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## VENTURE CAPITAL IN KARNATAKA

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### ABSTRACT

India is the fastest-growing Venture Capital market in Asia and fastest developing nations in the new millennium. It is one of the hotspots for investments with reaping rich benefits. In that, Karnataka happens to be the state where it has been observed that, before the information technology (IT) revolution since 1995 onwards; there were negligible diffusion of venture capital funding, predominantly having an agro-based economy, Karnataka has shifted their focus from Agriculture to IT and IT enabled services as it started enjoying the benefits during the second-generation reforms starting from 1995 onwards. From the review of different literature and statistical data, it can be inferred that with higher human capital and social capital, Karnataka is exploring the venture capital market extensively. (C.K .Nath) In this context, we made an attempt to study the growth and investment of venture capital companies and their funds.

**Key words:** Venture Capital, Seed Corn Capital, etc.

### INTRODUCTION

Karnataka is one of the high economic growth state and is considered as a pioneer in the field of industrialization in India. Karnataka is best known for its software industry and now biotechnology and the state has recorded the highest growth rates in terms of GDP and per capita GDP in the last decade compared to other states. The state has been in the forefront of industrial growth of our country since independence. In the era of economic liberalization since 1991, the state has been spearheading the growth of Indian industry, particularly in terms of high-technology industries such as Electrical and Electronics industries, Information & Communication Technology (ICT) industries, Biotechnology industries and more recently in terms of Nanotechnology industries. However, the industrial structure of Karnataka presents a blend of modern high-tech capital goods and knowledge intensive industries on the one hand and traditional consumer goods industries on the other.

The growth of venture capital in some of advance states of India where VCF (Venture Capital Fund) has taken place in large numbers. Maharashtra is leading in terms of venture capital movement followed by Gujarat, Tamilnadu, and Karnataka.

Bangalore has rapidly made the transition to the new economy in Information Technology (IT). Bangalore plays a prominent role in international electronics, telecommunications and information technology contributing almost 40% of India's production in high technology industrial sectors. Bangalore is home of the corporate giants in IT and ITES (Information Technology enabled Services) like Infosys, Wipro, IBM, Compaq, HTMT, Siemens. E&Y, etc. Karnataka's IT industry is mostly concentrated in and around Bangalore; hence popularly nick named as “Silicon City”. Karnataka's software industry has shown a steady and high growth rate in comparison with other states in the country.

The several international-standard research institutes, the entrepreneurial spirit, pro-active policies by the Central and State Governments, the cultural and economic milieu of a high-tech city are all ingredients for the success Bangalore's IT and ITES industry.

## **VENTURE CAPITAL**

Venture Capital refers to the commitment of capital as shareholding, for the formulation and setting up of small firms specializing in new ideas or new technologies. It is not merely an injection of funds into a new firm, it is a simultaneous input of skill needed to setup the firm, design its marketing strategy and organize and manage it. It is an association with successive stages of firm's development with distinctive types of financing appropriate to each stage of development.

Venture capital is the support by investors of entrepreneurial talents with finance and business skills to exploit market opportunities and thus obtain capital gains. Venture Capital commonly describes not only the provisions of start-up finance or 'seed corn' capital but also development of capital for later stages of business. A long-term commitment of funds is involved in the form of equity investments, with the aim of venture capital gains rather than income, and active involvement in the management of customer's business.

Venture capital financing means providing a proper mix of medium and long-term investments in high-risk industrial projects with high reward possibilities. It may be at any stage of implementation of the project or its production cycle viz., to start-up an economic activity or an industrial or commercial project or to improve a process or a product in an enterprise associated with both risk and reward. Medium-term refers to a period ranging between 3-5 years and 'long-term' covers a period of 5-15 years.

**International Finance Corporation. Washington, (IFC)** defines Venture Capital as equity or equity-featured capital seeking investment in new ideas, new companies, new products, new process or new services that offer the potential of high returns on investment. It may also include investment in turnaround situations.

## **AIM OF THE PAPER**

This paper is designed to provide a comprehensive picture of venture capital industry in Karnataka.

**Statement of the Problem** Karnataka is shifting its focus from Agriculture to IT; in this context study recognizes to know the Growth of venture capital investments in Karnataka.

**SCOPE OF THE STUDY**

The present study is confined to venture capital firms located in Karnataka under the registration of SEBI and functioning in Karnataka. At present as on May 30, 2012, total 13 venture capital firms and 21 of their funds located in Karnataka.

**OBJECTIVES OF THE STUDY**

1. To study the Growth of venture capital funds in Karnataka
2. To study the total investment of venture capital firms in Karnataka
3. To know the individual investment of venture capital firms in Karnataka
4. To know the sector which gains more importance in investments of VC in Karnataka
5. To study which stage venture capitalists are financing more in Karnataka
6. To offer suggestions based on the findings of the study.

**Data collection**

The data collected for a period of 13 years between 1998 to Nov 2012, from all the venture capital firms Registered under SEBI, functioning in Karnataka.

**Sources of Data**

Primary data Collected through questionnaire, interview method and Secondary data from venture intelligence, company website, company’s magazines, and other relevant documents.

**Sampling**

In this study data is collected from the entire population i.e. VC firms which are functioning in Karnataka under SEBI guidelines. And Red wood Capital, Spice Capital Fund, High Street Venture Capital funds transactions not found .

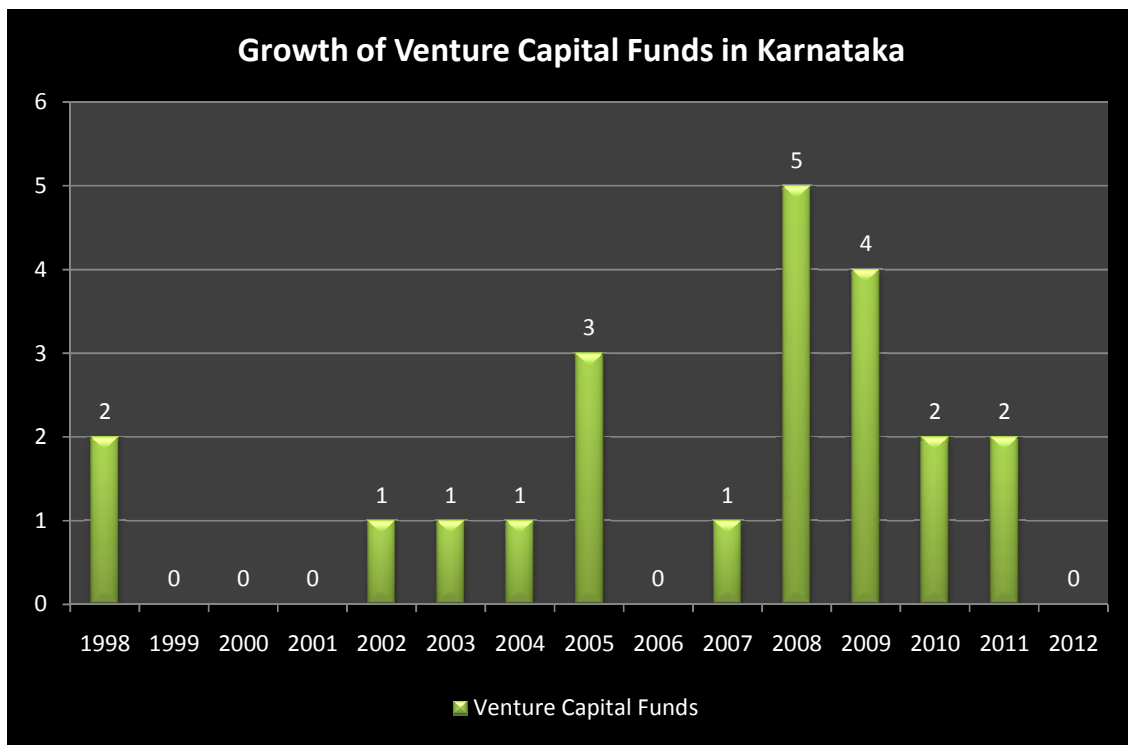
**ANALYSIS PART**

**Growth of Venture Capital Funds in Karnataka as on May 31<sup>st</sup> 2012**

Sl.No.	Name of venture capital Fund	Year of Registration
1	KITVEN Fund	1998
2	Canbank Venture Capital Fund	1998
3	India Advantage Fund I	2002
4	India Advantage Fund	2003
5	Spice Capital Fund	2004
6	India Advantage Fund III	2005
7	India Advantage Fund IV	2005
8	India Advantage Fund V	2005
9	Foot Print Venture Capital Fund	2007
10	India Advantage Fund S31	2008
11	Forum Synergies India Trust	2008
12	High Street Venture Capital Trust	2008
13	KITVEN Fund II	2008
14	ACA Private Equity trust	2008
15	Zephyr Peacock India II Trust	2009
16	PI Opportunities Fund I	2009
17	PI Opportunities Fund II	2009
18	India Value Fund IV	2009
19	India Advantage Fund RES2	2010
20	Red Wood capital Trust	2011
21	Karnataka Venture Capital Fund	2011

**Analysis**

The Genesis of Venture Capital in Karnataka started in 1998, with only two venture capital funds namely KITVEN and Canbank Venture Capital fund. However another three years Venture Capital didn't see any rise in Karnataka. In 2002, 2003 and in 2004, there was only a marginal increase in their number. Due to tremendous growth in IT and ITES sectors in Karnataka, especially in Bangalore, three venture capital firms started its operations in 2005, totaling the number to 8. After 2005, the Venture Capital sector, started gaining momentum and reached its peak in 2008 and 2009. By the end of December 2009, there were totally 18 venture capital firms, registered as per SEBI guidelines and functioning in Karnataka. Global recession after 2009, has affected the growth of venture capital. As a result, it could be noticed that in 2010, there was only one venture capital firm and in 2011 only two venture capital funds started their operations in Karnataka. 2012, didn't witness any growth in venture capital.



**Inference**

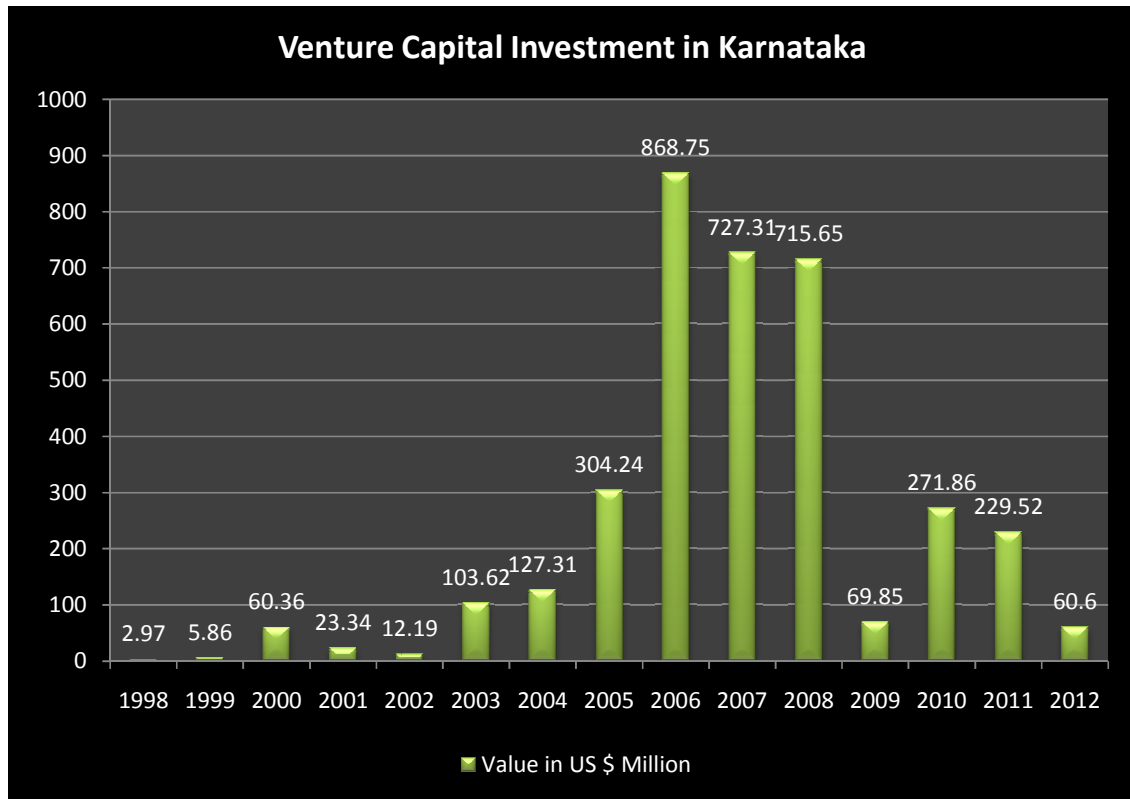
It is clearly evident from the above graph that, venture Capital made its beginning in Karnataka only after 1998. Another three years i.e., from 1998 to 2001, Venture capital didn't see any rise. But Growth of IT and ITES sector contributed tremendously for the growth of Venture Capital in Karnataka. As it is depicted in the above graph, in 2002, 2003 and 2004 there were one venture capital fund started respectively. However, after 2005, the growth of Venture Capital accelerated and in 2008 alone five companies started their operations. Similarly in 2009, 2010 and in 2011, four, two and two venture capital companies were started respectively.

Investments of Venture Capital Firms in Karnataka as on 30<sup>th</sup> Nov 2012

Year /VC firm	kitve n	UTI	ICICI	2i Capital	PI opp.	India value fund	Ascent capital	Can bank	Footpr int	Forum synergies	Kazei n trust	Zephyr peacock	Total
1998			2.97										2.97
1999	0.1		5.76										5.86
2000	0.22		60.14										60.36
2001	1.27	4.3	12.48			4.15							23.34
2002		0.69	7.5			4							12.19
2003		11.35	81.29			8							103.62
2004		3	91.97			32.34							127.31
2005		43.77	202.62			57.85							304.24
2006	1.24	65.5	193.37	595.18		11						2.46	868.75
2007		176.3	513.3		3.78	12.27			4.34			17.32	727.31
2008		119.9	211.4		199	177.5			2.85			5	715.65
2009	0.52				0	69.33							69.85
2010	1		31		43	38.82	134		9.04			15	271.86
2011	1.1	37.44	105.83			20	43	2	1		7.15	12	229.52
2012					25		10	7		3	3.6	12	60.6
Total	5.45	462.25	1519.63	595.18	270.78	435.26	187	13.12	17.23	3	10.75	63.78	3583.43

**Analysis**

The above table represents the total investments of venture capital firms in Karnataka from 1998 to 2012. Total investments made by these firms are 3583.43 US \$ Million as on Nov 2012. In that, ICICI venture invested maximum amount in Karnataka. Maximum amount of investment was made in 2006, and second largest investments in 2007 and 2008 witnessed the third highest investments. This clearly indicates that there is a growing tendency and shift, in financial institutions moving from the principles of ‘Safety’ towards, risk takers. Priority will be given to financial viability of the project and its future capital gains and appreciations rather than Safety and immediate returns from the fund.



**Inference**

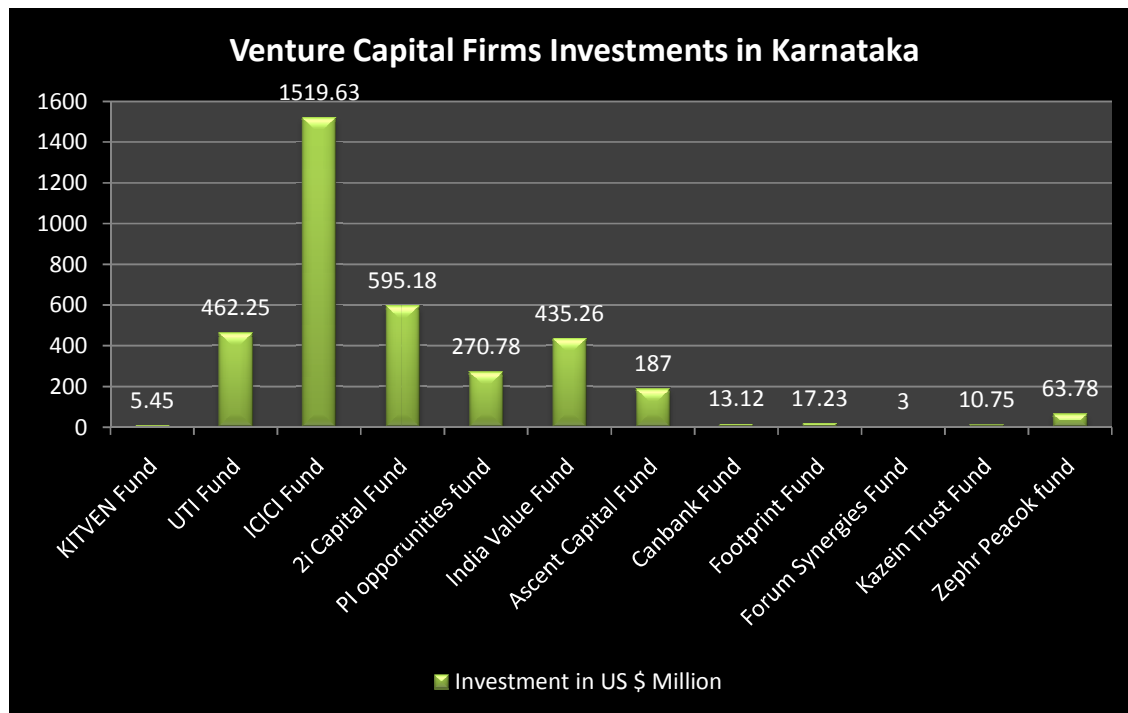
The above diagram depicts the investment made by Venture Capital firms in Karnataka, during various years. As it is evident, during 1998, it was as low as 2.97 million US \$ and it was maximum during 2006, amounting to 868.75 million US \$. Venture Capital necessarily does not mean, merely injecting funds into a new firm, it is a simultaneous supply of inputs such as skill, needed to setup the firm, designing its marketing strategy, organizing and managing it. Total investments made by these Venture Capital firms was 3583.43 US \$ Million, with in a span of 15 years. It is a clear indication that in this competitive world, new ideas, new companies, new products, new process or new services which offers the potential of high returns on investment, are encouraged more than time tested, well proven track record projects. Financial institutions also come forward to investment in such high risk projects, than ‘play safe’ strategy.

**INDIVIDUAL VENTURE CAPITAL FIRMS INVESTMENTS AS ON 30<sup>th</sup>Nov 2012**

Venture Capital Firm	Amount of Investment (US \$ Million)
Kitven	5.45
UTI	462.25
ICICI	1519.63
2i Capital	595.18
PI opp.	270.78
India value fund	435.26
Ascent capital	187
Can bank	13.12
Footprint	17.23
Forum synergies	3
Kazein trust	10.75
Zephyr peacock	63.78
<b>Total</b>	<b>3583.43</b>

**Analysis**

The above table shows the total amount of finance, invested by various Venture Capital firms from 1998 to 30<sup>th</sup> November 2012. Totally 3,583.43 million US \$ has been invested in Karnataka so far. ICICI heads the race, with a total investment of 1,519.63 million US \$, whereas 2i Capital occupies the 2<sup>nd</sup> place with an investment of 595.18 million US \$. UTI, India Value fund occupies 3<sup>rd</sup> and 4<sup>th</sup> place respectively. Despite global recession, India could record a growth rate of 5.3 % in her GDP, which opens up wider horizons for Venture Capital.



**Inference**

This diagram shows the share of different Venture Capital companies during 1998 to 2012. While ICICI fund contributed largest towards Venture Capital, 2i Capital fund comes after that. UTI fund and India Value fund and PI Opportunities Fund occupy the later spots respectively. Totally 3,583.43 million US \$ has been invested in Karnataka during 1998 to 2012. Global recession has adversely affected the Venture Capital investment in Karnataka. Never the less, this is an effect of trade cycle and after recession and depression, economy will surely recover and reaches prosperity. Hence recession stage is not permanent. Looking into the future prospects, Venture Capital has wider scope.

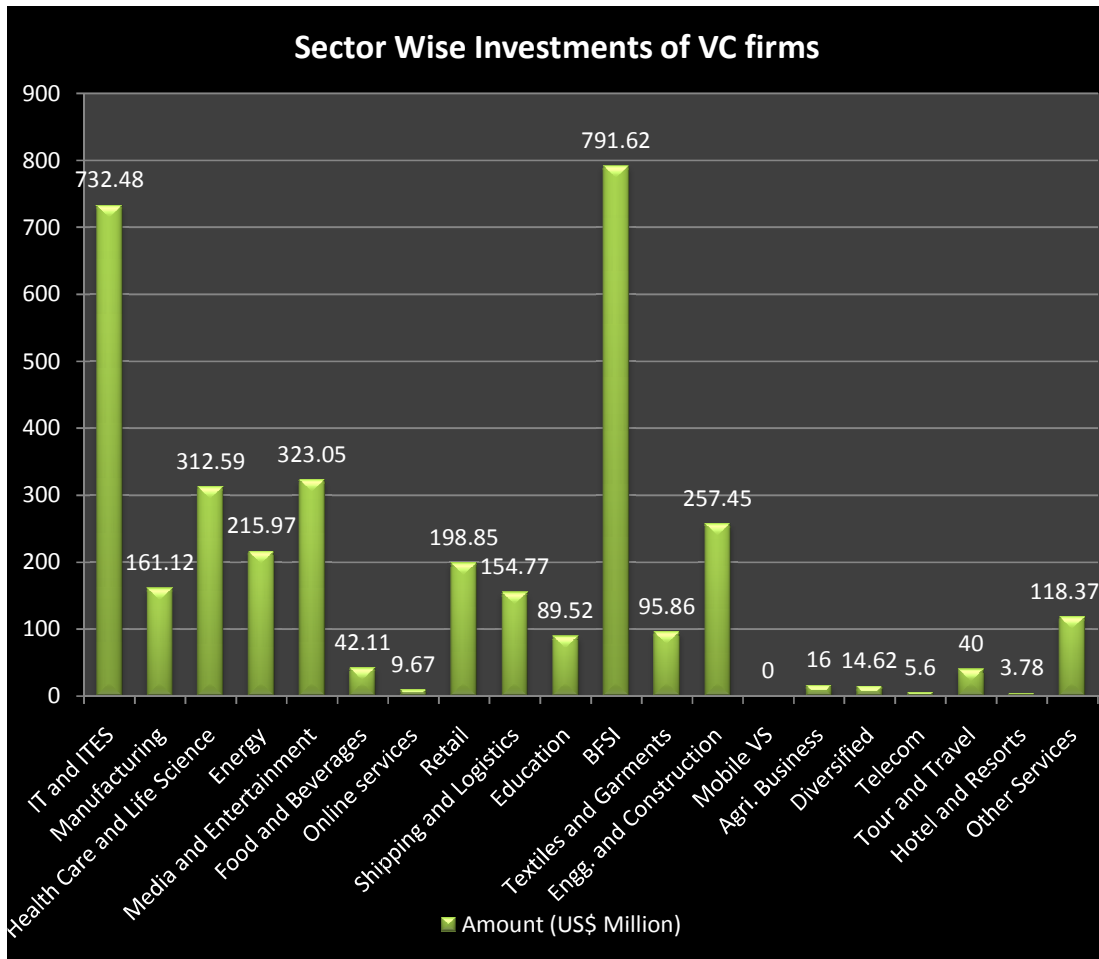
**Sector wise investments of VC firms as on 30<sup>th</sup>Nov 2012**

Sectors	Amount (US \$Million)	Percentage
IT and ITES	732.48+NA	20.44
Manufacturing	161.12+NA	4.49
Health Care and Life Science	312.59+NA	8.72
Energy	215.97+NA	6.03
Media and Entertainment	323.05+NA	9.02
Food and Beverages	42.11	1.18
Online services	9.67	0.27
Retail	198.85	5.55
Shipping and Logistics	154.77	4.32
Education	89.52+NA	2.49
BFSI	791.62	22.1
Textiles and Garments	95.86	2.68
Engg. and Construction	257.45	7.18
Mobile VS	NA	NA
Agri. Business	16	0.45
Diversified	14.62	0.41
Telecom	5.6	0.16
Tour and Travel	40	1.12
Hotel and Resorts	3.78	0.11
Other Services	118.37	3.30
Total	3583.43	100

**Analysis**

The above table shows the sector wise investment of Venture Capital in Karnataka. Banking, financial Services and Insurance sector is the largest beneficiary of Venture Capital with a share of 22.1%. After BFSI, IT and ITES sector, is the second largest recipient with a total share of 20.44 %. Media and Entertainment stood at third place with an investment of 323.05 million US \$, making it 9.02 %. Health care and Life Sciences attracted 8.72% of the total share.





**Inference**

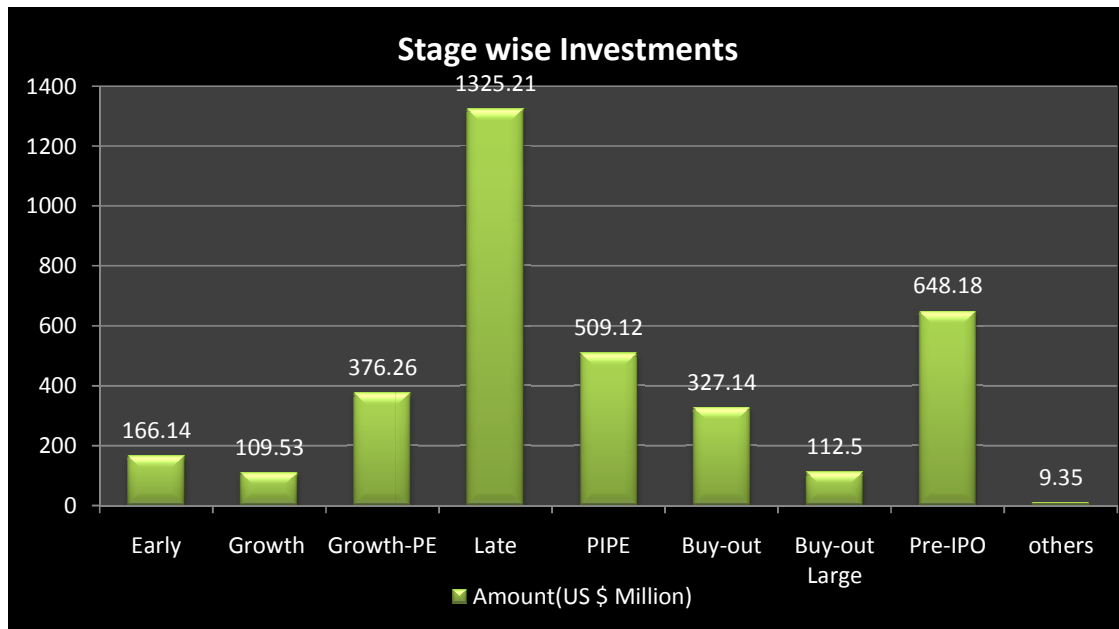
The above diagram states that BFSI sector (Banking, Financial Services and Insurance), attracted the maximum share of Venture Capital during 1998 to 2012 followed by IT and ITES sector. Media and entertainment, Health Care and Life Sciences were the most preferred sectors after BFSI and IT and ITES.

**Stage wise investments as on 30<sup>th</sup>Nov 2012**

Stage	Amount(US \$ Million)	Percentage
Early	166.14	4.64
Growth	109.53	3.06
Growth-PE	376.26	10.5
Late	1325.21	36.98
PIPE	509.12	14.21
Buy-out	327.14	9.13
Buy-out Large	112.5	3.14
Pre-IPO	648.18	18.09
others	9.35	0.26
Total	3583.43	100

### Analysis

The above table represents the stage wise investment of Venture Capital. Investors showed more interest in investing in Late stage of the company i.e., when an existing company opts for expansion and diversification of their regular product and services. Later investor prefers to invest during Pre-IPO stage, as it offers better stability and financial strength of the company.



### Inferences

Diagram reveals that investors preferred to invest in Late Stage than in the Early Stage. Pre-IPO stage was the most preferred stage to invest after Late Stage, as it offers higher stability and returns.

### FINDINGS

1. The Genesis of Venture Capital in Karnataka started in 1998.
2. Karnataka shifted their focus from Agriculture to IT and IT enabled services.
3. Karnataka is exploring the venture capital market extensively because of human and social capital.
4. Karnataka, particularly Bangalore city is in the 4<sup>th</sup> place in attracting venture capital fund in India.
5. KITVEN and Canbank are the first VC firms were started functioning in Karnataka.
6. Total 21 registered venture capital funds are functioning in Karnataka.
7. Total 13 venture capital firms are registered under SEBI guidelines and functioning in Karnataka.
8. Total investments made by VC firms are 3583.43 US \$ Million as on Nov 2012.
9. Maximum amount of investment was made in 2006, and second largest investments in 2007 and 2008 witnessed the third highest investments by VC firms in Karnataka.
10. ICICI heads the race, with a total investment of 1,519.63 million US \$, whereas 2i Capital occupies the 2<sup>nd</sup> place with an investment of 595.18 million US \$. UTI, India Value fund occupies 3<sup>rd</sup> and 4<sup>th</sup> place respectively in Karnataka.

11. Banking, financial Services and Insurance sector (BFSI) is the largest beneficiary of Venture Capital with a share of 22.1%.
12. After BFSI, IT and ITES sector, is the second largest recipient with a total share of 20.44 %.
13. Media and Entertainment stood at third place with an investment of 323.05 million US \$, making it 9.02 %. Health care and Life Sciences attracted 8.72% of the total share.
14. Venture Capital Investors showed more interest in investing in Later stage of the company in Karnataka.

### **SUGGESTIONS**

1. Karnataka Government needs to promote capital market segment exclusively to knowledge sector. Since Karnataka has large number of knowledge workers with high per capital income, it is possible to develop such capital market activities in Karnataka.
2. The world is becoming increasingly competitive. The Government of Karnataka should make an attempt to bring the state at par and above the developed state by promoting venture capital financing to new, innovative concepts & ideas, and by liberalizing taxation norms, providing tax incentives to venture firms, giving a Philip to the creation of local pools of capital and holding training sessions for the emerging VC investors.

### **CONSLUSION**

Knowledge industry requires considerable risk capital. Venture capital funds can provide risk capital for knowledge industries. Compare to other states of India like Maharashtra, Gujarat, and Tamil Nadu the growth of venture capital in Karnataka is not up to the mark even though it has enough opportunities. Karnataka is having good number of Knowledgeable Human Resources; it requires risky capital i.e. Venture Capital to come up with knowledge industry. So State Government need motivate venture capitalists to function more and more in Karnataka. At last no doubt, in comparison with others states of India the growth of venture capital market in Karnataka are not so bad but scope for further improvement is plenty.

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