Indian Venture Capital & Private Equity Firms Trends and Practices - A Study

Dr. Prashanth Aare, Mr.Sandeep Kumar , Mr.S.Naresh
Assistant Professor
Dept. Of MBA
Swami Vivekananda Institute Of Technology,Sec-Bad,Telangana,India.

ABSTRACT

The venture capital industry, as an institution, is a good example that prides itself on 'value addition' to the companies, rather than just financing them, as money is only part of the contribution venture capitalists make to growing businesses. The roles played by venture capitalists are many: they offer their experience, knowledge and contribute to the growth of companies through their value addition (like strategic and operational guidance, connecting investors (syndicating), connecting customers (marketing), hiring board members and employees), monitoring the financial performance, help their portfolio firms attract alternative sources of financing, help to build a distribution network, and also help to attract top-flight management. They understand the entire life cycle of a company, from getting started to building business, going public or being acquired as a venture entrepreneur. Today, VC/PE industry in India is evolving differently from the classical Silicon Valley model, the smart money is going to areas very different from what anyone had imagined. Venture capitalists are getting more selective about funding start-ups and looking beyond information technology and training their money and efforts on a variety of other emerging sectors. Therefore, it is found necessary to know the composition of fund focus of VC/PE for a developing country like India where venture capitalists are attracting considerable attention. The present study highlights that IT&ITES, customer related industries and financials attracted the highest amount of investment throughout the year (2016). On the other hand, sector like real estate, infrastructure showed encouraging signs of deal activity in the current year. Further, the southern region of India witnesses a huge increase in the deal value.

Key words: venture capital, fund focus, start-ups, deals by value and volume

INTRODUCTION

There are many entrepreneurs in India with a potential idea but because of lack of capital and previous entrepreneurial experience, they are unable to successfully develop and introduce their new product ideas into the market place. Therefore, they look for those who can help convert their potential ideas into reality with capital infusions and the management assistance to make their products available to the public market. Venture Capital, the new age finance emerged as a significant innovation of the twentieth century, helps opening a new window for such projects and entrepreneurs, financing the growth of knowledge based industries and helping to realize entrepreneurial dreams. Venture capital partners bring technology, alliances, finances, people placement, and business development together by using a strong network of successful technologists and reputed financial executives and institutions to help entrepreneurs grow and take an active role in the development of the new enterprise. Historically venture capital evolved as a method of early stage and technology oriented financing, but the notion of venture capital recognizes different stages of financing in diversified sectors.

LITERATURE REVIEW

Cumming and Na Dai (2011) argue that if reputable venture capitalists acquire negative new information regarding the potential of the company, they will stop investing in the company.

SVCA (2006) documented that, other parameters of a venture capital funds strategy can be based on the stage in the development of a venture (e.g. pre-seed, seed, start-up, expansion) that the investment is placed in. By grave and Hunt et al. (2005) summarized that venture capital firms typically invest in industries such as high technology and biotechnology, which tend to have a high level of ambiguity, necessitating ongoing adjustments to investment strategy. Dimov (2002) showed that venture capital partners education, functional expertise and prior experience in particular industries strongly determines whether the venture capital firm was prepared to invest in individual portfolio companies at certain development stages and in particular industries. Smith (2001) briefed that the value-added activities of venture capital providers are knowledge-based (e.g., product development assistance, business and marketing plan formulation) and network-based (e.g., investor relations, customer and distributor contact). Mason and Harrison (2000) documented that after the boom and bust of the Internet hype, since 2000, the interest of venture capital firms has shifted from seed and start-up situations to more mature investment stages, because such investments are considered safer, easier to manage. New York Times (2000) viewed that venture capitalists have sought to differentiate themselves by the quality of business services and reputational capital they bring to their portfolio companies. Elango et al. (1995) explicitly tried to find out in the ways venture capitalists differ and summarized that they differentiate between the stage of investment, support intensity, firm structure, and geographical orientations. Gompers et al. (1995) documented that in order to minimize risk, venture capitalists take an active role in the development of their portfolio firms. As part of their active role they often require board seats in the firm. Funds that place their investments in later stage investments tend to focus more on the long-term goals and less on daily routines in the firm. Another mechanism to control the risk of early stage investors is to stage the investments according to specific milestones. Barry (1994) states that VCs typically specialize by emphasizing a particular industry, such as biotechnology, or by emphasizing a particular stage of company development, such as startup companies or companies in the expansion stage. Finally, it must be noted that the institution of venture capital does more than mere financing of the start-ups. MacMillan *et al.* (1988) documented that because of their experience with numerous ventures and their extensive exposure to financial, labor and other resource markets, venture capitalists are uniquely positioned to provide valuable assistance to their portfolio companies in key aspects.

NEED FOR THE STUDY

Today VC/PEs has expanded from largely a ‘product’ focus to investing in service businesses. India, as a whole, has moved from the ‘labor arbitrage’ to ‘value add’ model in the outsourcing space. India now provides solutions for the global market place and VC/PEs are following in the same footsteps, most importantly VC/PE space is expanding to sectors beyond technology. With fundamental economic growth spanning across sectors in India, segments that escaped the scrutiny of VC/PEs during the tech boom have begun attracting attention. The major focused areas include media, healthcare, education, infra, retail and food services. The modern VC/PE ecosystem is a mix of IT and non-technology, catering to domestic, global solutions demand.

However, the success of any venture capital fund would depend on the type of businesses it chooses, selection of entrepreneur, due diligence process, structuring the deal and the legal framework within which it works. Therefore, there is a need to study the interest and trends of VC/PE firms' for their investments. The present study is expected to help prospective entrepreneurs, academia and others in knowing the trends of Indian venture capital industry.

OBJECTIVES AND METHODOLOGY

The broad objective of the present study is to know the fund focus of venture capital & private equity for investments in India and the study is based on secondary sources of information and the sources include, namely literature of venture capital reports, IVCA Indian Venture Capital Association-newsletter, Venture Intelligence, VC Circle, VC/PE related websites, etc. The Study specifically looks venture capital & private equity investments in India by volume and value, by industry, by stage, by region, etc.

RESULTS AND DISCUSSION

Economic liberalization of India has brought new financial products and services to nurture and support the growth of the industrial sector. In such direction venture capital financing has come to assure significantly the development of entrepreneurship and exploit technological potential of India. The U.S. has the most developed venture capital market in the world with a high level of deal processing expertise. In contrast, the Indian venture capital market emerged in the late 1980s following a series of measures to establish government sponsored risk capital corporations and capital gains tax concessions for venture capital investments. The venture capital industry in India has subsequently witnessed increased activity with a rise in the number as well as the pool of funds for investment. However, VC/PE investments in India declined significantly in the year 2016 both in terms of number of deals as well as by amount. Further, trends in deal value suggest that investors have started being more selective (focused on companies with clear business models and greater profitability potential) in their investments and the decline is characterized by low fund raising, moderate exits and a declining deal market which has been across all investor types, though angel/seed funds shown their presence. However, the IT sector attracted the biggest share of VC/PE money, BFSI and Healthcare presents an attractive investment opportunity for Indian firms. **(See Table 1)**

Table 1 Classification of VC/PE sector focus in India -2016

Sectors	VC/PE sector focus in the year 2016 by value & volume			
	Deals	(%)	Amt (USD million)	(%)
IT & ITES	78	54.2%	1,173	27.8%
BFSI	22	15.3%	1,852	43.9%
Healthcare & Life Sciences	15	10.4%	254	6.0%
Manufacturing	4	2.8%	88	2.1%
Food & Beverages	4	2.8%	17	0.4%
Shipping & Logistics	3	2.1%	132	3.1%
Agri-business	2	1.4%	42	1.0%
Others	16	11.1%	660	15.6%
Total	144	100%	4,218	100%

(Source: Venture Intelligence, November 2016)

Every year, some sectors catch the fancy of venture capitalists. The hot areas for VC/PE investments generally include IT&ITES, Healthcare & Life Sciences, Financial, Education, Renewable Energy (Cleantech) and Consumer related. The trigger point could be that these sectors have reached an inflection point or that some feisty entrepreneurs have demonstrated scalable and promising business models. In the year 2016 IT/ITES continued to rule for VC/PE investments and sectors like consumer discretionary, healthcare and financials were significant contributors. However, the decline across all sectors remains secular. A combination of these factors typically strengthens the investment thesis for venture capital investors. As may be seen from the table 1, the highest number of investments happened in the IT/ITES sector (78) with 54.2%, followed by BFSI (22) with 15.3% and healthcare & life Sciences Sector (15) with 10.4% of total share. However, it also should be noted that BFSI sector remains high in the amount of investments (43.9%).

Table 2 Classification of VC/PE deals by Segment

Deals by Segment type	Year 2015	Year 2016
Entertainment Tech	70	26
Travel Tech	127	51
Food Tech	158	54
Edu Tech	40	26
Health Tech	99	69
Fin Tech	122	183
Total	616	409

(Source: VCCEdge)

As the tides of investments change over time, venture capital (VC/PE) funds are shifting their focus to businesses related to consumer demand such as education, media and entertainment, food & beverages, real-estate, telecom, BFSI, manufacturing (advanced packaging; high value materials recovery; natural chemistry; sensors; smart construction materials; and precision manufacturing instruments), transportation (hybrid vehicles, lighter materials, smart logistics software and telecommuting), logistics, games and payment and management solutions and alternative energy. Sectors such as e-waste management, education, water purifications systems (water recycling and ultra-filtration systems (UV and membrane based systems), sensors and automation systems and desalination equipment), sanitation projects, cotton trading solutions for farmers, education and even beauty salons and service apartments and clean technology have got funds from venture capital firms in India. Table 2 refers to the classification of VC/PE deals by segment/sector. In terms of segment funding, fintech attracted more number of deals , followed by health tech. Overall, the highest amount of funding continues to be attracted by consumer technology start-ups, though the investors have become more selective in their investment decisions.

Table 3:Classification of Stage wise VC&PE Investments in India FY2015-16 versus 2014-15

Stage	No. of deals		By Value (Amount in USD Million)	
	2015-16	2014-15	2015-16	2014-15
Venture Capital	512	361	1,768	1,272
Buyout	22	15	1,049	248
Buyout-Large	11	2	3,647	206
Growth-PE	78	72	4,350	2,603
Late	129	146	6,916	7,739
Other	3	4	125	203
PIPE	44	60	2,135	1,649
Pre-IPO	-	2	-	16
Total	799	662	19,990	13,935

(Source: Venture Intelligence, November 2016)

Table 3 refers to the classification of stage-wise VC&PE investments in India in the year 2015-16 versus 2014-15. As may be seen from the table, there was an increase in the overall investment activity, and venture capital retained its position as the largest sub-sector in terms of deals in the PE industry with over 60% of total deals in the year 2015-16. Further, the trend in the total value in the PE stage deals reflects increased exit opportunities through financial investors.

Table 4 Classification of VC/PE by Region for the year 2016

Region	Value USD Million	Volume	Value USD Million	Volume
	Year 2015		Year 2016	
South	3,618	233	7,078	263
West	6,019	198	5,851	245
North	3,156	158	3,791	219

Others	**1,142**	**73**	**3,269**	**72**
Total	**13,935**	**662**	**19,989**	**799**

(Source: Venture Intelligence, November 2016)

Table 4 refers to the classification of VC/PE by region for the year 2016. As may be seen from the above table, southern India continues to constitute the highest deal value and volume as compared to other regions in India. The southern region of India witnesses a huge increase in the deal value in the year 2016 to USD 7.1 billion compared to USD 3.6 billion in the year 2015.The reason could be that southern region is a potential destination for IT/ITES, with a pharmaceutical hub, garments and textile clusters and emerging biotechnology and growing healthcare industries with one metro city.

Table 5 Classification of VC/PE Investments in 2016

Year	Amt in USD million	No of Deals
2012	829	999
2013	1,089	916
2014	1,304	1117
2015	2,193	1800
2016	1,034	1203

(Source: VCC Edge)

Table 5 refers to the classification of VC/PE investments in the year 2016.As may be seen from the table PE/VC investments into India have declined by almost 50% in 2016 to USD 10.34bn (based on data till mid-Dec 2016) after showing on all-time high of USD 21.93 billion in 2015. The decline was not only visible in the deal value, but also in the total volume of deals both in the PE and VC space. However, the e-commerce sector, specifically, witnessed a sharp fall in investments mainly due to a decrease in the valuation of companies.

Table 6 Classification of VC Investments in 2016-2017

Quarter & Year	Amt in USD Million	No of Deals
Q2 FY 16	499	125
Q3 FY 16	329	108
Q4 FY 16	304	121
Q1 FY 17	222	102
Q2 FY 17	353	87

(Source: Venture Intelligence, November 2016)

Table 6 refers to the classification of VC investments in the year 2016-2017. As may be seen from the table, VC firms reported investment of USD 353 million across 87 deals in Q2 FY 2016-17, the amount invested was 59% more than the previous quarter and 29% lower compared to the same period in the previous year. The median deal size is USD 5.0 million.

Table 7 Classification in terms of deal volume and type of deal in USD Millions

Deal type by Volume in USD	Value	Volume	Value	Volume
	2015		2016	
Public Equity	3172.26	67	2433.8	46
Pre-IPO	90.04	4	42.79	1
PE	11747.99	206	4991.1	122
VC	6511.61	583	2566.96	333
Angel/Seed	409.21	874	308.68	701

(Source: VCCEdge)

Table 7 refers to the classification in terms of deal volume and types of deal. As may be seen from the table, in terms of deal volume based on type of deal, 2016 witnessed a smaller number of deals happening in both the PE and VC space. However, angel and early stage investments were affected much less than other types of investments. These trends clearly suggest that investors are very selective in their investments. Similarly, PE and VC investments in 2016 totaled USD 4,991million and USD 2,567 million respectively and shows a drop of more than 50% in total deal value compared to the year 2015.

Table 8 Classification of VC/PE by funding the start-ups in the year 2016

Start- up deals	Value of deals 2015 (USD million)	Value of deals 2016 (USD million)
Jan-Mar	612	400
Apr-June	774	332
July-Sep	572	309
Oct-Dec	684	411

(Source: VCCEdge)

A startup may seek funding for varied reasons and funding can provide capital required to back its business plan of the place at which it aims to grow visibility and reputational benefits and investor that will constantly guide it in making critical business decisions for allocation and other benefits. However, most startups spend a lot of time developing their business and tend to neglect various legal and regulatory compliances. The importance of a legal diligence cannot be underestimated. A legal diligence exercise typical conducted at the seed and the growth/early stage rounds on funding and exercises. Risk associated with the investment to a risk mitigation plan and a list of items that would need to be inserted to the definite documents in the nature of conditions precedent to funding conditions, subsequent representations and warranties to be obtained from the founders and indemnities. Table 8 refers to the classification of VC/PE by funding the start-ups. As may be seen from the table investment in start-ups also saw a significant change in the current year (2016) as comparative to the year 2015 and the number of deals decreased by (28%) and value of deals by 44%. Though, the first quarter saw investors backing start-ups, both deal value and volume dropped significantly across all the remaining three quarters of the current year 2016.

CONCLUSION

The study highlights that VC/PE firms are becoming more restrictive about the industries in which they are willing to invest and firms are embracing market opportunity in a wide variety of sectors beyond IT&ITES, however, IT/ITES continued to rule for VC/PE investments in the current year. The trigger point could be that the other sectors have reached an inflection point or that few potential entrepreneurs have demonstrated scalable and promising business models.

VC/PE investment in India declined significantly in the year 2016 both in terms of number of deals as well as by amount invested comparatively to the previous year and the turn down in investment can be attributed to the declining interest of investors in online and e-commerce business models. Further, customer discretionary industries and financials attracted the highest amount of investment throughout the year and sectors like real estate, and infrastructure showed encouraging signs of deal activity for VC/PE firms. Finally, it can be said that the investment environment in India is becoming stable and VC & PE investors are looking forward for clearer business models from potential entrepreneurs.

SCOPE FOR FURTHER STUDIES

The present study focused on trends and investments practices of Indian VC/PE firms. Future research could be on studying the detailed performance of major VC/PE firms with sector and stage preference in India.

REFERENCES

1. Barry, Christopher B. (1994), New directions in research on venture capital finance. Financial Management 23(3), 3-15.
2. By grave, Timmons. (1992), Venture Capital at the Cross Roads, Harvard Business School Press: Boston, MA.
3. Colin M. Mason and Richard T. Harrison, (2002), The Geography of Venture Capital Investments in the UK, Transactions of the Institute of British Geographers, New Series, Vol. 27, No. 4, pp. 427-451.
4. Dimov, D., Shepherd, D.A., Sutcliffe, K.M. (2007). "Requisite expertise, firm reputation, and status in venture capital investment allocation decisions", Journal of Business Venturing, Vol.22, No.4, pp 481-502.
5. Donald F. Kuratko, Richard M.Hodgett., (2005), Entrepreneurship Theory Process Practice, 6th Edition, Thomson South-Western press.
6. Elango B, Fried VH, Hisrich RD, Poloncheck A. (1995), How Venture Capital Firms Differ. Journal of Business Venturing, 10,157-179.
7. Gompers. (1995), Optimal Investment, Monitoring and the Staging of Venture Capital. Journal of Finance, 50(5), 1461-1489.
8. Indian Venture Capital and Private Equity Directory (IVCA) 2008 and 2011
9. MacMillan, Kulow, Khoylian (1988), Venture Capitalists Involvement in Their Investments: Extent and Performance, Journal of Business Venturing 4, 27-47.