Venture Capital Funding in India

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Venture Capital Fund

Venture Capital Fund (**VCF**) is a privately pooled investment vehicle. It can be established or incorporated in the form of a trust, a company, a limited liability partnership, or a body corporate which collects funds from investors, for investing in accordance with a defined investment policy for the benefit of its investors.

Current scenario in India

As per the report of Bain and Company[1] "India Private Equity Report 2018"; 2017 was a good year for private equity in India as the country witnessed the highest investment of Private Equity (**PE**) /Venture Capital (**VC**) ever, i.e. an investment of around $26 billion.

Securities and Exchange Board of India (**SEBI**) regulates both domestic and offshore funds by the virtue of various regulations. Domestic VC funds are regulated under SEBI (Alternate Investment Fund) Regulations and offshore VC funds are regulated under SEBI (FVCI) Regulations, 2000.

Instruments

Some of the preferred instruments for a VC fund outside equity are (a) compulsorily convertible preference shares are one such type of instrument as they carry a preferential right over dividend and gives investors a preferential right to recover investment in case the company is wound-up; (b) compulsorily convertible debentures are another, investment instrument that may be considered. It is a debt instrument compulsorily convertible into equity after a specified time period; (c) convertible notes[2] as an investment option is permitted for startup companies with

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[1]https://www.bain.com/insights/india-private-equity-report-2018/; last seen 21.08.
[2] Convertible Note' means an instrument issued by a startup company evidencing re
debt, which is repayable at the option of the holder, or which is convertible into suc
of such startup company, within a period not exceeding five years from the date of i
note, upon occurrence of specified events as per the other terms and conditions agr
instrument.

effect from January 10, 2017. A foreign investor is permitted to invest in convertible notes up to twenty five lakh rupees or more in a single tranche.[3]

Documentation

Typically, a VC fund enters into various documents in connection with its investment which includes (a) term sheet: capital financing is initially captured by a term sheet. It covers various important aspects such as valuation of the company, the constitution of the board, the right to veto, exit rights, future funding, right to financial information etc.; (b) Share subscription agreement: it provides for the issue of shares to the investor for subscription money, determined as per the valuation of the company. It provides the purpose for which the money may be used, representations and warranties by the founder pertaining to the startup, provides a safeguard against any liability which the investor may face due to legal, regulatory or tax related liabilities of the startup etc.; (c) Shareholders' agreement: it provides for the structure of the board of directors, the appointment of the investor's directors on the board, liability of the founder to provide investor with financial reports from time to time, pre-emptive right, right of first refusal, the exit route available to the investors etc.

Exit Options/Routes available to the investors are as set out below:

One of the key aspects for a VC fund in connection with its investment is the right to exit the portfolio company. Typically the exit options include (a) initial public offering, (b) buyback of shares, (c) redemption of fully paid-up preference shares / debentures, (d) registration rights: a right of investor to register its securities for sale in case the company lists its securities on a foreign stock exchange, (e) tag along rights: investor can sell its share on the same terms and conditions as the shareholders exiting the company to a third party, (f) drag along rights: investor can compel the other shareholders to sell their shares on the same terms and conditions as the investor to a third party, (g) put option :investor can sell shares back to the other shareholders at a predetermined price/terms and conditions (h) call option: investor can purchase the shares of another shareholder at a predetermined price/terms and conditions as specified under the shareholders agreement.

Judicial pronouncements

The Indian Courts with recent judicial pronouncements are likely to instil more confidence amongst the investor, creating a favourable climate for investments. The Delhi High Court in a recent judgment upheld an international arbitral award passed in favour of foreign investor, and against the promoters, of an India company for having concealed information about proceedings against them by American food and drug department while selling their

[3] https://rbi.org.in/scripts/FS_Notification.aspx?Id=11253&fn=5&Mode=0

shares. In another judgment of NTT Docomo v.Tata Sons Limited[4] the court by upheld the arbitral award in favour of Docomo. The court by this decision clearly brought out the need to create a favourable environment for foreign investment by holding the Indian parties liable to their commitments under the contracts disabling them to take defence of the Foreign Exchange laws.

Conclusion

Economic growth in any country depends upon the consistent growth of business and an environment which nurtures investor confidence. Investor confidence can be ensured when investors are able to exit the companies after accruing profits and without suffering any loss due to wilful default or misrepresentation of the other shareholders or promoters. With laudable judicial precedents and liberal laws India is likely to achieve high investment and business growth in the coming years.

[4] (2017) 241 DLT 65