair value. More significantly, VCs have the ability to exit immediately after a company it has invested in goes for listing, provided the foreign fund had made its investment a year prior to the initial public offering (IPO).

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