

RESEARCH PAPER

A PARADIGM SHIFT IN INDIAN VENTURE CAPITAL INDUSTRY

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ABSTRACT

Venture Capital Industry is a very young industry, which has been changing rapidly. Since the 1990's venture capital in India is growing steadily. The future is likely to offer even greater opportunities as entrepreneurs are encouraged, creating new legal structures, commercial arrangements. The vision and mission of venture capital in India is changed in 2012. It is an exciting year since 2013 for India's Venture Capital investing, as new innovations, business models in areas such as e-commerce, mobile applications, health care delivery, medical devices and its technology, financial inclusion, clean technology and IT are likely to drive most of the activity. The paper is conceptual in nature, focus and discusses the performance of venture capital industry in past 15 years and the present scenario. The researcher has used secondary data for analysis. This study is limited to Indian situations. The growth of India's investor community and the resulting increase in the amount of capital being invested in purely domestic opportunities provides India's Venture Capital Industry for the coming year is relatively positive.

JEL Classification: G24, G23, O31

Keywords: *Venture Capital, Investor Community, Innovations, Investments.*

1. INTRODUCTION

India has become one of the fastest developing nations in the new millennium. It is one of the hotspots for investment with reaping rich benefits. Beside the successful information technology, there is a huge potential for investment, growth and development in quite a few other sectors like pharmaceuticals, Telecommunications, Healthcare, Electronics, Food Processing and Business Process Outsourcings (BPOs). The competitive edge of India over other developing countries like China, Russia etc, lies in its huge skilled human capital and knowledge entrapped in the research laboratories. There should be a form of finance that links all the available resources for exploration and effectual utilization. This connection is available in numerous forms such as bank loans, private debt, equity, bonds etc.; however each of them has their own pros and cons which lead to inapplicability under different contexts. Development in the high growth sector needs not only high technology and huge capital but also the ability to take enormous risks. Venture capital is the vehicle that suits this role. Venture capital has been considered as the engine of economic growth and for promoting equitable development through knowledge based enterprise. Venture capital industry plays a significant role in technological and economic escalation of economy through its direct involvement in the development of wide variety of knowledge-intensive enterprises. (Srinivas K T, 2013).

2. CONCEPT OF VENTURE CAPITAL

The term venture capital comprises of two words that is "Venture" and "Capital". Venture is a course of processing, the outcome of which is uncertain but to which is attended by the risk or danger of "loss". The term "Capital" refers to the resources to start the enterprise. However, the term venture capital can be understood in

two ways. According to narrow sense, the capital which is available for financing the new business ventures is called venture capital. Generally, it involves lending finance to the growing companies. In the broad sense, venture capital is the investment of long-term equity finance where the venture capitalist earns his returns primarily in the form of capital gain.

The organization that provides venture capital is called the venture capital firm or venture capitalist or venture capital fund. According to SEBI (Venture Capital Funds) Regulations, 1996, a *Venture Capital Fund* is a fund established in the form of a trust or a company including a body corporate and registered under these regulations that has a dedicated pool of capital raised in a manner specified in the regulations and invests in accordance with these regulations.

3. REVIEW OF LITERATURE

Gorman and Sahlman (1989) in their research article entitled "*What do Venture Capitalist do?*" identify that Venture Capitalists devote considerable time to monitor their Portfolio Companies.

Ray (1991) in his research paper entitled "*Venture Capital and Entrepreneurial Development in Singapore*", revealed there is a significant differences between the US and Singapore Venture Capital Market.

Gupta and Sapienza (1992) in their research paper "*Determinants of Venture Capital Firms Preferences Regarding the Industry Diversity and Geographic scope of their Investments*", try to identify some factors affecting VC's Preferences regarding industry and geographic scope of their investments.

Pandey (1998) in his research article entitled "*The*

Process of Developing Venture Capital in India” investigates the process of developing venture capital in India through TDICI.

Zider (1998) in his research paper entitled “*How Venture Capital Works*” there are four major participants in the venture capital industry, namely, the entrepreneur, the investor, the investment bankers and the venture capitalists.

Mayer, Schoors and Yafeh (2005) in their research paper compare VC fund investment focus and sources of finance across Germany, Israel, Japan, and the United Kingdom.

Rajan (2009) in his research paper entitled “*India Venture Capital and Private Equity*” taken VC/PE sample in India for the period 2004-2008. The results certain factors don't favours long term growth of VC industry in India.

Dheeraj Pandey and Thillai Rajan (2011) in their research paper entitled “*Empirical Study on Venture Capital and Private Equity Investments: US and India*” the study investigates dotcom influence on US VC industry, investment patterns comparisons across industries and exit strategies. The data analyzed also shows the attractiveness as well as immaturity of Indian VC industry.

Reddy and Subbaiah (2011) evaluate the performance of APIDC VCL in Venture Capital Financing.

Srinivas and N Nagaraja (2012) in their research study entitled “*Venture Capital in Karnataka*”; study covered total 13 venture capital firms and 21 of their funds located in Karnataka and addresses the growth and investment of venture capital companies and their funds and growth of venture capital market in Karnataka.

4. MATERIALS AND METHODS

Research Gap: Researcher found in the review of literature that, most of the studies on Venture capitalists decision making process, investment criteria, growth and investments of SEBI registered VC funds. So in this article an attempt is made to study the growth and investment of venture capital investments and their funds in India.

Objectives:

- To know the growth and amount of investment in terms of different sectors.
- To give a comprehensive picture of venture capital industry in India.

Scope of the Study: The data is collected from Venture Intelligence for the period 1998 to 2012 and also analyzed for the period of 15 years.

5. RESULTS AND DISCUSSION

To achieve the objectives researcher gathered the data from secondary sources from venture intelligence for the period 1998-2012 and used the statistical tools Standard deviation, Correlation for analysis.

6. INDIAN SCENARIO OF VENTURE CAPITAL INDUSTRY

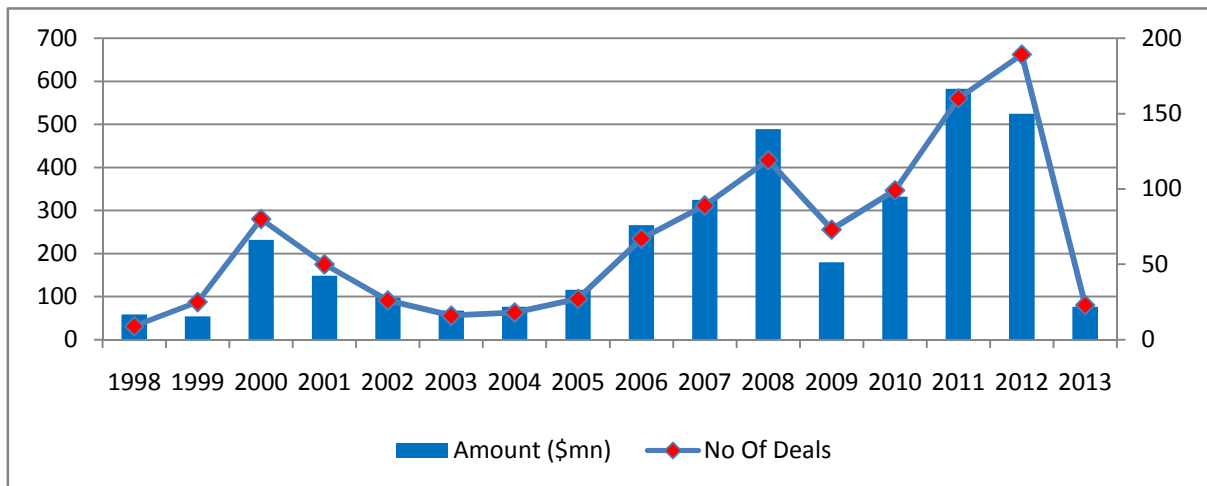
There is an impending demand for highly cost effective, quality products and hence the need for right access to valuable human expertise to guide and monitor along with the necessary funds for financing the new projects. With the advent of liberalization, India has been showing remarkable growth in the economy in the past 23 years. The Government of India is promoting growth in capacity utilization of available and acquired resources and hence entrepreneurship development capital.

Table 1: Investments and No. of Deals by Stage of Development

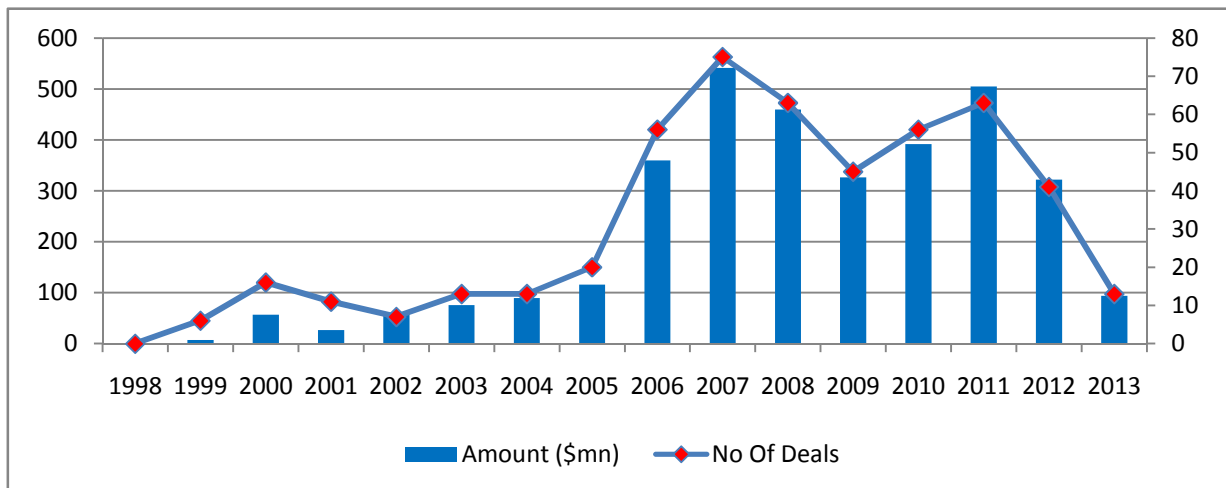
| Year | Early | | Growth | | Total | |
|-------------------------------------|--------------|---------------|--------------|---------------|--------------|---------------|
| | No. of Deals | Amount (\$mn) | No. of Deals | Amount (\$mn) | No. of Deals | Amount (\$mn) |
| 1998 | 9 | 58.4 | 0 | 0 | 9 | 58.4 |
| 1999 | 25 | 54.29 | 6 | 6.86 | 31 | 61.15 |
| 2000 | 80 | 231.72 | 16 | 56.69 | 96 | 288.41 |
| 2001 | 50 | 148.47 | 11 | 26.18 | 61 | 174.65 |
| 2002 | 26 | 98.44 | 7 | 57.4 | 33 | 155.84 |
| 2003 | 16 | 67.71 | 13 | 75.52 | 29 | 143.23 |
| 2004 | 18 | 76.43 | 13 | 89.16 | 31 | 165.59 |
| 2005 | 27 | 116.09 | 20 | 116.03 | 47 | 232.12 |
| 2006 | 67 | 266.07 | 56 | 359.49 | 123 | 625.56 |
| 2007 | 89 | 324.87 | 75 | 541.3 | 164 | 866.17 |
| 2008 | 119 | 488.77 | 63 | 459.67 | 182 | 948.44 |
| 2009 | 73 | 179.68 | 45 | 326.71 | 118 | 506.39 |
| 2010 | 99 | 331.94 | 56 | 391.97 | 155 | 723.91 |
| 2011 | 160 | 582.64 | 63 | 505.19 | 223 | 1087.83 |
| 2012 | 189 | 524.87 | 41 | 321.86 | 230 | 846.73 |
| 2013 | 23 | 76.65 | 13 | 93.7 | 36 | 170.35 |
| Average | 66.88 | 226.69 | 31.13 | 214.23 | 98.00 | 440.92 |
| Stdev | 53.90 | 177.39 | 25.05 | 193.48 | 74.13 | 354.71 |
| Median | 58.50 | 164.08 | 18.00 | 104.87 | 78.50 | 260.27 |
| Correlation No. of Deals and Amount | 97% | | 99% | | 97% | |

Source: IVCA, and TSJ Media 1998-2012

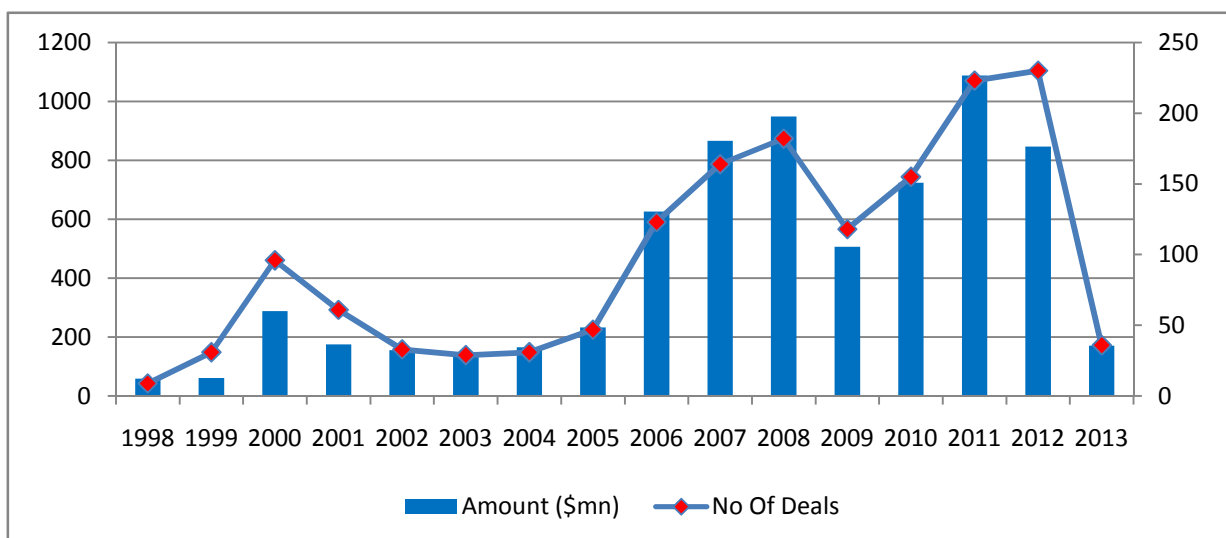
Graph 1: Investments and No. of Deals at Early Stage of Development



Graph 2: Investments and No. of Deals at Growth Stage of Development



Graph 3: Investments and No. of Deals Both Early and Growth Stage of Development



Investments and No. of Deals by stage of Development: Table-1 gives an account with regard to the amount of investments and number of deals at early and growth stages. It is clearly observed that investment and number of deals analysis of venture capital since 1998 to 2012 shows there is a strong relationship between the two variables. This means that changes in one variable are strongly correlated with changes in the second variable. We can conclude that there is a strong relationship between No. of deals and Amount of Investments.

Table 2: Venture Capital Investments by Region/Location

| Year | Regions (Amount US \$) | | | | | |
|-------------------------------------------|------------------------|---------|-------|---------|---------|----------|
| | North | South | East | West | Central | Overseas |
| 1998 | 35.7 | 12 | 0 | 1.7 | 0 | 9 |
| 1999 | 0 | 29.63 | 0 | 31.52 | 0 | 0 |
| 2000 | 53.9 | 102.31 | 0 | 125.2 | 0 | 7 |
| 2001 | 15 | 109.35 | 0 | 52.65 | 0 | 2.5 |
| 2002 | 22.55 | 87.03 | .46 | 38.3 | 0 | 7.5 |
| 2003 | 30.4 | 78.74 | 0 | 34.09 | 0 | 0 |
| 2004 | 5.4 | 115.1 | 0 | 28.09 | 5 | 12 |
| 2005 | 45.9 | 113.84 | 1.6 | 70.78 | 0 | 0 |
| 2006 | 100.9 | 317.63 | 5.5 | 185.53 | 0 | 16 |
| 2007 | 88.74 | 345.1 | 31 | 337.33 | 0 | 49 |
| 2008 | 251.89 | 361.78 | 11.25 | 224.94 | 0 | 79.5 |
| 2009 | 92.96 | 230.09 | 0 | 124.74 | 11 | 45.6 |
| 2010 | 174.97 | 309.92 | 19.6 | 188.22 | 0 | 31.2 |
| 2011 | 362.01 | 375.46 | 8.19 | 260.22 | 9.5 | 55.45 |
| 2012 | 204.61 | 443.66 | 8.3 | 126.61 | 1 | 62.55 |
| Total Amount of Investments Million US \$ | 1484.93 | 3031.64 | 85.9 | 1829.92 | 26.5 | 377.3 |

Source: IVCA, and TSJ Media 1998-2012

Descriptive statistics:

| | North | South | East | West | Central | Overseas |
|---------|---------|---------|-------|--------|---------|----------|
| Min | 0 | 12 | 0 | 2 | 0 | 0 |
| Max | .7362 | 444 | 31 | 337 | 11 | 80 |
| Mean | 99.07 | 202.13 | 5.73 | 122.07 | 1.80 | 25.20 |
| Median | 54.00 | 115.00 | .0 | 125.00 | .0 | 12.00 |
| Std.dev | 105.140 | 143.538 | 9.091 | 99.237 | 3.764 | 26.652 |

Venture Capital Investments by Region/Location: From a geographic point of view, the south area of India continues to absorb most venture capital investments. In the last fifteen years, south region attracted USD 3031.64 million, north region attracted USD 1484.93 million, East region attracted USD 85.9 million, West region attracted 1829.92, and central region attracted 26.5 million and 377.3 million. The most popular industries for investors in the south region are IT & ITES, Health care and life science, education, FMGC and other services. There are fewer investments in the central region, which is not perceived as presenting startup companies with the proper conditions for eventual commercial success.

Table 3: Sectoral Venture Capital Investments in India

| Industrial Sectors | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|------------------------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|-------|
| Advertising & Marketing | 0 | 0 | 0 | 0 | 2.3 | 0 | 0 | 2 | 0 | 10 | 1 | 0 | 0 | 0 | 23.5 |
| Agri-business | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 5 | 0 | 18.09 | 1.57 | 5 | 6.22 | 8.5 | 12.5 |
| BFSI | 0 | 1.95 | 25.01 | 8.21 | 0 | 0 | 15.42 | 20.1 | 11.16 | 68.59 | 73.31 | 27.6 | 51.79 | 74.88 | 57 |
| Diversified | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Education | 0 | 0 | 3.1 | 0.3 | 0 | 0 | 0 | 0 | 1.13 | 21.59 | 40.44 | 22.93 | 63.49 | 32.52 | 77.28 |
| Energy | 20 | 0 | 6.1 | 0 | 0 | 10.02 | 0.6 | 3.74 | 22.65 | 15.8 | 93.79 | 43.15 | 56.51 | 124.21 | 61.5 |
| Engg. & Construction | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 7 | 7.3 | 0.6 | 21.07 | 22.71 | 23.7 | 18 | 0 |
| FMCG | 0 | 3.6 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 2.5 | 2 | 0 | 0 | 5 | 10 |
| Food & Beverages | 0 | 12.24 | 1 | 5.2 | 15 | 1.5 | 0 | 4.5 | 16.5 | 26.76 | 1 | 5.75 | 3.29 | 14.4 | 22.2 |
| Gems & Jewelry | 0 | 0 | 1.75 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Healthcare & Life Sciences | 0 | 1.25 | 3.5 | 5.61 | 0 | 0.64 | 8.2 | 11 | 35.65 | 98.36 | 54.25 | 32.88 | 70.91 | 112.36 | 107.3 |
| Hotels & Resorts | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 15.78 | 4 | 15.4 | 16 | 0 | 0 |
| IT & ITES | 3766 | 3775 | 20726 | 12702 | 11988 | 1125 | 1238 | 13685 | 40861 | 45117 | 49236 | 24087 | 27705 | 56022 | 3927 |
| Manufacturing | 0.74 | 1.06 | 0 | 0.67 | 0.01 | 0.52 | 0 | 6.6 | 40.6 | 10.6 | 37.1 | 12.26 | 11 | 5.82 | 2.8 |
| Media & Entertainment | 0 | 0 | 3.6 | 3.62 | 17.55 | 18.05 | 1.3 | 7 | 25.3 | 33.9 | 43.02 | 22.62 | 32.34 | 13.5 | 2 |
| Mining & Minerals | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Services | 0 | 0 | 1 | 4.1 | 0 | 0 | 2.4 | 11.2 | 17.79 | 15.89 | 19.95 | 11.63 | 55.75 | 36.13 | 24.95 |
| Real Estate | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Retail | 0 | 0 | 9.4 | 0 | 0 | 0 | 13.87 | 9.13 | 19.72 | 29 | 21.78 | 1.8 | 14.76 | 11 | 0 |
| Shipping & Logistics | 0 | 0 | 7.71 | 19.92 | 1.1 | 0 | 0 | 1.5 | 4.83 | 0 | 33 | 16.06 | 35.6 | 16.34 | 26 |
| Sports & Fitness | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1.1 | 0.5 | 0.85 | 0 | 1 | 0 |
| Telecom | 0 | 0 | 18.3 | 0 | 0 | 0 | 0 | 0 | 13.32 | 26.44 | 7.3 | 16.48 | 5.5 | 5.6 | 0 |
| Textiles & Garments | 0 | 3.3 | 0.68 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 6 | 0 | 25.35 | 27 |
| Travel & Transport | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6.5 | 0 | 20 | 0 | 2.4 | 0 | 23 | 0 |
| Total Investments in Million US \$ | 584 | 61.15 | 28841 | 17465 | 15584 | 14323 | 16559 | 23212 | 62556 | 86617 | 94844 | 50639 | 72391 | 108783 | 84673 |

Source: IVCA, and TSJ Media 1998-2012

Sectoral Investment of Venture Capital in India: The total Venture Capital investment in India has been classified into various industrial sectors which lie in both services related and manufacturing related sectors. From Table-3 it is shows

that venture capital is directly moving towards the services related industries such as IT & ITES, Education, media, telecommunications, health care & life sciences, and other services that have a major share in concreting share of venture capital in emerging service sectors.

Table 4: Top Venture Capital Exits

| TOP VC Exits via. M&A | | | |
|----------------------------------|-------------------------------------------------------------------------|----------------------------|------------------|
| Portfolio Company | PE Firm(s) | Deal Amount (US\$M) | Deal Date |
| Neuland Laboratories | ICICI Venture | 0.28 | Nov-2001 |
| Spectramind | ChrysCapital | 60.49 | Jul-2002 |
| Jareva Technologies | JumpStartUp | 62 | Dec-2002 |
| HDFC | Warburg Pincus | 57 | Jun-2003 |
| HDFC | Warburg Pincus | 38 | Jul-2003 |
| Baazee.com | ChrysCapital, ICICI Venture, Others | 50 | Jun-2004 |
| RPG Cellular | IIML | 22.6 | Jan-2004 |
| i-flex Solutions | Citi | 593 | Jul-2005 |
| Edelweiss Capital | Connect Capital | 12 | Oct-2005 |
| Firstsource | ICICI Venture | 29.85 | Dec-2006 |
| OysterBay | ICF Ventures | 2.5 | Mar-2006 |
| Sundaram Home Finance | IFC, FMO | 25 | Feb-2007 |
| Nipuna Services | Intel Capital, Olympus Capital | 163.6 | Sep-2007 |
| Excel-soft Technologies | UTI Ventures | 31 | Apr-2008 |
| Subhiksha Trading Services | ICICI Venture | 56 | Sep-2008 |
| Telsima | NewPath Ventures, JAFCO Asia, CMEA Ventures, NEA, Intel Capital, Others | 12 | Mar-2009 |
| Learning Mate Solutions | Carlyle | 10 | May-2009 |
| i-mint | ICICI Venture | 22.5 | May-2010 |
| Basix | IFC, ICICI Venture, ShoreCap International | 18 | Jul-2010 |
| TutorVista | Sequoia Capital India, Lightspeed Ventures | 127 | Jan-2011 |
| Gluster | Nexus Ventures | 50 | Oct-2011 |
| Manthan Systems | ePlanet Ventures, IDG Ventures India | 13.5 | Feb-2012 |
| NewsWire18 | Capital18 | 17 | Dec-2012 |
| HHV Solar | SIDBI VC | 1.8 | Jan-2013 |
| Transpole Logistics | Fidelity Growth Partners | 14 | Jan-2013 |
| | Mean | 59.56 | |
| | Stand. Dev. | 117.448 | |

| TOP 5 VC Exits via. IPO | | | |
|--------------------------------|-------------------------------------------------------------------------|-------------------------------|------------------|
| Portfolio Company | PE Firm(s) | Size of the IPO(US\$M) | Deal Date |
| SKS Microfinance | Sequoia Capital India, Unitus, Samaa Capital, Kismet Capital, Sandstone | 359 | Aug-2010 |
| OnMobile | Goldman Sachs, Polygon Investment Partners, Argo Global | 124 | Jan-2008 |
| Firstsource | Temasek, Sequoia Capital India | 100 | Feb-2007 |
| Sequans Communications | Reliance Venture | 77 | Apr-2011 |
| YES Bank | Citi, ChrysCapital, AIF Capital | 73.3 | Jun-2005 |
| | Mean | 146.66 | |
| | Stand. Dev. | 120.430 | |

Source: IVCA, and TSJ Media 1998-2012

VC Exits: From the above table it shows the exit routes of venture capitalists and their portfolio companies through Mergers and Acquisitions and IPO. Strategic buyers are a more likely exit route for Indian VC backed companies than IPOs. The very low level of IPO exits (both in 2011 and 2012) reflects the absence of a junior stock market.

Exits are a combination of fresh investment by new VC funds and strategic M&A, with a bias towards the latter because strategic deals tend to command higher valuations.

7. CONCLUSION

2012 and 2013 was a challenging year for Venture capital investment. Both the amounts raised and the number of

rounds declined to their lowest point since 2009. At every level, the market came under pressure from the ongoing tough exit environment. This was reflected in a drop in

the number of VC-backed initial public offerings (IPOs) and mergers and acquisitions (M&A) exits, and VC funds again reduced activity in early-stage investment. However, Angel investors and Crowd funding platforms continued to step up their involvement to fill the gap at the start-up stages left by VCs, which moved toward later-stage, high-growth ventures.

VC industry key growth drivers include high GDP growth, a growing middle class, a large and vibrant entrepreneurial ecosystem, entrepreneurs and fund managers paying increased attention on early-stage investments, and the emergence of a domestic network of angel funds. Thus, both demand and supply side factors should support healthy activity in the industry.

The growth of India's investor community and the resulting increase in the amount of capital being invested in purely domestic opportunities provides India's VC industry for the coming year is relatively positive.

8. REFERENCES

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