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For Private Circulation Only

VENTURE CAPITAL FUND (VCF)

VCF is private equity fund provided in cash by third-party investors to new companies which cannot raise capital through debt issue for having limited operating history.

Kinds of Venture Capital Funds

1. **Foreign Venture Capital Funds** - Provided by Foreign Financial Institutions (FII) or companies through Foreign Direct Investment to the host companies;
2. **Domestic Venture Capital Funds** - Provided by domestic financial investors / companies / investment banks.

Regulating Body - Securities & Exchange Board of India through SEBI (Foreign Venture Capital Investor) Regulations, 2000 and FEMA Regulations, 2000 for regulating Foreign VCF and through SEBI (Venture Capital Fund) Regulations, 1996 for Domestic VCF.

Setting-up Process - Domestic VCF

STEP 1: Registration – Firstly, either as trust under Indian Trust Act, or as company under Indian Companies Act, 1956. Thereafter with SEBI within 3 months from commencement of its establishment

SEBI Registration - Through application with constitution Documents, i.e. Memorandum of Association / Registered Trust Deed, having VCF as its main object

STEP 2: Issue of Placement Memorandum or Subscription Agreement containing all the terms and conditions of the process of raising money from the investors.

Essential ingredients of placement memorandum / subscription agreement -

- (i) Details of the trustee and the trust as well as the directors and principal officers of the venture capital fund (VCF).
- (ii) Minimum amount of money to be raised to start the VCF and the minimum amount of share needed to be invested in every scheme of the VCF.
- (iii) Tax implications which shall apply to the investors
- (iv) Manner of the subscription of each fund
- (v) Period of maturity of the fund, if any
- (vi) Manner in which the fund shall be wound up.

STEP 3: Venture Capital Investment – Sequential process involving six steps

- (i) Deal origination;
- (ii) Initial Screening of all projects on basis of investment size, geographical location and stage of financing;
- (iii) Due Diligence, i.e. evaluating an investment proposal and risk analysis;
- (iv) Deal Structuring, i.e. negotiating the amount, form and price of the investment and other terms of the deals;
- (v) Post Investment Activities including the role of a partner and collaborator;



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(vi) Exit from venture capital investment through -

1. Initial Public Offerings (IPOs)
2. Acquisition by another company
3. Purchase of the venture capitalist's shares by the promoter, or
4. Purchase of the venture capitalist's share by an outsider.

Setting-up Process – Foreign VCF

STEP 1: Registration with SEBI

STEP 2: Approval of RBI for making Investment

STEP 3: Investment in domestic VCF or in unlisted equity shares or equity linked instruments of Venture Capital Undertakings or other modes as permitted

Conditions for Investment:

- Minimum investment in VCF – Rs. Five (5) Lacs
- Maximum 25% of fund shall be invested in a single venture capital undertaking
- 2/3rd of fund to be invested shall be invested in unlisted equity shares or other instruments linked to equity shares of the venture capital undertaking
- 1/3rd of fund shall be invested by way of IPO of a venture capital undertaking whose shares are proposed to be listed, the debt instrument of the venture capital undertaking in which the VCF has already invested, preferential allotment of equity shares of listed company, equity shares or equity linked instrument of financially weak company and SPV's which have been created by the VCF.

Restrictions:

- i. No VCF shall get its units listed on any recognized stock exchange, till the expiry of three years from the date when they were issued to the investors.
- ii. VCF shall also not invite any public member through advertisement to subscribe.
- iii. VCF may receive investments only through the private placements of its units.

Due Diligence of Investee / Host Company

Venture Capital Investments being illiquid requiring 3-7 years time to harvest, venture capitalists are expected to carry out detailed due diligence prior to making their investments. Such due diligence would involve the following requisites –

1. Knowledge of internal trading regulations of the investee company;
2. Legal, Commercial and financial aspects of the investment;
3. Analyzing the risks involved in the process of investment, specifically those pertaining to the credit, regulatory and legal aspects

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4. Identification of the terms and conditions of the stock purchase agreements, additional warranties and indemnities, corporate governance, etc.

Rights of Venture Capitalists –

1. To receive various reports, financial statements and related information;
2. To have its stock registered for sale in public offering at the company's cost;
3. To maintain its percentage share ownership in the company by participating in future stock offerings.