Publication: Economic Times Mumbai; Date:2008 Nov 07; Section:EFM; Page Number: 7

TAPPING THE DOLLAR FLOW

RBI opens doors to 10 VCFs amid liquidity crunch

Reena Zachariah MUMBAI

THE Reserve Bank of India, which has been holding back applications of several foreign venture capital funds (VCFs) for a few years, is slowly opening the doors to these investors — a decision which could be partly driven by the dollar shortage following the FII outflow.

During the last fortnight, the central bank has cleared proposals of as many as 10 foreign VCFs which are adequately capitalised.

Many VCFs were setting up entities in Mauritius with only a few thousand dollars as the overseas investors in the funds were reluctant to park the money in Mauritius before the regulatory clearance. This was unacceptable to RBI. Indeed, RBI had returned more than 16 foreign VCF applications to Sebi citing 'under-capitalisation' as the reason.

After this, several foreign VC funds began capitalising the investment company before approaching the financial sector regulators. Sources said Sebi has already issued the in-principle approval to 10 applicants. However, while clearing the cases, RBI has inserted a new clause, which restricts investments by these foreign funds to certain sectors, similar to those prescribed under the Income Tax Act for availing of a tax pass-through for Sebiregistered VCFs.

Under this, foreign VCFs will be permitted in 10 sectors like infrastructure, biotechnology, IT related to hardware and software development, nanotechnology, seed research and development, R&D of new chemical entities in pharma sector, dairy industry, poultry industry, production of bio-fuels and hotel-cum-convention centres with seating capacity of more than 3,000.

Sources said the new guidelines will be applicable to only new applicants and will not impact the existing foreign private equity players. Also, foreign venture capital investors hereafter will be only allowed to invest in those domestic venture capital funds which have exposure to these 10 sectors.

"While the idea in the current economic scenario would have been to attract more foreign capital, imposing such restrictions may significantly hamper the investment activities of these FVCIs," said Vikram Shroff, senior associate (funds practice), Nishith Desai Associates.

These 10 foreign approved VCFs have committed about $4-5 billion to India, sources said. "By restricting investments by foreign VCFs into these specific sectors, RBI is trying to promote them. However, these sectors are of limited usage for us. Some sectors don't even appeal to us considering the returns they generate. We just hope that RBI would increase the sectors in this list," said a senior executive of a US-based private equity fund who has received the approval," said a source.

Even at this point, close to 50 applications are still pending before RBI. Of these, nearly 20 applicants are funds keen on investing in real estate sector. At present, there are close to 100 registered foreign VCFs in the country. Most of these funds are based out of Mauritius due to the natural advantage that a doubletaxation avoidance treaty offers.

reena.zachariah@timesgroup.com