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WEB 3.0 AND VENTURE CAPITAL LANDSCAPE: THE ROLE OF SEBI AND OTHER INDIAN REGULATORY BODY

By Saksham Jain

Introduction

Web 3.0, is the third-generation evolution of web technologies[1]. It is characterised by decentralisation, driven by machine learning and artificial intelligence, and leverages blockchain technology[2]. Web 3.0, also known as the "read/write/own" upgrade to the Internet[3], allows users to have more control over their data and content.

The potential of Web 3.0 is vast, as it could revolutionise how we interact with the internet and create new opportunities for businesses and individuals. For example, it can enable more secure online transactions, improved data privacy, and better access to information[2]. Additionally, Web 3.0 can open new possibilities for digital marketing, e-commerce, and other online activities[3].

Venture Capital and its role in Web 3.0

Venture capital has played an important role in the development of Web 3.0, a new generation of web technologies that are more secure, efficient, and synergistic than their predecessors[4].

The potential for businesses to raise money through Initial Coin Offerings (ICOs), a type of crowdfunding that leverages bitcoin, is one of the distinctive features of Web 3.0. While ICOs can give businesses a method to acquire money without turning to conventional VC, they also carry a high level of risk for investors. Several ICOs have been deceitful or have fallen short of their claims. As a result, organisations intending to raise money through ICOs can benefit from the valuable due diligence and vetting provided by VC firms that specialise in Web 3.0.

Venture capitalists have invested billions of dollars in crypto and blockchain startups in 2021[5], and this trend is expected to continue in 2022 with venture capital firms pouring even more money into these industries[6].

In 2021, Sequoia Capital launched a $9 billion fund to expand tech startups in China, with a focus on blockchain and related industries, such as cryptocurrency[7]. This shows that venture capitalists are increasingly recognizing the potential of Web 3.0 technologies and investing heavily in them.

Venture capital has been instrumental in helping Web 3.0, reach its full potential by providing the necessary resources for startups to develop innovative products and services. By investing in these companies, venture capitalists are helping to create a more secure, efficient, and synergistic web experience for users around the world.

Current Status of Web 3.0 and Venture Capital in India

Investment in Web 3.0 startups in India has been steadily increasing over the past year. According to data from Tracxn, $143.3 million was invested across 21 Web 3.0, and crypto startups until April 2022[8]. International funds invested over $500 million this year in Indian startup and blockchain ecosystems[9].

Web 3.0, software-as-a-service (SaaS) and fintech are emerging as the big focus areas for investors in 2022, with Web 3.0 being one of the most popular areas for investment[10]. India currently has the third-largest Web 3.0 talent pool in the world, with over 450 active Web 3.0 startups, including four unicorns[11]. This indicates that there is a strong potential for further investment in Web 3.0 startups in India in the coming years.

Web 3.0 investment in India vs Other Countries

Web 3.0 is a paradigm shift for the internet that is defined by a collection of decentralized protocols and networks run by network participants worldwide[12]. It has been gaining traction in recent years, with investments totalling USD 25.2 billion in Web 3.0-related start-ups worldwide[13]. Global Web 3.0 Blockchain Market revenue is expected to reach USD 23.3 billion by 2027[14].

India is investing heavily in Web 3.0 technologies and startups, with venture capital firms betting big on these companies[9]. According to KPMG LLP's knowledge report, Web 3.0 and related technologies are shaping the next stage of digital transformation[15]. Digital asset technology offers India a $1 trillion economic opportunity to participate in the booming Web 3.0 industry[16]. FleishmanHillard India's 'Web 3.0 Influencer & Intelligence Report 2022' lays out the Web 3.0 conversational landscape for brand adoption and identifies trends[17].

It is difficult to compare India's investment in Web 3.0 to other countries without more specific information about their investments. However, it is clear that India is investing heavily in this technology and taking advantage of its opportunities. Further, it can be assumed that countries such as China, which has been investing heavily in blockchain technology and other Web 3.0, are likely to have higher levels of investment than other countries[13]. Additionally, the report from Globenewswire presents a country-wise and region-wise analysis of the market share and growth rate of the Web 3.0 Blockchain Market during the forecast period[14], which may provide some insight into the level of investment in different countries and regions.

The Regulatory Framework in India

The current legal and regulatory framework related to venture capital investment in India

The legal and regulatory framework for venture capital investment in India is governed by the Securities and Exchange Board of India (SEBI) Act of 1992 and the SEBI (Venture Capital Fund) Regulations of 1996. According to these regulations, any company or trust proposing to carry on the activity of a Venture Capital Fund must obtain a certificate from SEBI[18].

The regulations also state that at least 80% of the funds should be invested in venture capital companies, with no other limits prescribed[19]. Tax incentives are also available for venture capital investment in India[20]. In September 2000, regulations were introduced for domestic Venture Capital Funds (VCFs), but foreign venture capital or private equity investors were not regulated or monitored until then[21].

The definition of a VCF according to the Alternative Investment Funds (AIF) Regulations is an AIF that invests primarily in the unlisted securities of start-ups and early-stage venture companies[22].

Role of SEBI and other regulatory bodies in regulating venture capital investment

The Securities and Exchange Board of India (SEBI) is the primary regulator of venture capital investments in India[23]. SEBI regulates stock market activities through trade rules and regulations, ensuring the integrity and safety of legitimate traders and investors[24]. The SEBI Regulation restricts the investment by Venture Capital Funds (VCF) in unlisted equity or equity-related instruments and listed securities of financially weak or sick companies[25].

The Reserve Bank of India (RBI) also plays a role in regulating venture capital investments in India. The RBI issued notifications allowing Domestic Venture Capital Funds registered with SEBI to make investments in offshore Venture Capital Funds[26]. In addition, SEBI amended its regulations governing Alternative Investment Funds (AIFs) used for venture capital investments. These amendments included changes to the registration process, disclosure requirements, and restrictions on investments[27].

Overall, SEBI is the primary regulator of venture capital investments in India, while the RBI provides additional insight. Both regulators have implemented rules and regulations to ensure that venture capital investments are conducted safely and ethically.

The Role of SEBI in Regulating Venture Capital Investment in Web 3.0

The Securities and Exchange Board of India (SEBI) plays an important role in regulating venture capital investment in Web 3.0 startups. SEBI regulates venture capital firms in India through the Alternative Investment Funds (AIF) Regulations 2012[28]. The AIF Regulations define a Venture Capital Fund (VCF) as an AIF that invests primarily in unlisted securities of start-ups and early-stage venture companies[22].

Analysis of the current and proposed regulations related to venture capital investment in Web 3.0 startups

In 2021, SEBI established a committee to review the regulations related to venture capital investment in Web 3.0 startups. The committee recommended an increasing focus on equity or equity-linked instruments of unlisted startup companies and proposed raising the investment ceiling for VCFs[19].

The Indian venture capital (VC) investment landscape has seen significant growth in recent years, with a convergence of heady tailwinds coming together to drive investments into Web 3.0 startups, blockchain, and crypto projects[29]. This trend is expected to continue as more VC funds are launched to expand tech startups in China and other countries[7].

The role of SEBI in enforcing these regulations

SEBI regulates stock market activities through trade rules and regulations, ensuring the integrity and safety of legitimate traders and investors[24]. Domestic and offshore VC funds investing in India are regulated by SEBI, which has recently begun to quiz old VC funds over term extensions[30]. SEBI also regulates domestic VC funds through the SEBI Venture Capital Funds Regulations, 1996[31]. Additionally, venture capitalists are regulated by the SEC's insider trading laws, which prevent the misuse of nonpublic information for financial gain[32]. SEBI Regulations do not provide for any sectoral restrictions for investment, except for investment in companies engaged in financial services[19].

The Impact of the Regulatory Framework on Web 3.0 Startups

SEBI regulations have not yet addressed the impact of Web 3.0, startups, although the Indian state government is looking to accredit Web 2.0, Web 3.0, and blockchain projects[33]. Experts suggest that India's crypto regulations do not recognize the full scope of web3[34], and SEBI has proposed amendments to the regulations pertaining to Innovators Growth Platform (IGP) under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018[35]. Venture capitalists are rerouting funding to Web3.0, gaming startups as they represent the next generation of the Internet[36].

Evaluation of the effect of the current regulatory framework on the development and growth of Web 3.0 startups in India

The current regulatory framework in India has had a positive effect on the development and growth of Web 3.0 startups. Indian venture capital firms are betting big on Web 3.0, viewing them as developers of products in the next stage of digital transformation[9]. The country has the potential to accelerate the web 3.0 economy in the world with its growing ecosystem of technology entrepreneurs, innovators, and startups[15].

In 2022, India's policy decisions kept many startups and stakeholders in emerging sectors on their toes[37], but this did not stop the global Web 3.0 blockchain market from growing to $23.3 billion[14]. Digital assets and underlying technologies still have the potential to transform business models across sectors[38], making India an attractive destination for Web 3.0 startups looking to capitalise on this potential.

Web 3.0 startups in India have seen a surge in investment and fundraising in recent years, with international funds investing over $500 million this year alone[9]. This has been driven by the country's strong startup ecosystem, which is well-positioned to weather any potential recession[39]. Early-stage venture capital firms such as Antler India have committed to invest in 25-30 startups in the Web 3.0 space[9], while discussions with leading investors suggest that the current funding environment is conducive for business operations[40]. Overall, Web 3.0 startups in India are enjoying a period of ease when it comes to investment, fundraising, and business operations.

Other Regulatory Bodies and Their Role in Web 3.0 and Venture Capital

In addition to the Securities and Exchange Board of India (SEBI), there are several other regulatory bodies in India that play a role in regulating venture capital investment in web 3.0 startups. The Alternative Investment Fund (AIF) Regulations, which were introduced by SEBI in 2012, provide the framework for venture capital funds (VCFs) to invest in unlisted securities of start-ups and early-stage ventures[22].

The Department of Industrial Policy and Promotion (DIPP) has also played an important role in promoting venture capital investments by introducing the Innovators Growth Platform (IGP) regulations[35]. These regulations provide a framework for companies to list stock exchanges without undergoing the traditional IPO process. Additionally, the government has implemented reforms to recognise the benefits of private equity and venture capital investments[22].

India is beginning to recognize the potential of Web 3.0 startups and venture capital investment, with several initiatives being taken to nurture the industry at a national level[15]. The Indian government has implemented grants and frameworks for education, regulatory sandboxes, VC investments, and other measures to support the growth of Web 3.0 startups[41].

Venture capital firms in India are betting big on Web 3.0 startups, with early-stage VC firm Antler India committing to invest in 25-30 such startups in 2021[9]. According to a report by Venture Intelligence, crypto and Web3 startups have raised more than $1 billion in funding across 43 deals in just 2020[42].

Overall, India is taking steps towards creating a supportive regulatory framework for Web 3.0 startups and venture capital investment. This will help foster innovation and create new opportunities for entrepreneurs.

Finally, private investments such as seed, angel, venture capital, and private equity funds have been instrumental in expanding the Indian startup ecosystem[43]. These funds provide much-needed capital for web 3.0 startups to grow and develop their products.

International Comparison

India is emerging as a leader in Web 3.0 and venture capital investments, with 11% of the global web 3.0 talent located in India[15]. In 2021, venture capital investments in India had a banner year, with a meteoric rise in Web 3.0/crypto-focused investments[29]. Indian venture capital firms are betting big on Web 3.0 startups as they view such companies as developers of products for the next stage of the internet[9].

Web 3.0 is a paradigm shift for the internet that is defined by a collection of decentralized protocols and networks run by network participants worldwide[12]. With the right set of regulations, India is poised to become the blockchain and web 3.0 capital of the world[15]. CrossTower estimates that Web 3.0 could drive $1.1 trillion of economic value for India by 2032 if the right policies and regulatory framework are put into place[16].

Comparing India's regulatory framework for Web 3.0 and venture capital investment to other countries is difficult due to varying levels of regulation across different countries. However, India has the potential to become a leader in this space if it can create an environment conducive to innovation and investment.

The Indian regulatory framework for Web 3.0 and venture capital investment has both strengths and weaknesses. On the one hand, the Indian government is taking a "very sound and balanced approach" to the development of crypto-markets, Web 3.0, and blockchain-based economies[15]. This includes encouraging innovation while balancing risks [44]. Additionally, India is making progress on an ESG (Environmental, Social, and Governance) regulatory framework that encourages sustainable finance[45].

On the other hand, there are still challenges in developing a regulatory framework that balances risks with innovative potential[38]. Furthermore, Indian venture capital firms are highly interested in investing in those startups that have the potential to grow exponentially but lack proper regulations to protect investors from fraud or scams[46]. As such, more work needs to be done to ensure that the Indian regulatory framework for Web 3.0 and venture capital investment is effective in protecting investors while also encouraging innovation.

Recommendations for Improving the Regulatory Framework

To improve the regulatory framework for Web 3.0 and venture capital investment in India, the government should focus on building a cryptocurrency framework[41]. This will help nurture startups at a national level and create an environment conducive to Web 3.0 technologies[15]. Additionally, the government should provide clarity on the legal status of digital assets and create regulations that protect investors while encouraging innovation[16].

Furthermore, it is important for the government to educate citizens about Web 3.0 technologies and their potential benefits[12]. This will help to ensure that citizens are aware of the risks associated with investing in digital assets and can make informed decisions when investing in them. Finally, the government should promote collaboration between industry stakeholders to ensure that all parties are working together towards a common goal of creating a safe and secure environment for digital asset investments. By taking these steps, India has the potential to unlock $1.1 trillion of economic value by 2032[16].

The recommendations for Web 3.0 startups and venture capital investment in India are positive. Indian startups have made significant progress across all facets of Web 3.0, metaverse, and AI, with many creating an impact on the global stage[15]. Venture capitals are rerouting funding to

Web3.0, gaming startups as they view such companies as developers of products for the next stage of digital transformation[36].

Web 3.0, software-as-a-service (SaaS) and fintech are emerging as the big focus areas for investors in 2022[10], while Indian venture capital firms are betting big on Web 3.0 startups[9]. VC investments in India had a banner year in 2021, with a 6.6x growth over 2020 in tech investments and a 28x growth over 2020 in Web 3.0 or crypto-based start-ups[29]. These trends indicate that there is great potential for Web 3.0 startups and venture capital investment in India.

Conclusion

In the final analysis, the regulatory setup for venture capital investment in Web 3.0 companies in India is pivotal in fostering the progress and maturation of this sector. Although still in its nascent stage, the Indian Web 3.0 and venture capital sector exhibits noteworthy potential for expansion and invention. The Securities and Exchange Board of India (SEBI) and other regulatory bodies have a crucial role in controlling the investment atmosphere and making sure it is safe, secure, and open.

Research has demonstrated that the present regulatory framework has both advantages and drawbacks and that there is room for development. For instance, regulations that catalyze investment in Web 3.0 startups and offer a straightforward and explicit structure for venture capital investment are essential for the development of this industry. However, excessively strict or convoluted regulations could impede the growth of Web 3.0 startups and venture capital investment in India.

It is recommended that the Indian regulatory framework be examined and updated in light of the above in order to facilitate the expansion and development of Web 3.0 businesses as well as venture capital investment in India. A more welcoming framework for investments will entice more capitalists and entrepreneurs to this industry, driving more growth and innovation. India has a promising future for Web 3.0 and venture capital, and with the correct regulatory structure, it might take the lead in this industry.

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