INDIAN PRIVATE EQUITY
& VENTURE CAPITAL ASSOCIATION

India Venture Capital and Private Equity Report 2010

The Contours of Smart Capital

An analysis of Venture Capital and Private Equity Investors in India during 2004 – 09

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RESEARCH PE INDIA

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Foreword

It has always been our endeavour at IVCA to provide timely insight for the Indian Private Equity and Venture Capital industry. Thus, it is with great pleasure, we collaborated with IIT Madras, and present the IVCA - IIT Madras Indian Venture Capital an Private Equity Report 2010 – ‘The Contours of Smart Capital’.

We believe the report is a must-have for all those prospecting in India, putting the current challenges and opportunities presented to the industry in perspective, along with a detailed analysis of investment trends according to stage, sector and players.

This is just one of the many measures IVCA is taking to promote the industry within India and throughout the world and encourage investment.

We trust that you find this report useful.

Mahendra Swarup

President – IVCA

Preface

We, along with the Indian Private Equity and Venture Capital Association (IVCA), are happy to present this second annual report on the Indian Venture Capital and Private Equity Industry. The annual report series, which was started as a pilot initiative last year, has been received well. The request for the 2009 report has come from all corners of the globe. We were encouraged by the strong response to our first report which in a way confirmed our belief that there is a need for a report of this nature to get a systematic understanding of the evolution of the Indian Venture Capital and Private Equity (VCPE) industry.

The main focus of this report is on the VCPE investors who have invested in India during the years 2004 – 2009, unlike the 2009 report which was focused more on the investments. With the Indian economy growing at an average annual rate of around 8 percent over the last five years and other macroeconomic factors and policies favorably complementing the growth, India has emerged as an attractive investment destination. Global investors looking for investment opportunities in emerging markets in order to tap the growth potential as well as to diversify and mitigate their risk are getting increasingly attracted to Indian markets. Consequently India's share in global pool of private equity investments is steadily rising.

While research on the Indian VCPE industry has been limited, studies on the VCPE investors themselves have been even scarce. We hope that this report will fulfill a strong need among the entrepreneurs to know more about the VCPE investors. The analysis of 338 investors and 1,870 investments highlight interesting aspects of the Indian VCPE industry. What categories of investors are driving the growth in investments? What sectors are they investing in? How inclusive are their investments? How consistent are the investors in making their investments? These are some of the questions for which we provide some answers in this report. We hope you will find the results and analysis both interesting and insightful.

We thank all those who have constantly encouraged and urged to continue our efforts. Specifically, we would like to acknowledge the support from Prof. C. Rajendran, Head, Department of Management Studies, and Prof. L. S. Ganesh, Professor in charge, C-TIDES to all our activities. We would also like to acknowledge the support of the research scholars M.B.Ragupathy and Dheeraj Pandey for their background research support. We thank Santhosh Kumar for his support in the production of this report and taking care of all the logistics. We gratefully acknowledge the financial support received from IIT Madras and the Indian Council for Social Sciences Research (ICSSR) for this study and the preparation of this report.

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1.0 Overview of the 2009 Report

The 2009 report was the first report in the India Venture Capital & Private Equity Report series and was an outcome of a major research project undertaken at the Indian Institute of Technology Madras. It was one of the first comprehensive studies done on a large dataset on the Indian venture capital industry. The report was based on an analysis of 1713 Venture Capital and Private Equity (VCPE) transactions that were recorded during the five year period 2004 – 08. This section summarizes the key findings from the India Venture Capital & Private Report 2009.

1.1 Venture capital and private equity investments in India

VCPE investments in India had witnessed a phenomenal growth both in terms of amount invested (from $1.8 billion in 2004 to $22 billion in 2007 before tapering off to $8.1 billion in 2008) as well as the number of deals (from 80 in 2004 to 481 in 2007 and then slowing down to 297 in 2008).

- The VCPE investment activity in India was becoming more matured and broad based. While 4 out of 10 industry categories accounted for more than 80% PE investments in 2004; investments were much more evenly distributed across the 10 industry categories in 2008.
- There were huge PE investments in technology-led, capital intensive sectors like Telecom, Power and Infrastructure in addition to those sectors that were traditionally preferred by VCPE investors like IT & ITES, Healthcare, etc.
- The rate of growth in number of deals was consistently lower than the growth rate of amount invested.
- The overall inclination in VCPE investment was towards having lesser number of high quality deals of larger size and hence average amount per deal was rising steadily.
- Late stage and PIPE (Private Investment in Public Equity) deals had consistently accounted for a major share of VCPE investments over the five year period with late stage deals being the least affected even in the period of economic downturn while early stage deals had suffered the most.
- Buyout investments were comparatively very few in India and constituted only 3% of total number of PE investment deals. The trend was also consistent across the industry categories except for IT & ITES.
- Majority of early stage investments were contributed by domestic investors while a large share of PIPE and buyout investments was funded by foreign investors probably suggesting the tendency by foreign investors to invest in established businesses.

The report also compared the trends in Indian markets vis-à-vis leading VCPE markets like US and UK. It was found that VCPE investments in India were much more uniformly distributed across different industries as compared to developed markets like US and UK where three out of ten industry classes accounted for more than 70% investments.

- As far as Y-o-Y growth in VCPE investments were concerned, India had experienced extremely high growth rates of 379% and 118% in 2006 & 2007 respectively followed by steep decline of 63% in 2008. The corresponding rise and fall in investments was relatively moderate in the US.

- Indian VCPE investments with a CAGR of 47% during 2004-2008 (i.e. even after considering the severe negative growth in 2008) were one of the highest in world. The CAGR in the US for the same period was just 6%.

- Nearly 70% of the VCPE investment deals in India were below $ 20 Million. This was quite similar to deal sizes in UK where 77% of deals are below £10 Million. Also only 5% of the deals in India were above $100 million.

- While VCPE investments in India as a percentage of GDP had grown from a mere 0.4% of GDP in 2004 to more than 1.5% of GDP in 2008, VCPE investments in US as a percentage of GDP was relatively constant and hovered around 0.7-0.8 % of GDP.

- There was a strong correlation between investments in VCPE markets and Capital markets. This trend was observed not only in developed markets like the US and UK but also in emerging markets like India and Brazil.

1.2 Investment lifecycle analysis

Main findings from the analysis of investment lifecycle and exits were:

- Though VCPE investments were considered as medium to long term investments, the average duration of VCPE investments in India was remarkably low i.e. 17 months. The average time interval between successive rounds of VCPE funding typically varied between 10-15 months.

- 82% of total amount invested by VCPE investors over the last five years in India were new or fresh investments thereby signifying very low proportion of follow-up investments which indicates the inclination of VCPE investors to continually look for newer high growth avenues and modify the investment choices accordingly.

- 1226 out of 1503 (or 81%) companies that received VCPE funding had received only one round of VCPE investment and only 79 (5%) companies had received more than two rounds of PE-VC funding.

- Our analysis revealed the propensity of VCPE investors to invest in well-established firms as nearly 50% of the investments were in companies that had been incorporated for at least 8 years.

- The overall ratio of IPO to M&A exits over the five year period was 0.5 and the trend was similar across industries with the exception of Engineering & Construction and Transportation & Logistics sectors. Year wise analysis also showed that the ratio varied from 0.3 to 0.6 for most of the years except 2006, probably owing to boom in Indian IPO markets in 2006-07.

- The average duration of investment in firms with IPO and M&A exits was found to be 12 and 23 months respectively.

- It was also observed that as many as 75% of growth stage investments have had exits in less than 2 years. The proportion of exits within 2 years from investments is 87% for late-stage funding.

- Analysis of firms with one or more rounds of VCPE funding during the last five years but no exits revealed that the time elapsed since last investment was more than 3 years for only 108 (or less than 10%) out of 1276 such firms, This may lead us to conclude that VCPE financed firms are doing reasonably well in India as the operations of two-third (866) of such firms were viable enough to attract VCPE funding at least once during the previous 24 months.

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2.0 Structure and Regulation of Venture Capital and Private Equity Funds

2.1 Structure of VCPE firms

VCPE firms are Investment managers that act as agents for investors such as High Net-Worth Individuals (HNIs) and institutional investors such as University Endowments, Foundations, and Pension Funds. The VCPE firms raise funds from these investors and in turn invest the funds raised in companies, which offer opportunities for attractive returns. Generally, the investment is made in equity or equity type instruments in private companies. The VCPE firms get their returns when they sell their investment either in a public offering of shares, or in an M&A transaction, or in a secondary sale of shares in a stock exchange after listing.

Generally, the capital is raised from investors for a specific fund, which has a specified life and investment objectives. The fund life, generally, is around 10 years which could be further extended up to 2 years. The investment objectives clearly indicate what type of companies and sectors would be fund invest in. At the end of the fund life or after an exit from an investment, the VCPE firms returns the capital to its investors along with the returns earned.

The fund is formed as a legal agreement in which the investors in the funds, such as wealth individuals or institutional investors are called as Limited Partners (LPs) and the fund managers in the VCPE firm are called General Partners (GPs). Such a partnership structure leverages the financial management and operational expertise of the GPs and the availability of capital from the LPs. Each investor in the fund has a liability that is limited up to the amount invested by them in the fund, and hence they are called LPs. The GP-LP is essentially a principal agent relationship, where the GPs (Agent) are the investment managers for the funds pooled by the LPs (Principal). Often GPs also contribute a portion of the fund capital so as to provide some form of assurance to the LPs on the quality of the deals that are going to be funded.

2.2 Limited liability partnerships

Most VCPE firms operate under a unique legal frame work known as the Limited Liability Partnership (LLP) framework. Though this is a generic framework for operating a business where its partners share a limited liability, VCPE firms have taken the advantage of this as it provides them the flexibility that is needed in operating in a high risk environment.

The Ministry of Corporate Affairs (MCA), Government of India, defines the Limited Liability Partnership (LLP) as “A corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in a flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership”.

It was felt that a legal framework for governing and regulating LLP’s would bring together a combination of entrepreneurs, knowledge and risk capital, which can then provide an impetus to the growth of the Indian economy. A major milestone was reached in January 2009, when the Limited Liability Partnership Act 2008 was enacted. Important features of this act include:

- The LLP is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement.

- The LLP will be a separate legal entity, liable to the full extent of its assets, while the liability of the partners would be to the extent of to their agreed contribution in the LLP. Also no partner would be liable on account of unauthorized action or misconduct of any other partner.

- The LLP shall be under an obligation to maintain annual accounts reflecting true and fair view of its state of affairs. A statement of accounts and solvency shall be filed by every LLP with the Registrar every year. The accounts of LLPs shall also be audited, subject to any class of LLPs being exempted from this requirement by the Central Government.

- The Indian Partnership Act, 1932 would not be applicable to LLPs

Thus the LLP framework helped HNIs, corporations, pension funds etc., to come together and pool money and invest in attractive opportunities. The capital gains or profits generated from such investments were than shared among the partners according to the agreement signed at the incorporation of the LLP. The legal framework protected the investors against double taxation in the form of corporate taxes paid by the firm invested in and again at hands of the individual partners. LLP structure has gained strong popularity and 2607 LLPs were registered by October 2010, within two years of enactment of the Act.[1]

2.3 Routes of VCPE investments in India

There are 4 major routes through which VCPE investments happen in India:

- The investor can register with SEBI (Securities Exchange Board of India) as a Domestic or Foreign Venture Capital Fund. This route provides for certain pass through tax benefits (No capital gain or with-holding tax on dividend). But it comes with some disadvantages that certain services of such funds are restricted as per the SEBI Regulations.

- Direct Investment in an Indian company from outside India. This is usually done through a Mauritius subsidiary. The Indian Mauritius Tax-treaty provides the benefit of charging no capital gain tax in either India or Mauritius on the sale of shares of the sale of shares of an Indian company by a Mauritius company.

- Investment in an Indian subsidiary of a US company. This is mainly done by US companies or investors who have set up their back end systems or support processes to cater to the front-end business in the US. Funding comes through Foreign Direct Investment (FDI) through the automatic route in sectors where 100% FDI is permissible.

- The 4th route is similar to that mentioned in point 2 where a US company invests in a subsidiary in India by routing the investment through a Mauritius subsidiary of the US company to avail tax benefits of the India-Mauritius Tax Treaty.

[1] http://www.llp.gov.in/aboutllp.htm, accessed on 26 October 2010.

2.4 Regulatory aspects of VCPE investments

The role of regulating VCPE activity in the country is being done by SEBI through the enactment of Securities and Exchange Board of India (Venture Capital) Regulations, 1996. Since the time of its enactment, the act has undergone amendments September 2006, March 2008 and April 2010, in addition to the numerous administrative circulars of SEBI. Recognizing the importance of Policy support, two advisory committees were appointed in 2000 and 2003 to identify critical areas of regulatory support. Following is the brief description of the policy environment relating to VC industry:

SEBI (Venture Capital Funds) Regulations, 1996

According to SEBI (Venture Capital) Regulations, 1996, a venture capital fund can be formed as a:

- Trust, registered under Indian Trusts Act, 1882 or
- Company, registered under Companies Act, 1956 or
- A body corporate, set up or established under the laws of the central or state legislature

In all forms, the main objective of the entity should be to engage in venture capital investment and the trust deed or the memorandum should explicitly state that [Section 4].

Fund generation

Investors can invite contribution to the pool either through private placement or through an agreement with investors for contribution or subscription. The minimum pool size for each fund is fixed at INR 50 million [Section 11(c)]. For the purpose generating the pool of fund for investment, a placement memorandum or contribution or subscription agreement with the investors needs to be issued, a copy of which should be filed with SEBI [Section 16]. The document shall contain information like, the details of the trustees, fund managers, fund size, duration of the fund, manner of subscription, investment strategies, tax implications to the investors [Section 17].

If the VC fund is formed as a company, the memorandum and articles of association should explicitly prohibit the firm from making an invitation to the public to subscribe to its shares [Section 4(a-ii)]. It may receive monies for investment through private placement of units [Section 15] and such units are not entitled for listing in any recognized stock exchange [Section 13].

Investment

Regulation 1996 makes it mandatory for the VC firm to disclose the investment strategy of the fund at the application stage itself [Section 12(a)]. It caps the investment in any one firm at 25% of the corpus [Section 12(b)]. A venture capital undertaking could be an Indian company or a firm registered in a foreign country. Firms not registered in India should with RBI regulations in addition to that of SEBI. Of the generated pool of capital, at least 66.67% should be invested in equities or equity linked instruments of unlisted entities [Section 12(d-i)]. Remaining 33.33% of the pool can be invested in:

- IPOs of venture capital undertakings
- Debt instruments of the portfolio firms

- Preferential allotment of equity shares of listed companies with one year lock-in period [Section 12(d-ii-c)]
- The equity shares or equity linked instruments of financially weak or sick companies whose shares are listed [Section 12(d-ii-d)]
- SPVs created by the firm in accordance with SEBI (VC) Regulations 1996 [Section 12(d-ii-e)]. Section 12 (c) prohibits investment in associate companies

Winding-up

Section (23) lists down the occasions under which a fund can be wound-up. The first and most obvious reason is the fund maturity as per the memorandum. Additionally, a fund can be wound-up on following occasions before the period of the scheme is over:

- In the opinion of the trustee / trustee company, it is beneficial for the investors to have the fund wound up
- 75% of the investors pass a resolution at a meeting of unit holders in support of winding up
- If SEBI so directs in the interest of the investors

If the fund is formed as a company or as a body corporate it would have to be wound-up in accordance with the respective act or the statute under which it is created. Once wound-up, no further investment can be made on behalf of the scheme and within 3 months, the scheme should be liquidated and proceeds distributed to the investors after meeting all liabilities.

Changes in the SEBI (Venture Capital) Regulations, 1996

Some of the major changes are listed below:

- The minimum investment size in the unlisted equities has been reduced from 75% of the investible funds to 66.67%, vide amendment in April 2004.
- Lock-in period of one year for the pre-IPO shares held by the VC fund is removed vide the above amendment.
- VC firms are permitted to invest in real estate companies, NBFCs and gold financing companies since April 2004 amendment.

Changes in other relevant legislations

Due to the sustained effort by the venture capitalists and the policy makers, other legislations that have an influence on the VC industry too were modified to stimulate the VC industry and the entrepreneurial initiatives in the country. Some of them are listed below:

- Securities transfer tax has been waived for shares transferred from a VC firm to the promoters or the company, if done as per a pre-existing agreement.

- Companies (amendment) Act, 2001 allowed fresh equity shares in six months after the company completes the buyback of shares. Earlier it was 24 months. It accelerated the additional capital generation by at least 18 months.

- Companies (Issue of Share Capital with Differential Voting Rights) Rule, 2001, allowed every company to have shares with differential rights in voting and dividend. This provision increases the flexibility of investor while structuring investment.

- In 2003, SEBI (DIP) Guidelines granted 'QIB' status to VC firms. This facilitated VC firms to subscribe to the IPOs of their portfolio companies.

SEBI (Foreign Venture Capital Investors) Regulations, 2000

SEBI brought out a separate regulation to enable foreign VC funds to invest in Indian entities. While most provisions in both SEBI (VC) Regulation, 1996 and the SEBI (FVCI) Regulations, 2000 are similar, certain changes are provided in the later regulation to accommodate and integrate foreign investors into the Indian system.

According to SEBI (FVCI) Regulations, 2000 a "foreign venture capital investor" means an investor incorporated and established outside India, is registered under the Regulations and proposes to make investment in accordance with the Regulations. An FVCI has to appoint a domestic custodian for the purpose of custody of securities. The domestic custodian would monitor the investment of FVCI in India and furnish periodic reports and other information as required to SEBI.

A foreign VC fund is exempted from the 25% cap on investment in a single VC undertaking through an Amendment in 2004. All other conditions on investment like the minimum 66.67% of the pool to be invested in unlisted equities, 33.33% on other securities of the funded ventures, lock-in period for preferential allotment, and investment in equities of listed but financially weak or sick companies remain the same as given in SEBI (VC) Regulations, 1996, for domestic VCs.

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3.0 Data and Analysis

3.1 Sources of data

The main data for the report was obtained from 3 database sources viz., Venture Intelligence India, Asia Venture Capital Journal (AVCJ) and ResearchPEIndia (RPE). A comprehensive dataset was then created for this report by integrating these databases. The comprehensive dataset thus created was then checked for consistency, duplications, and information gaps. Whenever there was a discrepancy in the data between the three databases, it was resolved by independently checking for data from other sources like the website of the investee company or the investors, or in the Internet. The dataset thus created contained a large amount of information on the investors such as the location of the investor, year in which they began operations, companies in which they have made investments, company stage in which they had invested, time of investment, investment amount, etc.

The list of registered foreign and domestic VC funds was obtained from the website of the Securities and Exchange Board of India (SEBI) and this was used in the classification of domestic and foreign investors. While all VC funds were not registered with SEBI, it was felt that those registered with SEBI would form a large proportion of those operating in India. For those funds that are not registered, we looked at their websites to classify them as either domestic or foreign investors. The database of RPE was used for an exhaustive list of VCPE Investors along with their official websites.

The dataset created also included information on the region of operation as well as the location of the registered office of the investee company. For those investments where this information was not available, we used the MCA21 Database of the Ministry of Corporate Affairs, Government of India to get this information. Though most of the region data was available in the Venture Intelligence India and AVCJ databases, the MCA21 Database was used to complete the missing data points.

We also referred to industry publications such as the Asia Private Equity Review as well as the VCPE related news in leading newspapers and magazines in our analysis.

3.2 Description of data

The report is based on the analysis of 338 VCPE Investors who had invested in as many as 1,870 deals during the period 2004-2009. Deal value of the investments was available for 309 investors for 1511 deals. While the data might not include all the investors or investments during the period, we believe it accounts for a significant proportion of investors operating and investments made during the period.

3.3 Data classification

To facilitate further analysis, data was further classified based on two dimensions – investors and the investee companies.

Investors

The classification of investors was done on 2 criteria. The first criterion was based on the geographic origin of the investor. That is, on the basis whether the investor was registered as a domestic or a foreign investor. The second classification was based on the nature of promoters of the VCPE funds. The funds were broadly classified into five categories based on the promoters of the fund. The five categories along with a short description for each of them are given below:

a. **Corporate Venture (CORPVEN)**: These include VCPE operations set up by non financial companies. Large companies (e.g., Intel, Siemens) that have venture capital investment divisions within their organizations would fall under this category. Usually, in a CORPVEN program, the entire investment funds would be provided by the parent company. CORPVEN differentiates itself from the PRIV (see below) categories by the close links between the venture and business operations of the parent company. The corporations use a venture program to invest in companies that can have strategic significance to their existing or future operations. Occasionally, CORPVEN investments are also made in areas that are unrelated to the existing operations of the corporation, thereby making it a purely financial investment.

b. **Financial Corporations (FINCORP)**: VCPE operations that are promoted by financial institutions such as banks, term lending institutions, etc. would fall in this category. Examples of VCPE firms under this category include ICICI Venture, IL&FS Investment Managers, and AXIS PE.

c. **Investment Banks (IBANK)**: VCPE operations that are promoted by investment banks fall under this category. Investment banks are also widely called as merchant bankers in India and they provide a gamut of services such as underwriting, trading of securities, advisory services, etc. Financial corporations that do not have significant fund based operations would fall in this category. Examples of VCPE firms under this category would include the venture operations of JM Financial, Motilal Oswal, etc.

d. **Government Institutions (GOVT)**: VCPE firms and operations that are backed and managed by governments, multilateral agencies, and development financial institutions would fall in this category. Even if the venture operations are of the type of FINCORP, if there is a strong government influence on the investment operations, then it would be classified under the GOVT category. For example, Gujarat Venture Finance Limited (GVFL) would be classified as a GOVT VCPE fund.

e. **Private Equity/ Venture Capital Firm (PRIV)**: Boutique or specialized VCPE fund management companies would fall under this category. These are promoted by independent fund managers, who raise capital from various investors to make investments. Examples in this category would include Nexus Venture Partners, TVS Capital, etc.

In addition to the formal channels of VCPE funds, early stage investment also occurs from a network of informal channels, called as angel investors. Angel investors are wealthy individuals who invest their personal capital in start up and entrepreneurial companies. While this report does not focus on angel investors, Chapter 7 provides a preliminary analysis of the profile of angel investors in India.

Investments

The industries in which the investments were made were classified into 9 categories. Investments were further classified as Early, Late, Pre-IPO, PIPE (Private Investment in Public Equity) and Buyout Deals, based on the stage of investment. Table 3.1 and Table 3.2 provide details of these classifications.

Table 3.1: Classification of investments on type of industry

S. No.	Industry class	Sectors included
1	IT & ITES	IT & ITES / Software / Internet/ Computer Hardware / Semiconductors / Electronics
2	Healthcare	Healthcare / Pharmaceuticals / Medical services / Life sciences / Biotechnology
3	Manufacturing	Light & Heavy manufacturing / FMCG / Foods & Beverages / Consumer & Business products
4	Engineering & Construction	Engineering / Capital goods / Construction / Real estate / Energy / Oil & Gas / Infrastructure
5	Telecom & Media	Telecommunications & ISPs / Print & Electronic Media / Entertainment
6	Transportation & Logistics	Shipping & Logistics / Distribution / Transportation
7	Financial services	Banking / Financial Services / Insurance
8	Non-Financial Services	Advertising & Marketing / Education / Hotels & Resorts (Hospitality) / Travel & Tourism / Leisure / Sports & Fitness
9	Others	Agriculture / Retail & Wholesale / Mining & Metals / Textiles & Garments / Chemicals

Table 3.2: Classification based on stage of investment

S. No.	Financing stage	Type of funding
1	Early	Seed Capital / R&D / Start-up / Early Stage
2	Growth	Expansion / Growth Capital (< 10 yrs old)
3	Late	Expansion / Growth capital at later stages / Rapid growth towards liquidity / Special Purpose Vehicles (SPV)
4	Pre-IPO	Mezzanine / Pre-IPO funding / Bridge Loan
5	PIPE	Private investments in Public Equity / Private placements
6	Buyout	Buy-outs (MBO / MBI / LBO) / Acquisition of controlling or significant stake

Classifying the investors and investments into different categories helped in getting a better understanding of the underlying trends during analysis.

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4.0 Spatial Analysis of Investors and Investments

This chapter is an analysis of the investors classified on the basis of the type of promoters as well as origin. The analysis was based on investor locations as well as the locations of the companies in which they have made investments.

4.1 Investor types

Results from the classification of investors as given in Section 3 are indicated in Table 4.1.

Table 4.1: Category wise distribution of investors

Segmentation	Investor Type	No. of Investors
By fund promoters	CORPVEN	48
	FINCORP	38
	GOVT	11
	IBANK	27
	PRIV	214
	Total	338
By origin	Domestic	96
	Foreign	242
	Total	338

It can be seen that the category of independent VCPE firms, PRIV, account for a majority of the VCPE firms operating in India (63%). CORPVEN group constitute the second highest proportion of VCPE investors (14.2%). VCPE firms that were promoted by Financial Corporations, Investment Banks, and Government accounted for 11.2%, 8%, and 3.3% respectively. While firms in categories other than PRIV have many business activities with VCPE investments being just one of their activities, PRIV firms do not have other business activities, and are solely dependent on VCPE investment activity. Since a significant proportion of VCPE investors in India belong to the PRIV category, it indicates that many firms see the potential for VCPE investments as a standalone business in India.

We also categorized the investors depending on the type of origin as domestic and foreign VCPE investors. As indicated earlier, this classification was done based on the status of their registration with SEBI. Where the SEBI registration information was not available, the information was obtained from the websites of investors. Classification of an investor as a foreign investor does not indicate that they do not have a physical presence in India. Table 4 provides the details of domestic and foreign investors in India. Foreign investors account for a large proportion of VCPE investors in India. 242 (or 72%) of the 338 VCPE investors who have invested in India during 2004 – 09 are foreign investors. Though this does not measure their quantum of their investments, it does indicate the factor of confidence that foreign investors have on investing in India and in Indian companies. Domestic investors on the other hand constitute only 28% of the total investors, indicating the need for developing a strong domestic VCPE industry in India.

Table 4.2 provides details on the number of deals as well as the investment made by different investor categories. Foreign investors have invested in 69% of the deals and account for 85% of the total investment. Foreign investors dominate all categories of investors except in the case of FINCORP investors. For some category of investors, the domination of foreign investors is quite strong. One such example is the IBANK category. Domestic IBANK investors account for only 6% of the deals and 1% of the investment, whereas foreign IBANK investors account for 94% of the deals and 99% of the investment in that category. In the case of PRIV category, domestic investors account for 21% of the deals, and 10% of the investment, with the remaining coming from foreign investors in that category. On the other hand, for FINCORP investors, domestic investors have a higher proportion of investment as compared to foreign investors. Domestic investors account for 61% of the total deals and 54% of the total investment in the FINCORP category.

Table 4.2: Deals and investment for various investor categories

Funds classified by the type of their promoters	No. of deals			Amount of investment, $ million		
	Domestic investors	Foreign investors	Total	Domestic investors	Foreign investors	Total
CORPVEN	70	70	140	1,029.5	2,577.4	3,606.9
FINCORP	155	99	254	3,780.3	3,172.7	6,953.0
GOVT	63	100	163	141.6	4,807.6	4,949.1
IBANK	9	144	153	108.0	8,681.4	8,789.4
PRIV	170	632	802	2,102.9	19,827.2	21,930.2
Total	467	1,045	1,512	7,162.3	39,066.3	46,228.5

In the CORPVEN category, both domestic investors and foreign investors have equal proportion (50%) in terms of the number of deals. However, in terms of investments, domestic investors account for only 29% of the amount invested in the CORPVEN category, whereas, foreign CORPVEN investors account for the remaining 71%. The trend in the GOVT category is also interesting. 61% of the deals are from foreign GOVT investors, indicating that sovereign wealth funds and investments from multilateral agencies like the IFC play a significant role in VCPE investments in India. In terms of amount of investment, domestic GOVT investors account for only 3% of the total investment in that category, whereas foreign investors account for the remaining 97%. The average investment by the domestic GOVT investors stands at $2.25 million, whereas the average investment by foreign GOVT investors is $48 million. While more such interesting trends could be noted between domestic and foreign investors in different category of funds, the objective of this analysis is to highlight some of the key differences in the investment trends between different types of VCPE investors.

4.2 Location of investors

Investors were classified based on their location to start with. Investors can either have a presence (physical office) in India or could invest directly from abroad. Within India, the investors' were classified into four regions based on the location of their main office. Table 4.3 gives the details of the number of investors in each location across different years. It indicates that the total number of investors who have presence in India have significantly increased over the years. Today's variety of investors is a strong contrast to a handful of VCPE investors in the year 2000. Not only have the number of investors increased, but the diversity of the investors has also increased. The VCPE investors grew about 3.5 fold during 2000 - 2004 and nearly 5 fold during 2004 - 2009. In other words there was about an 18 fold increase in the number of investors within a decade. This translates an overall CAGR of 32% in the number of investors during 2000 - 09.

There are not many VCPE investors who are located in the Eastern region. This trend has not changed consistently over the years. Of the remaining three regions, a majority of the investors are located in the Western region, because of the presence of Mumbai, the capital of the financial industry. Southern region has the second highest number of investors, followed by North. It is interesting to note that the CAGR of the number of investors have more or less remained the same for each of the three regions over the nine year period. The growth rate of the number of investors in the Northern region has been 29%, whereas it has been 33% for both the West and the South.

Table 4.3: Region wise distribution of investors

Region	Number of investors in year		
	2000	2004	2009
North	3	8	29
West	10	34	131
South	4	15	51
East	0	0	2
Total number of investors with a presence in India	17	57	213
US	3	11	75
UK	0	1	18
South-East Asia	0	0	15
Middle East	0	2	15
Europe (Excluding UK)	0	2	6
China	0	0	3
Africa	0	0	1
Total number of investors who do not have a physical presence in India	3	16	133
Total number of investors investing in India	20	73	346[2]

Figure 4.1 indicates the growth in the number of investors across different regions in India over the years. Several observations could be made from the trend. There has been no major investor presence in the Eastern region, and there is no change in this trend over the years. Among the remaining three regions, the Western region accounts for a majority of the investors (about 60%). An observation of interest could be this proportion has more or less remained constant over the years – 59%, 60%, and 62% in 2000, 2004, and 2009 respectively. Though the numbers of investors have increased dramatically over the years, the Western region has remained the focal point for the Indian VCPE investors.

The Southern region in India has the second highest number of investors after the West. Like that of the West, the proportion of investors in the South have more or less remained the same over the years – 24% in 2000, slightly increasing to 26% in 2004 and then 24% in 2009.

The year 2003 constituted an inflection point in the growth of investors in India. This could be a result of various factors. This was the year in which the there was a strong growth in global GDP, led by the United States, as the economy recovered after the dot com crisis. This year also saw the beginning of one of the longest equity market bull runs, which sustained for more than 4 years in a row. Incidentally it was also the year when the Ashok Lahiri Committee released its recommendations that brought a great deal of flexibility to VCPE investors in India. It is

[2] This number differs slightly from the number of total investors in Table 4.1 because the data that was used for compiling this table was different from what had been used for Table 4.1. The difference is because Table 4.3 also includes investors for whom we did not find any investment information.

thus felt that the growth of the VCPE industry in India was a result of both the growth in global economy as well as the developments within India.

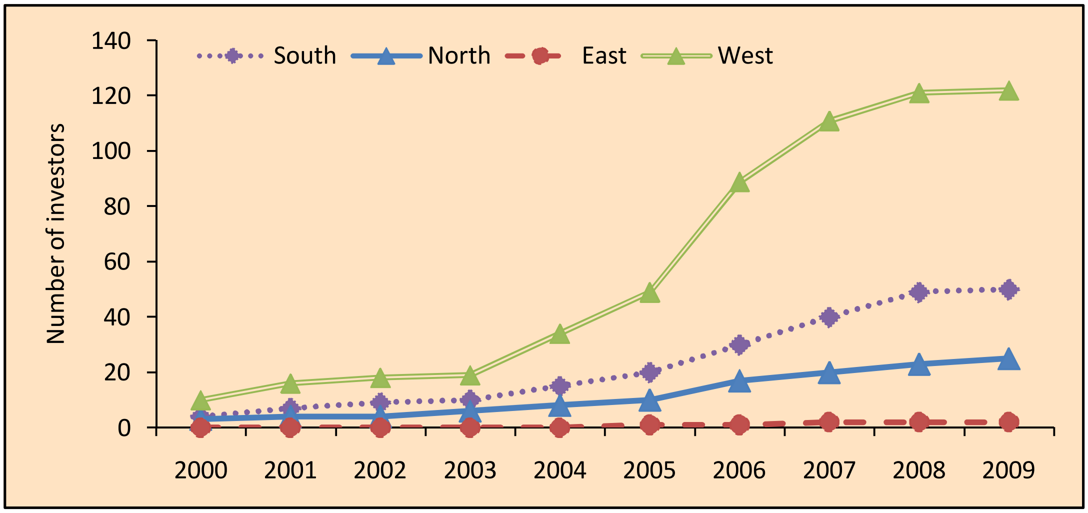

Figure 4.1: Growth in the number of investors for different regions

4.3 Regional distribution of investments

Further to the analysis on investors in different locations, we also analyzed the investments made in different regions. Table 4.4 indicates the investment pattern observed for both domestic and foreign investors in the regions. This trend was based on the analysis of 1205 deals for which region specific data of investee companies were available. Every investee company was classified in any of the four regions, viz., North, West, South and East depending on the location of their registered office as mentioned in the details of incorporation of the company.

Table 4.4: Percentage of investment across different regions

Investors	Investee Geographic Region			
	North	West	South	East
Foreign Investors	21.20%	43.11%	33.89%	1.80%
Domestic Investors	29.24%	39.28%	28.75%	2.74%

The results indicate that Western region accounts for most of the investments made by both domestic and foreign investors. While the trend is very similar to the region wise distribution of investors, the proportion of investments in the Western region is not as high as the proportion of investors who are located in the West. The Southern region occupies the second highest position in terms of investments, followed by the North and the East. The investment trend by and large remains the same for foreign and domestic investors, except in the case of South and North. The Southern region accounts for the second highest share of investments among foreign investors, whereas the Northern region accounts for the second highest share of investments among domestic investors.

Unlike other investors such as banks, VCPE investors work closely with the investee company after the investment has been made. In fact, the value addition provided by the investors to their portfolio companies is an important part of VCPE activity. Therefore, the proximity between investors and investee companies is an important investment criterion as it facilitates the value addition process. Academic literature has indicated that early stage VC investors invest in those companies that are located close to where the investors are located.

A cross tabulation of investments based on the geographical location of investors and investee companies is given in Table 4.5. The analysis was done for 1117 deals for which region specific data of VCPE as well as the investee company was available. Since we can classify the geographic region of the investors only if they have a physical presence in India, we excluded those deals where investments were made by investors who did not have a physical presence in India. 457 deals by foreign investors directly came from overseas and therefore have been excluded from this analysis.

Table 4.5: Region-wise mapping of Investors and Investee

Investor region	Investee region			
	North	West	South	East
North	25.21%	38.02%	32.23%	4.55%
West	20.47%	41.38%	34.61%	3.53%
South	15.98%	21.65%	60.31%	2.06%
East	0.00%	0.00%	50.00%	50.00%

Table 4.5 shows that VCPE investors tend to make most of their investments in the same regions where they are located (except for investors in the North). It can be noted that a majority of the investments by investors in the West are made in the Western region. This trend is even more pronounced in the Southern region. Investors from the South invest more than 60% of their investments in companies based in the South. This indicates that geographical proximity seems to influence investors' decisions. We do not have many investments in the Eastern region to make any reasonable trends. Deal wise analysis of investments may reveal the reason behind the departure from this trend in the Northern region.

These results indicate that the growth in VCPE investments in different regions would strongly depend upon the location of VCPE investors in the respective regions. For example, if the government wants to encourage entrepreneurship and promote increased VCPE investment activity in the East, then more VCPE funds have to be set up in the Eastern region. Similarly, for more VCPE investments to happen in the South there is a need for more funds to be located in the South. Increase in the number of VCPE firms operating in the Western region might not significantly increase the VCPE investments in other regions.

4.4 Inclusivity of VCPE investments

Apart from the geographical proximity, we also analyzed whether VCPE investments benefit companies that are not located in metropolitan cities. We tabulated the investments made by both domestic and foreign investors based on the location of the investee company, i.e., whether they are located in a metro city or a non-metro city. For the purpose of this analysis, the following six cities were considered as metropolitan cities: Bangalore, Chennai, Delhi, Hyderabad, Kolkata, and Mumbai. Investments that fall in locations other than the above six cities, were classified as non metro investments. A total of 1021 deals where the location of investee companies was readily available were used for this analysis. Table 4.6 and 4.7 presents the results.

As expected, a significant proportion of VCPE investments in India happen in companies that are located in metropolitan cities. In terms of the total number of deals, non metro locations account for only about 22% of the total deals and in terms of investment, non metro locations account for only about 16% of the total investment. Not only are number of investments lower in non metro cities, the average investment per deal in non metro locations is also lower. Between the domestic and foreign investors, domestic investors have a higher proportion of investments made in non metro cities as compared to foreign investors. 24% of the deals made by domestic investors are in non metro cities, while the comparable number for foreign investors is only 21%. In terms of amount of investment, 23% of the investment made by domestic investors is in non metro areas, whereas only 15% of the investment made by foreign investors goes to non-metro areas.

Table 4.6: Number of deals in metro and non metro locations

Location of investee company	Domestic investors	Foreign investors	Total
Metro city	251	544	795
Non Metro	80	146	226
Total	331	690	1,021

Table 4.7: VCPE investment in metro and non metro locations ($, million)

Location of investee company	Domestic investors	Foreign investors	Total
Metro city	3,539.95	18,732.53	22,272.48
Non Metro	1,036.47	3,048.03	4,084.5
Total	4,576.42	21,780.56	26,356.98

It is reasonable to assume that since domestic investors might be more familiar with the non-metro locations, they are able to make a higher proportion of their investments in domestic areas. While domestic investors account for only about 17% of the total investment, they account for 25% of the investment in non metro areas. This indicates that domestic investors can play an important role in expanding VCPE investments beyond the borders of metropolitan cities. Separately, our results also suggest the need for a detailed study on the reasons behind the low proportion of VCPE investments in non metro areas.

4.5 Summary

Foreign investors account for a large percentage of VCPE investors in India. Among the five different categories of VCPE investors, PRIV category constitutes 63% of the total VCPE firms. The total number of VCPE investors who have invested in India has grown at a CAGR of 32% during 2000 – 09. Not only have the number of investors increased, the diversity of the investors has also increased. The majority of the investors (60%) are located in the Western region, followed by the Southern region. Analysis of the regional distribution of investments indicates that investors tend to make most of their investments in firms that are located in same region as that of the investors. Large proportion of VCPE investments happen in metro cities. Non metro locations account for only 22% of the total deals and 16% of the total investment.

■

5.0 Temporal Analysis of Investment Patterns

This chapter provides the results from the analysis of the investments made by the VCPE investors during 2004 – 09. In the 2009 report, we looked at the of VCPE investments in India in various sectors. This section builds on that analysis by mapping the details of the investors in addition to the investments. It is hoped that such an analysis would enhance the understanding of the VCPE investors in India. The results are based on the analysis of 1511 Private equity deals across the years 2004 to 2009 by 338 VCPE investors.

5.1 Investments by type of investor

Table 5.1 shows year wise investments made by different categories of investors. Panel A indicates investments by different investors when they are classified on the basis of the type of promoters. Panel B indicates investments by investors when they are classified on the basis of their origin.

	Table 5.1: Year wise investments, $million (% of total investments in that year)						
	2004	2005	2006	2007	2008	2009	Total
Panel A: Investors based on the type of promoters							
CORPVEN	38.4 (2.21%)	97.52 (4.63%)	1,246.26 (12.49%)	1,051.42 4.87%)	970.5 (12.02%)	199.17 (7.2%)	3,603.27
FINCORP	324.5 (18.67%)	513.71 (24.41%)	1,576.56 (15.81%)	2,543.49 (11.78%)	1,243.4 (15.41%)	751.32 (27.16%)	6,952.98
GOVT	105.14 (6.05%)	237.97 (11.31%)	638.97 (6.4%)	3,310.46 (15.34%)	474.58 (5.88%)	182 (6.58%)	4,949.12
IBANK	210.5 (12.11%)	329.4 (15.65%)	1,000.08 (10.03%)	5,630.76 (26.09%)	1,295.5 (16.05%)	323.1 (11.68%)	8,789.34
PRIV	1,058.81 (60.94%)	925.3 (43.98%)	5,508.59 (55.24%)	9,043.6 (41.9%)	4,083.93 (50.61%)	1,309.95 (47.36%)	21,930.18
Panel B: Investors based on the type of origin							
Domestic	293.55 (16.89%)	540.2 (25.67%)	1,900.4 (19.06%)	2,090.38 (9.68%)	1,625.68 (20.14%)	712.28 (25.75%)	7,162.49
Foreign	1,443.8 (83.1%)	1,563.7 (74.32%)	8,070.08 (80.93%)	19,489.38 (90.31%)	6,442.23 (79.85%)	2,053.26 (74.24%)	39,062.44
Total	1,737.35	2,103.9	9,970.46	21,579.73	8,067.91	2,765.54	46,224.89

Major observations that could be noted are as follows:

- Foreign VCPE investors have invested $39062.44 million, which accounts for 84.4 % of the total VCPE investments in India during 2004-2009 compared to $7162.94 million by domestic VCPE investors in the same period.

- The year 2007 had the highest investments during the period 2004 – 09. However, it can be seen that the engine of growth for investments during that year has been the foreign investors. If we classify the investments based on the type of promoters, it can be seen that the growth has mainly come from IBANK, PRIV, and GOVT category investors. While it is understandable that IBANK and PRIV category investors have significantly increased their investments during the period of economic boom, what is surprising is the 5 fold increase in amount invested by GOVT investors. Since the total investments made by domestic investors during 2007 had not increased significantly, it can only be concluded that foreign GOVT funds have made significant investments during 2007. The GOVT investments also decreased by 86% in the very next year, indicating that foreign GOVT funds have dramatically reduced their investments during the global financial crisis.

- PRIV investors invested $21930.8 million (47% of the total investments) during the period 2004-2009. An interesting observation is that though 72% of the total investors come under the PRIV category, they account for only 47% of the total investments. We can therefore infer that PRIV investors invest in smaller deals than the average.

- The first signs of the global recession can be seen from the investment trends of CORPVEN investors in 2007, when their investments contracted by about 15%. On the contrary, the investments made by all other VCPE investors grew during 2007. It can probably be inferred that CORPVEN investors conserved their capital by reducing their VC investments to meet the capital requirements of their main businesses. Since VCPE investments is not a main activity for most CORPVEN investors, often the investment program is given a go-by in tough business situations.

- We also found out the "Year 2007" effect for all categories of investors. Since all the investors (except CORPVEN) had the highest investments in 2007, we calculated the percentage of investments made in 2007 by each of the investors. The figure is remarkably high for GOVT and IBANK investors, who had invested 67% and 64% respectively of their total investments in 2007. On the other hand the percentage for FINCORP and PRIV investors are only 37% and 41% respectively. Overall, year 2007 accounted for 47% of the total investments during the period 2004 – 09. This indicates the extreme volatility in investments by some category of investors.

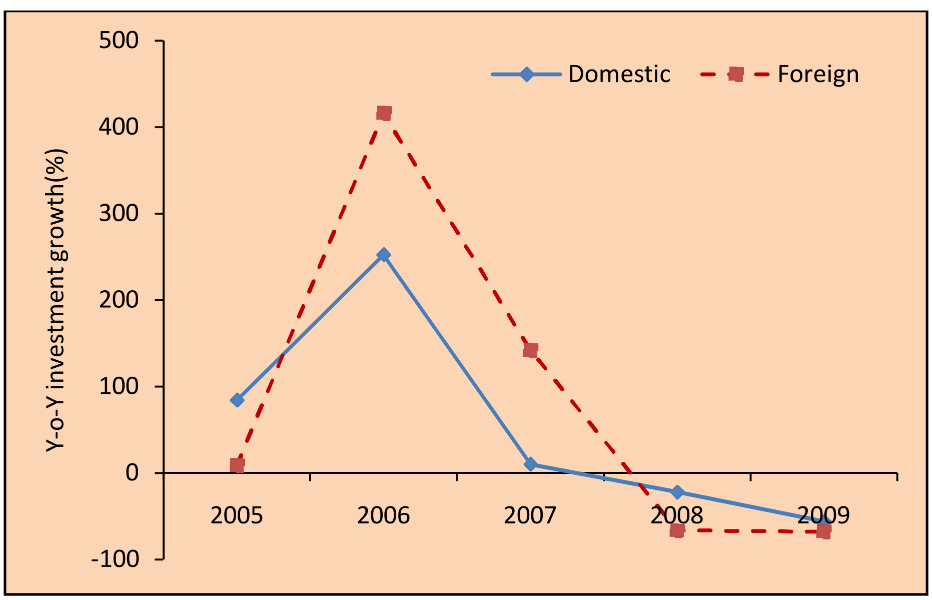

Figure 5.1: Investment growth rates for domestic and foreign investors

Figure 5.1 indicates that the domestic investors were early to sense the economic boom in 2005 and showed a Year-on-Year (growth of investments of 84% over that of 2004 compared to a flat growth of 8% for foreign VCPE firms. From then on, the growth rate of investments of foreign investors grew by 416% in 2006 and 141% in 2007. The domestic VCPE investors were able to respond faster to both the growth and contraction phases as compared to foreign VCPE investors.

5.2 Analysis of investment portfolio

This section is based on an analysis of the investment portfolio of investors. This would give an indication of investor preferences in terms of investment stage and industry. While we understand that the preference could change in the future, our objective was to see whether any preference patterns could be identified during the six year period 2004 – 09. Since the required information for such an analysis was not available for all the deals, this analysis was based on 1511 investments by 309 investors.

Since there is significant need for VCPE investment in the early stage, we specifically analyzed the trend in early stage deals for different investor categories and types. Figure 5.2 indicates the proportion of early stage investments made by domestic and foreign investors in each of the years.

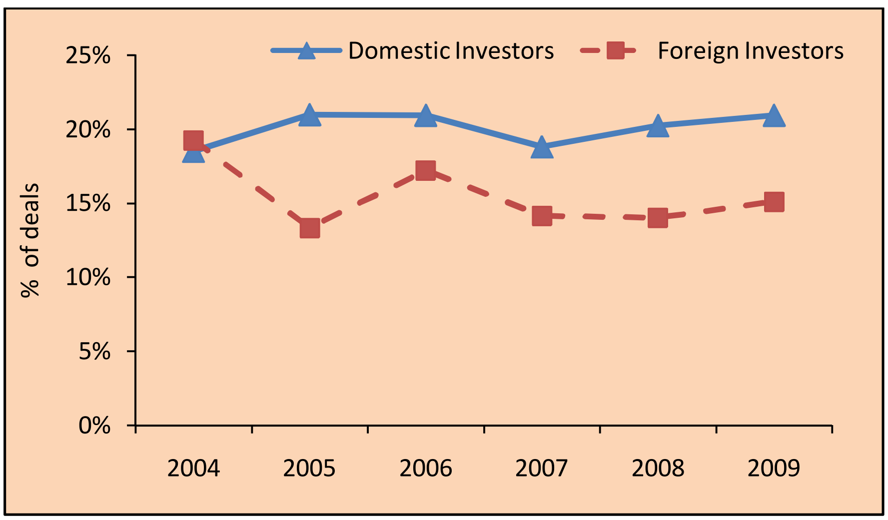

Figure 5.2: Proportion of early stage investments by domestic and foreign investors

It can be seen that, in terms of number of investments, 20% of the deals that domestic VCPE investors invest are early stage deals. Consistently, the proportion of early stage investments (in terms of number of investments) made by foreign investors have been lower than that of domestic investors.

Figure 5.3 indicates the trend in early stage deals as a percentage of the total number of deals for different investor types. GOVT investors have consistently made more early stage investments every year. 35% of their deals were early stage investments for the years 2005, 2006 and 2009. In the remaining years, at least 20% of the deals made by GOVT investors were early stage investments. The proportion of early stage investments made by PRIV investors have declined over the years, from 35% in 2004 to 20% in 2009. IBANK investors had no early stage investments till 2006 and have started making such investments from 2007. It is significant that IBANK investors, who have traditionally been active investors in the PIPE and Pre-IPO stages, have started making early stage investments. Early stage investing involves considerably more risk than investing in later stages. In most cases, entrepreneurs expect the early stage investors to provide some kind of value addition, which requires operational expertise. Many IBANK investors might not have such an expertise and it would be interesting to observe how IBANK investors manage the challenge of early stage investing.

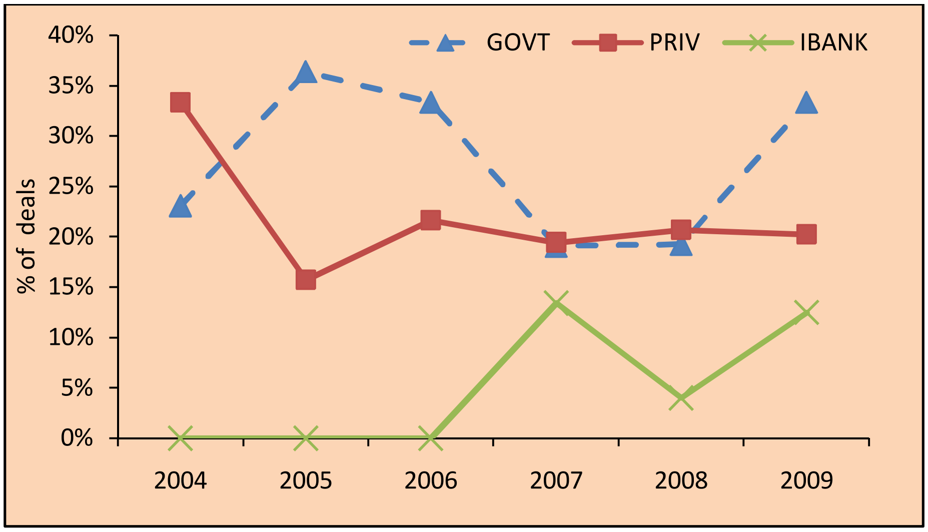

Figure 5.3: Proportion of early stage investments for different investor types

Another interesting trend that could be observed was in the CORPVEN category (Figure 5.4). One would expect that CORPVEN investors would make most of their investments in early or growth stage. However, it was observed that in India, much of the CORPVEN investments were in PIPE, Pre IPO, and Expansion stages. Our analysis indicate that there has been a steady decline from 2004 in the proportion of PIPE + Pre IPO deals in the total number of CORPVEN deals. On the other hand, the proportion of deals in expansion stage has steadily increased. PIPE + Pre IPO deals which accounted for 80% of the deals in 2004, were only 20% in 2009. Expansion stage deals which accounted for just 20% of the deals in 2004, accounted for 80% of the deals in 2009.

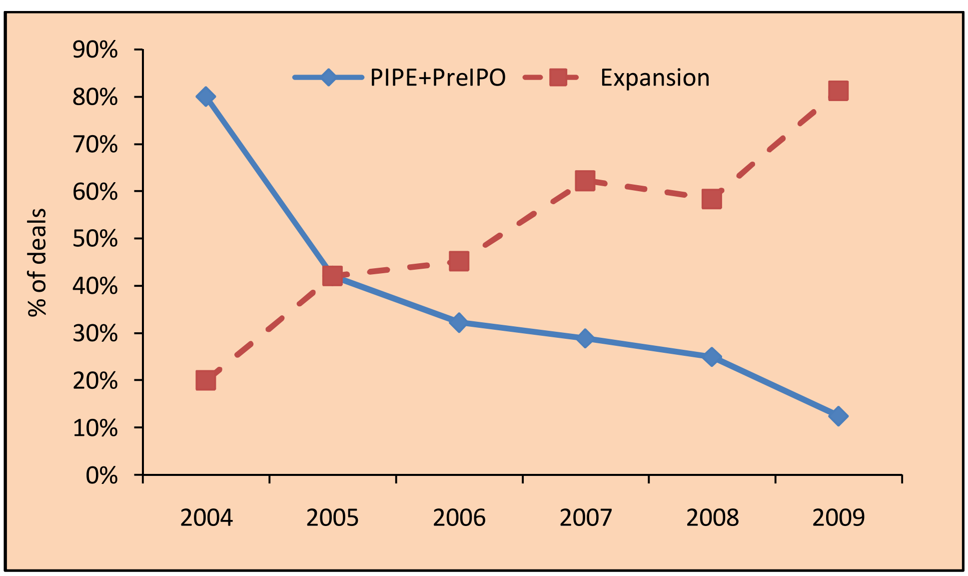

Figure 5.4: Proportion of PIPE + Pre IPO and Expansion stage investments for CORPVEN investors

There are contrasting trends in the percentage of deals by GOVT and IBANK investors in the BFSI sector (Figure 5.5). During the years 2004-2007 IBANK portfolio of deals in BFSI grew from 10% to 40% while GOVT deals increased moderately from 10% to 19%. But post 2007, with the onset of the global financial crisis the number of deals by IBANK in the sector fell to 0% for consecutive years 2008 and 2009, while that of GOVT investors in BFSI sector rose rapidly to 58%. Since the majority of the investments in both the IBANK and GOVT category are from foreign investors, the contrasting investment trends of both these investors is interesting and merits further study.

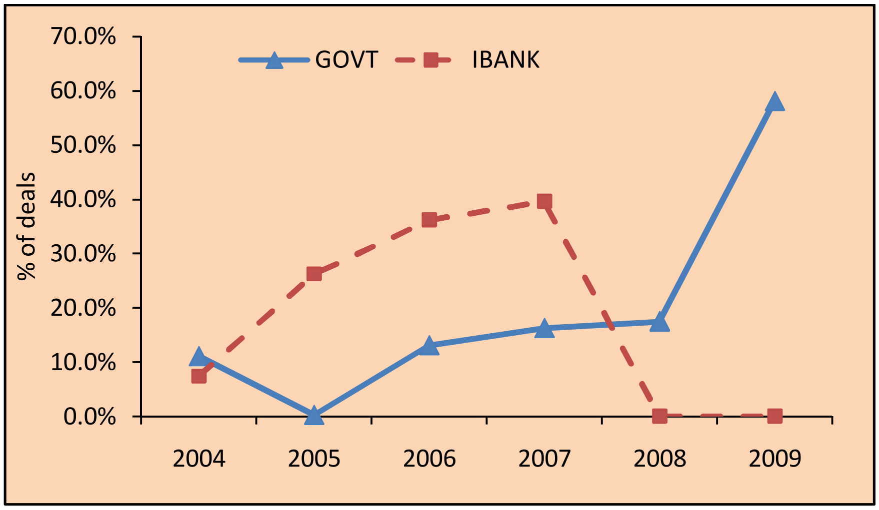

Figure 5.5: Proportion of deals by GOVT and IBANK investors in BFSI sector

Our analysis also indicates a significant reduction in the portfolio of deals in the IT and ITES sector by GOVT and CORPVEN investors. In 2004, the IT and ITES sector accounted for about 47% of the deals made by GOVT investors and 64% of the deals made by CORPVEN investors. In 2009, this sector accounted for just 1% of the deals of GOVT investors and about 17% of the deals of CORPVEN investors. Table 5.2 indicates that the percentage of deals by GOVT investors in the IT and ITES sector reduced significantly in 2005. The same trend could be observed for CORPVEN investors in 2006. Even in the subsequent years, the percentage has not significantly increased and has more or less stayed at the same levels. This indicates that the business models in the IT and ITES sector has matured over the years, and is no longer considered an attractive sector by the investors. The trend seen in the deals made by GOVT and CORPVEN investors mirrors the overall VCPE investment trends in this sector.

Table 5.2: Year wise percentage of deals in IT and ITES sector

Investors	Year					
	2004	2005	2006	2007	2008	2009
GOVT	46.64%	6.05%	4.52%	2.08%	9.18%	1.32%
CORPVEN	63.8%	48.9%	1.2%	6.4%	7.6%	17.1%

Figure 5.6 and Figure 5.7 indicates the percentage of investments in select 4 industry categories for domestic and foreign investors respectively. Several broad trends could be noted. Firstly, the investment trends between domestic and foreign investors do not have much common ground. While foreign investors have an increasing percentage of investments in the IT & ITES sector during 2007 – 09, the same sector accounts for a decreasing percentage of investments among the domestic investors. Similarly, the share of investments made by domestic investors in Engineering and Construction sector has grown substantially from 2007, whereas for foreign investors, the investment in this sector has been fluctuating and shows a decreasing trend in 2009.

Secondly, in recent years no single sector seems to dominate the investments made by foreign investors. Particularly in the years 2008 and 2009, the percentages of investments in each of the four sectors are quite close. Investments made by domestic investors on the other hand indicate strong preferences in various years. For example, in 2009, Engineering & Construction and Media accounted for more than 50% of the investments made by domestic investors. Similarly, in 2006, Engineering & Construction and BFSI accounted for more than 50% of the investments made in that year.

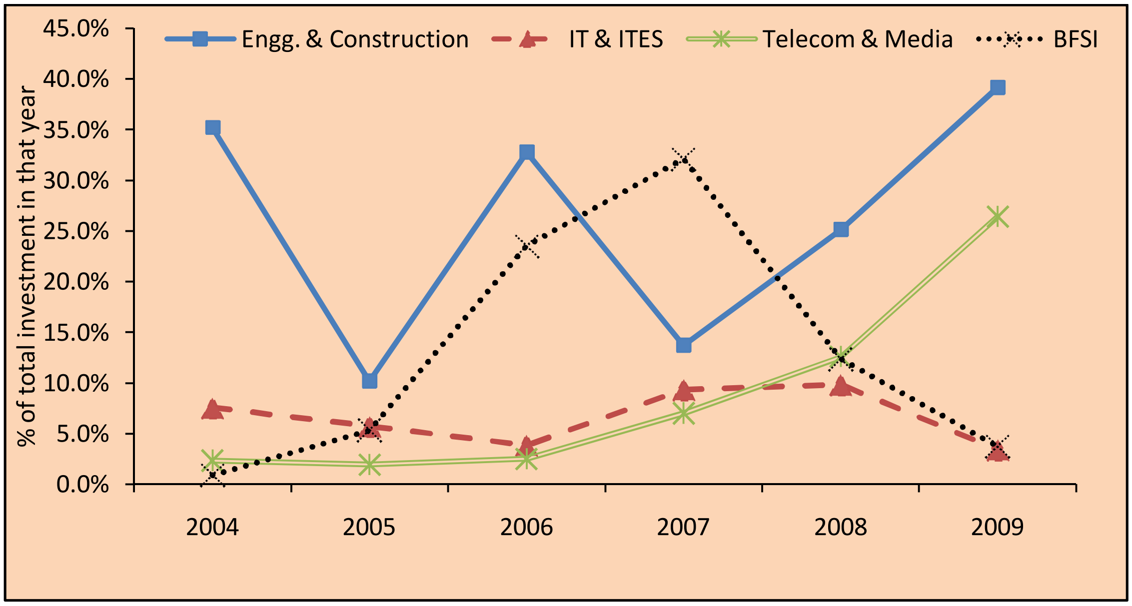

Figure 5.6: Distribution of investments in different sectors for domestic investors

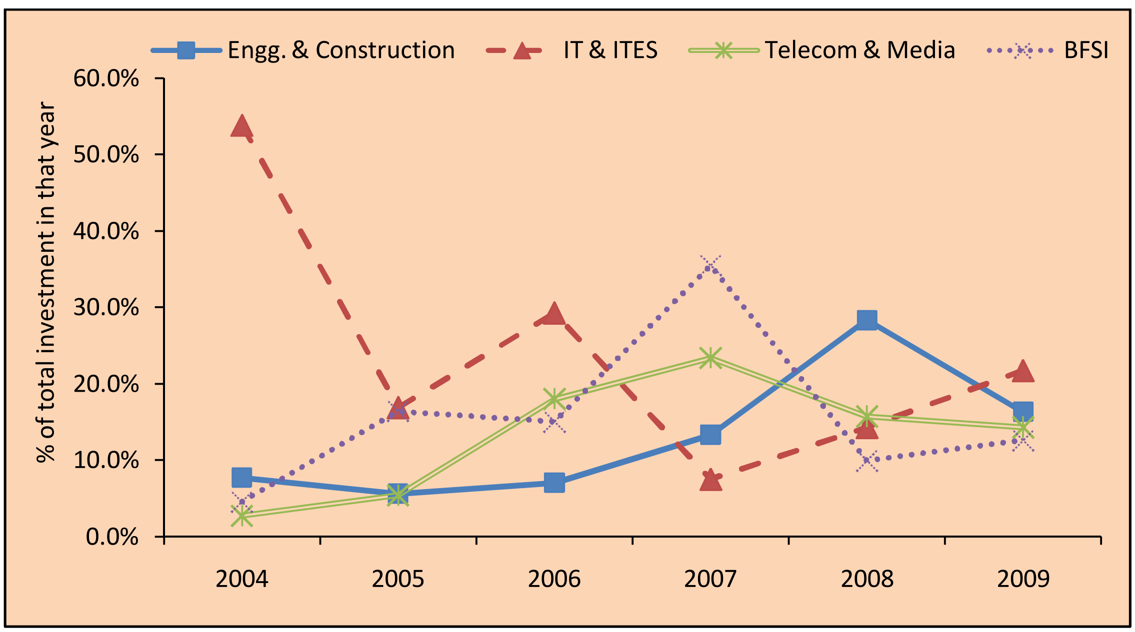

Figure 5.7: Distribution of investments in different sectors for foreign investors

5.3 Analysis of investor activeness

An indicator of investor activity is the amount of capital deployed over years. Every investment made by the VCPE investor goes through multiple stages such as deal sourcing, screening, selection, negotiation of valuation, and structuring of the investment, followed by actual investment. It is expected that on an average, the entire investment process could take between 3 – 9 months. This indicates that each investment involves significant effort on the part of the VCPE investor. Therefore it is felt that the total investment as well as the number of deals made by the investor during the study period would serve as an indicator of how active an investor has been in the marketplace. Table 5.3 presents the results of this analysis.

Table 5.3: Classification of investors based on their aggregate investment

Agg. inv. range ($, mil)	No. of inves-tors	Total investment ($, mil)	No. of deals	No. of deals/ investor	Fund type					Fund origin	
					CORPVEN	FINCORP	GOVT	IBANK	PRIV	Dom	Foreign
0-150	252	9,054.43	723	2.86	35	26	7	17	167	74	178
150-300	24	4,809.02	190	7.91	4	5	0	1	14	5	19
300-450	5	2,009.3	69	13.8	1	1	1	0	2	1	4
450-600	7	4,002.54	63	9	1	0	1	2	3	0	7
600-750	3	2,004.7	23	7.66	0	0	0	1	2	0	3
750-1000	5	4,306.92	108	21.6	2	0	0	1	2	2	3
>1000	13	20,038.02	336	25.84	1	2	2	2	6	2	11

As shown in Table 5.3 the investors have been categorized based on the total capital they have invested in the six year period. This is based on the analysis of 309 investors and 1512 investments for which investment information is available. The table shows the number of investors in each investment range, total investments made by these investors, and the number of deals by these investors. Interesting findings from this analysis are:

- Nearly 81% (or 252) of all investors constitute for just about 19.5% ($9,043 million) of the total investment made in the years 2004-2009. In terms of number of deals, they account for 48% of the total deals during the six year period. Each of these investors has made an aggregate investment of less than $150 million over the 6 years. This shows the skew in the distribution of investments and investors. In the Indian market, there are a large number of small investors, who are making very few investments. The proportion of PRIV investors constitute the largest category, accounting for 66% of the total investors in this investment range. This is slightly higher than the proportion of PRIV investors (63%) in the overall total number of investors. In terms of fund origin, foreign investors account for 71% of the total investors in this range. The average deal size in this range works out to $12.52 million. Though the aggregate investment amount is lower (the average total investment made by an investor is only $36 million), the average investment per deal is significantly high. This indicates that they are not making many investments of smaller deal sizes. This explains the paucity of funding in the early stage. Even though the aggregate amounts invested by the investors are lower, they are investing high amounts per deal. Since the average number of deals by an investor is only around three per investor, this translates to one deal for every two years during the six year period. This indicates that the large numbers of investors in the marketplace are not very active.

- The other interesting group is where the investors have made aggregate investments in excess of $1 billion. There are 13 investors in this category, constituting about 4% of the total investors. Together they have made an investment of more than $20 billion, which accounts for more than 43% of the total investments. The average number of deals per investor is about 26, which translates to about four investments in a year. This indicates that they are quite active. In terms of the number of deals, investors in this range, account for 22% of the total deals and the average deal size is $59.64 million. This indicates that the most active investors in India are those who invest in larger deals. Though the sample is very less in this range, foreign investors significantly dominate this category. 85% of the investors who have made an investment of more than $1 billion are foreign investors. PRIV investors account for the highest proportion (46%), but their proportion is not as high as what was observed in the 0 – 150 million range, where they account for 66% of the total investors.

Since the numbers of investors in various investment ranges between $150 to $1000 million are not very large, any interpretations might be subject to questions on statistical validity. Therefore, in order to make some effective interpretations, we consolidated the investment made into three ranges, less than $150 million, between $150 to $1000 million, and greater than $1 billion. The results are given in Table 5.4.

Table 5.4: Consolidated classification of investors based on their aggregate investment

Agg. Inv. range ($, mil)	No. of Inves-tors	Total Investment ($, mil)	No. of Deals	No. of deals/ investor	Fund type					Fund origin	
					CORPVEN	FINCORP	GOVT	IBANK	PRIV	Dom	Foreign
0-150	252	9,054.43	723	2.86	35	26	7	17	167	74	178
150-1000	44	17,132.48	453	10.29	8	6	2	5	23	8	36
>1000	13	20,038.02	336	25.84	1	2	2	2	6	2	11

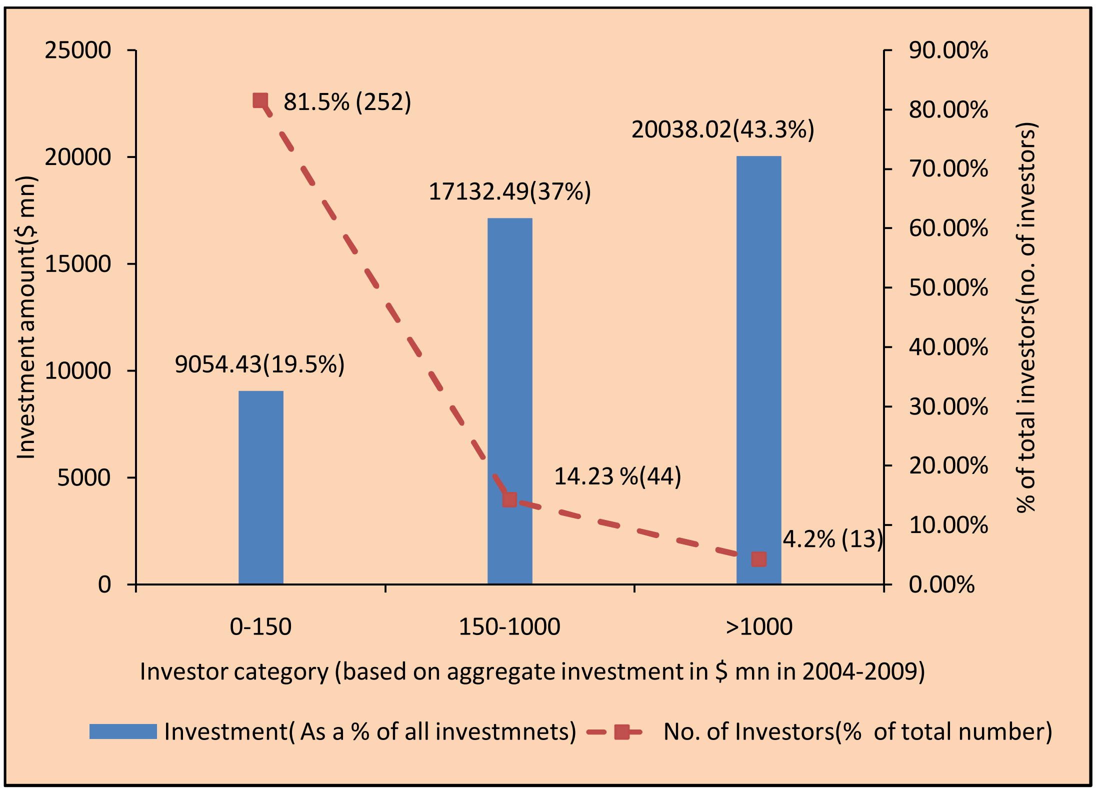

Figure 5.8: Illustration of total investment and number of investors for different total aggregate investment ranges

Table 5.4 is an ideal example of the 80:20 rule wherein 81.5% of the investors just constitute for 19.5% of the total invested amount. Most investors have invested in lower number of deals and lower deal sizes. Figure 5.8 provides a graphical illustration of this trend. Some of the other trends that could be noted from Table 5.4 are:

- As the aggregate investment range increases, the proportion of foreign investors also increases. From 71% for the investment range up to $150 million, it increases to 81% for the $150 - $1000 million range, and to 85%

when aggregate investments are more than $1 billion. In a way, this makes a forceful argument for strengthening the domestic VCPE industry.

- Most of the CORPVEN investors (80% of the total CORPVEN investors) have made aggregate investments less than $150 million during the six year period. This is in line with expectations as many corporations do not consider VCPE investments as their primary activity. Their VCPE investments can be either strategic in nature to support their existing businesses or opportunistic to achieve higher financial returns.

- It can be seen that about 50% of the deals are from investors who have each made aggregate investments of less than $150 million. This indicates the critical role played by the investors in this range in developing the VCPE investments in India.

- It can be seen that the increase in aggregate investments is a result of more number of investments as well as investments of larger size. Investors who have made aggregate investments of more than $1 billion have on an average invested in 25.84 deals as compared to 2.86 deals by investors who have made aggregate investments less than $150 million. The average investment size is $59.64 million and $12.52 million respectively for the two groups of investors. While it is important to have investors who make smaller investments, it is equally important that they invest in more deals. There should be targeted policy initiatives to encourage early stage VCPE investors to invest more actively in India.

5.4 Investment trends for the small and the large investors

Table 5.5 gives the year wise investments made and the number of investors for two groups of investors, i.e., those who have made aggregate investments less than $150 million and those who have aggregate investments more than $1 billion in the six year period 2004 – 09. A graphical illustration is given in Figure 5.9.

Table 5.5: Investments is $million (Number of investors) for years 2004-2009

Agg. inv. range ($, million)	Year					
	2004	2005	2006	2007	2008	2009
< 150 million [Group A]	255.4 (22)	523.1 (36)	1556.5 (87)	3473.5 (118)	2248.5 (95)	997.1 (70)
>1000 million [Group C]	1213.2 (9)	844.2 (9)	5123.5 (13)	9632.6 (12)	2168.7 (10)	1055.6 (10)

Key observations from Table 5.5 and Figure 5.9 are:

- The investments made by both the investor groups were more or less comparable in 2005. However, the investments made by Group C investors grew steeply in 2006 and 2007, but fell down do the same level as that of Group A investors in 2008 and 2009. This indicates that there is a lot of volatility in investments made by Group C investors. For steady growth of VCPE investments, we need to increase the participation of Group A investors.

- The investments made by Group C investors grew 6 fold in 2006 compared to a 3 fold rise in the investments of Group A investors. Group C (consisting of only 13 investors) accounts for 103% of the 316% in the growth of VCPE investments in India in 2006 (from $2,103 million to $9,970 million)

- The steep fall in investments in 2008 was a result of the rapid reduction in investments by the Group C investors. Investments by Group C investors reduced by 77% during the year. While the investments made by

Group A investors also fell in that year, the reduction was only half as much as that of Group C investors. The fall in investments from Group C led to a contraction of 65% in total VCPE Investments in India in 2008 (from $21,579 million to $8,067 million).

- While the numbers of investors and amount of investment have increased for Group A investors from 2004 to 2009, the same cannot be said for Group C investors. The number of investors as well as the amount of investment is comparable to what it was in 2004. While the amount invested increased in the intervening period, surprisingly, the number of investors in this segment did not change significantly throughout the entire six year period.

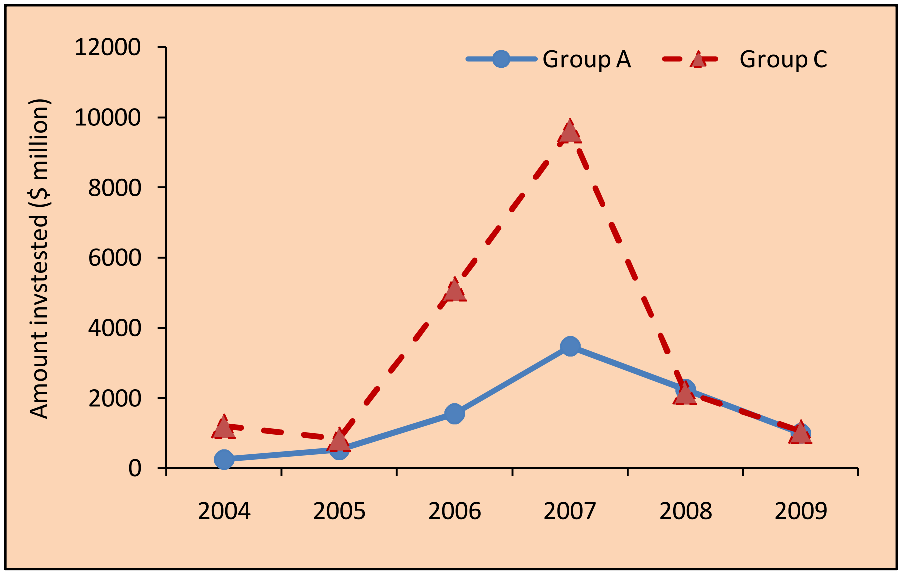

Figure 5.9: Total investments made by the small and large investors in different years

5.5 Summary

The findings indicate that the engine of growth in the Indian VCPE investments was driven by foreign investors. The total investment was the highest in 2007. Domestic investors invest in a higher percentage of early stage deals as compared to foreign investors. There has been a significant reduction in the deals in the IT and ITES sector over the years. The investment patterns seem to differ between foreign investors and domestic investors. While foreign investors seem to divide their investments across many sectors, one or two sectors account for a large percentage of the investments made by domestic investors. In 2009, the Engineering & Construction and Media sectors accounted for more than 50% of the investments made by domestic investors. The large investors, i.e., those who have aggregate investments of more than $1 billion during the six year period are the most active investors in the Indian market. Each of the investor in that category invests in about 4 deals every year. The small investors, i.e., those who made aggregate investments less than $150 million are the least active investors. On an average they have invested in one deal every two years. While the number of small investors has grown, the number of large investors has been surprisingly more or less the same throughout the six year period.

■

6.0 Deal Analysis

This chapter provides is a study of investors based on an analysis of the individual deals in which they have invested. The data sample used for the analysis was 338 investors and 1870 investments during 2004 – 09.

6.1 Deal and investment distribution

Table 6.1 provides the distribution of number of deals as well as amount invested for different investor types. Panel A provides the distribution for investors classified on the basis of their promoters and Panel B provides the distribution based on the origin of investors.

Table 6.1: Deal and investment distribution for various investors

Investor type	As a percentage of	
	Total number of deals	Total investment
Panel A: Investors classified based on their promoters		
CORPVEN	10.00%	7.79%
FINCORP	15.40%	15.04%
GOVT	9.67%	10.70%
IBANK	9.73%	19.01%
PRIV	55.18%	47.46%
Panel B: Investors classified based on their origin		
Domestic investors	31.65%	15.50%
Foreign investors	68.34%	84.50%

It can be seen that independent VCPE firms (PRIV) account for a major proportion of deals as well as amount invested. FINCORP investors account for the second highest percentage based on the number of deals. IBANK investors have a lower ranking in terms of the number of deals, but they occupy the second slot as far as investment made. This indicates that these investors invest in larger deals as compared to the overall average. A similar contrast, but on the reverse, can be noted for CORPVEN investors. They account for 10% of the total deals, but only 7.79% of the total investment, indicating that their deal sizes are smaller than the overall average.

Analysis based on the investor origin indicates the dominance of foreign VCPE investors in India. While they invest in more than two-thirds of the total deals, their share is even higher if we consider the investment amount. Foreign VCs account for more than five-sixth of the investment made. Taken together, this indicates that not only do the foreign investors invest more, but they also make larger investments than domestic investors.

6.2 Distribution of investors based on their number of investments

Figure 6.1 provides the distribution of investors based on the number of deals they have invested. We have grouped the investors into four categories: those who have invested in only one deal during the period, those who have invested in 2 – 8 deals, those who have invested in 9 – 15 deals, and those who have invested in more than 15 deals. The results indicate that close to 35% of the VCs had invested in only deal. About 48% of the VCs invested between 2 – 15 deals. Less than 10% of the VCs had invested in more than 15 deals. This indicates that though a large number of VCs invest in India, only a few of them are active and continue to make investments on a sustained basis. Many seem to be opportunistic investors making one off investments.

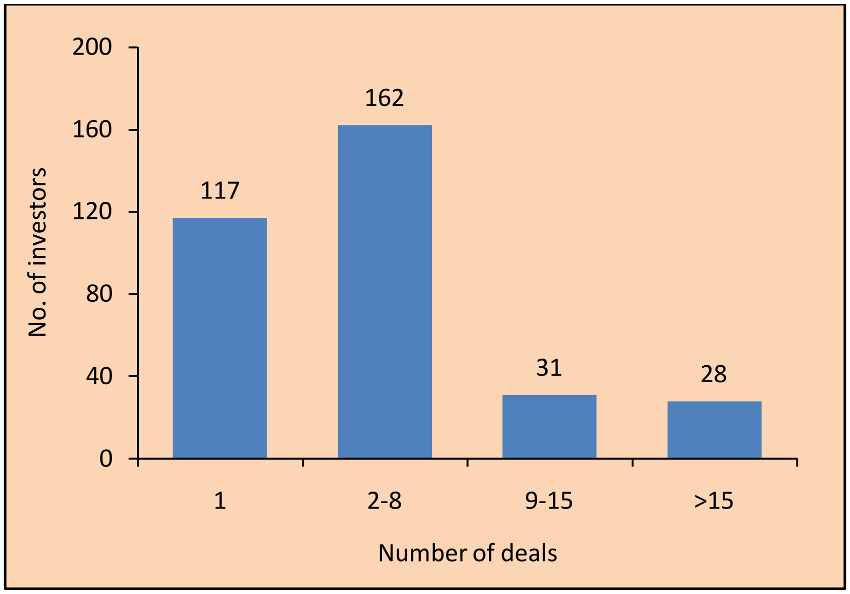

Figure 6.1: Number of investors vs. number of deals

Table 6.2 provides the distribution of different investor types on the basis of the number of investments. Several interesting trends can be noted. Foreign investors account for a substantial number (77%) of those investors who have made only one investment. It can be seen that the foreign investors dominate the domestic investors across all deal volume categories, similar to what we see in single investment category. In the 2-8 investments category, foreign investors account for 67%, in the 9 – 15 investments category, they account for 81% and in the greater than 15 investments category, they account for 64%. Overall, 37% of the foreign investors have invested in only one deal whereas the comparative figure for domestic investors is 28%. 55% of the domestic investors have made 2 – 8 investments, whereas the comparative figure for foreign investors is 45%.

If we analyze the investors based on their promoters, we find that 68% of those who have made only one investment are from the PRIV category. Among the PRIV investor category, 37% of the investors have invested in only one deal. Since the PRIV category investors are solely engaged in VCPE investments, a large number of such investors making single investments can be a cause of concern. About 42% of those investors in the CORPVEN category have also made only one investment. However, that can be explained by the fact venture investment is not a main focus for many corporations, and the corporate venture program in most cases becomes the first casualty in business downturns. Figure 6.2 provides a graphical illustration of the proportion of investors who have made only single investments in different investor categories.

48% of the total investors have made between 2 – 8 investments. On the other hand, only 8% of the total investors have made more than 15 investments. If we consider the number of investments, these 8% of the investors account for 42% of the investments. This indicates that though there are many investors in India, there has been a strong concentration with the top 8% accounting for disproportionally a large number of investments. The average number of investments made by the investors in this category is 27.72, whereas the average number of investments made by the investors in the 9 – 15 investments and 2 – 8 investments categories are 11.48 and 3.83 respectively. Long term growth of the industry will happen largely from investors who make regular investments rather than one off investors.

Table 6.2: Distribution of investments for different investor types						
Investor type	Deal volume	1	2-8	9-15	>15	TOTAL
Panel A: Investors classified based on their promoters						
CORPVEN	No. of investors	20	24	0	4	48
	No. of deals	20	87	0	80	187
FINCORP	No. of investors	9	22	2	5	38
	No. of deals	9	98	22	159	288
GOVT	No. of investors	0	6	1	4	11
	No. of deals	0	23	11	147	181
IBANK	No. of investors	9	12	4	2	27
	No. of deals	9	50	49	74	182
PRIV	No. of investors	79	98	24	13	214
	No. of deals	79	362	274	317	1,032
Total	No. of investors	117	162	31	28	338
	No. of deals	117	620	356	777	1,870
Panel B: Investors classified based on their origin						
Domestic	No. of investors	27	53	6	10	96
	No. of deals	27	208	69	288	592
Foreign	No. of investors	90	109	25	18	242
	No. of deals	90	412	287	489	1278
Total	No. of investors	117	162	31	28	338
	No. of deals	117	620	356	777	1,870

6.3 Analysis of single investment deals

To enable further analysis of the investors who have made only single investments, the year wise number of investors who have only single investments were identified (Figure 6.3). It can be seen that the foreign investors account significantly for such investments in each of the years. While there is a possibility that subsequent investments might happen from those investors who have invested in 2008 or 2009, there is little possibility of subsequent investment happening from the 51 investors who had invested during the period 2004 – 07. On the positive side, it can be seen that the entry of new foreign investors has been robust in the past few years, even during the 2008 – 09 years of global economic crisis.

While it is understandable that foreign investors use their initial investment to test the waters before deciding on their sustained commitment for investing in the country, it is difficult to reason why a significant percentage of domestic investors have not made more than one investment. The domestic investors would have a better understanding of the market as compared to foreign investors and may not need to make a test investment. The only reason we could think is that they were probably not successful in getting suitable investment opportunities in the increasingly competitive market for quality investments.

Seen in a different perspective, the instance of single investment investors can be considered as a result of the increased competition for investments that exists in the Indian markets today. Only capable and performing investors are able to make subsequent investments.

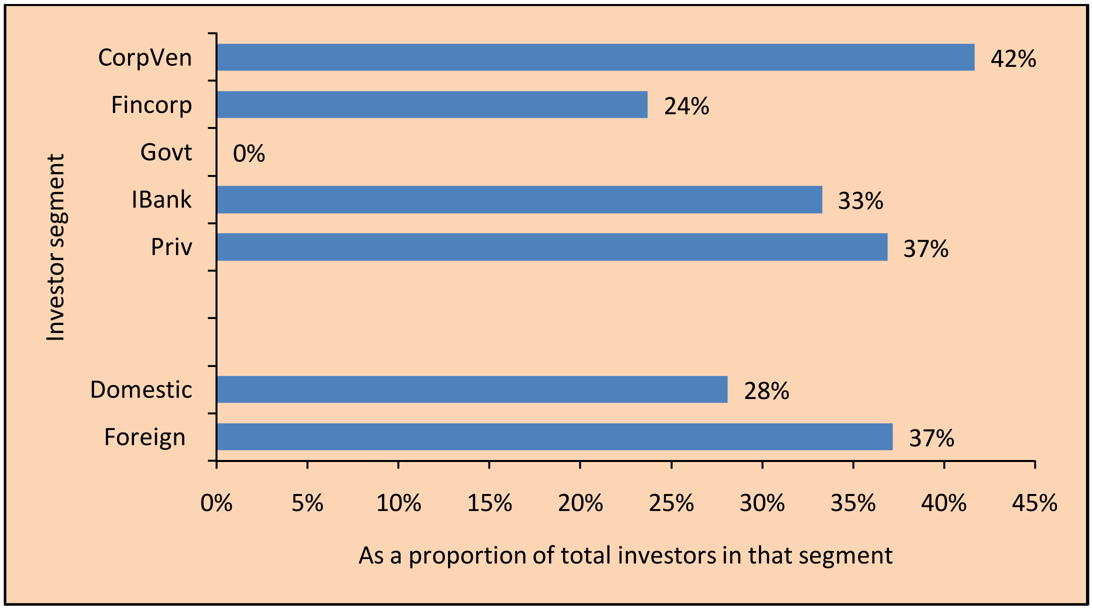

Figure 6.2: Proportion of investors in various categories who have made only single investments

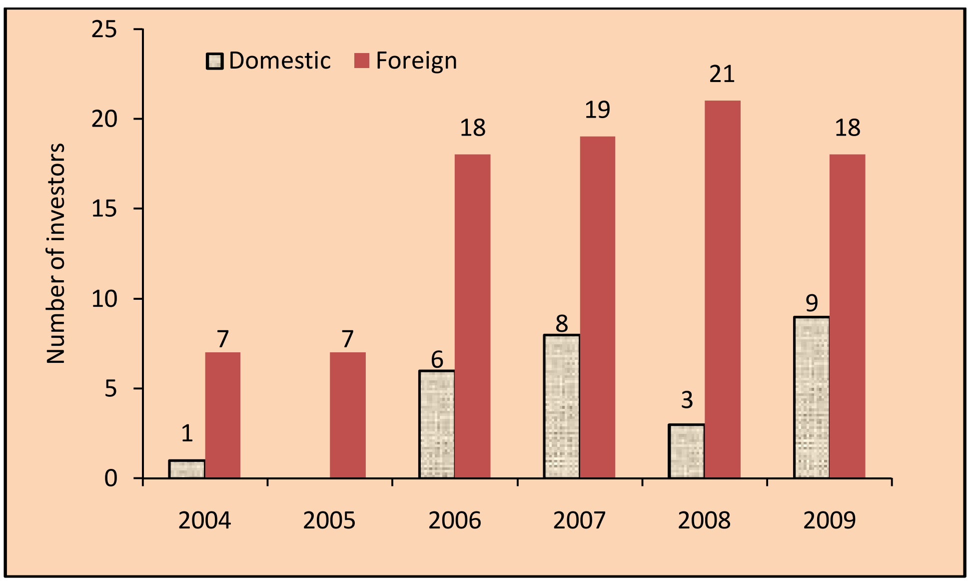

Figure 6.3: Year wise distribution of investors who have single investments

6.4 Investment patterns of domestic and foreign investors

Figure 6.4 indicates the average number of investments made by domestic and foreign investors in each of the four deal groups. The result is quite interesting. The average number of investments made by foreign investors and domestic investors is more or less the same in each of the deal groups. While one would have expected a higher number of investments for foreign investors the results does not indicate so. In the period that was studied, foreign investors are not making investments any faster than domestic investors. The total investments made by foreign investors are higher because of the higher number of foreign investors.

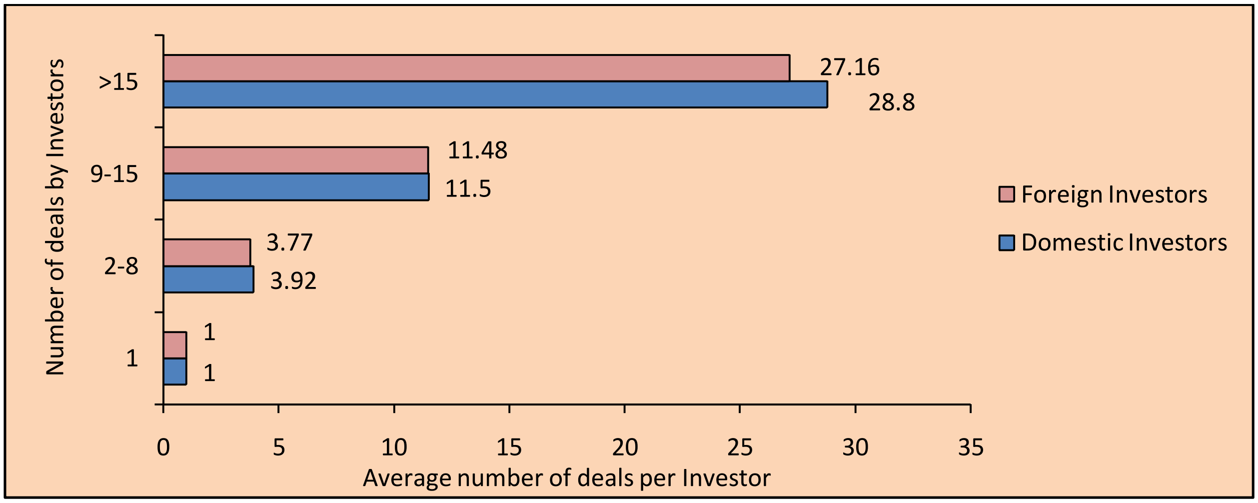

Figure 6.4: Average number of investments by domestic and foreign investors

6.5 Analysis of investors who have invested in more than 15 deals

We also analyzed the average number of investments made by different investors in the category where the investors had invested in more than 15 deals. The results are given in Figure 6.5.

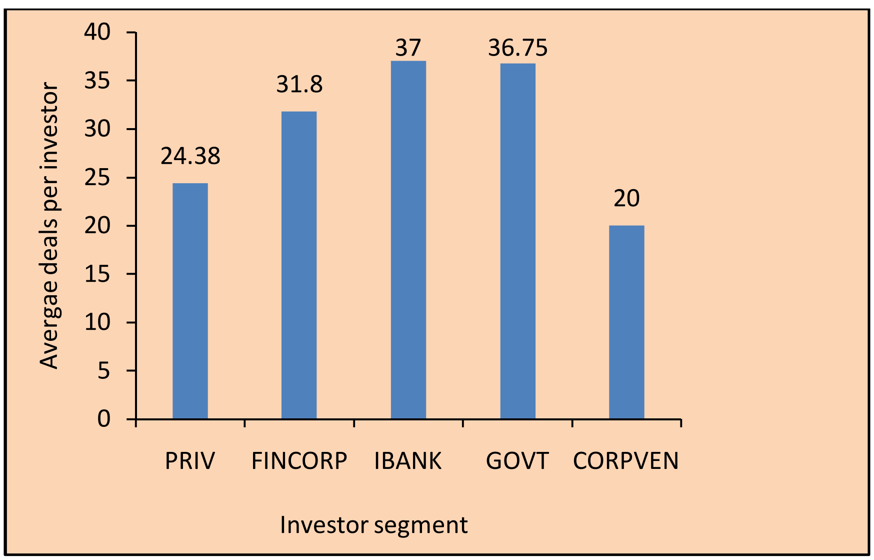

Figure 6.5: Average number of investments where investors had invested in more than 15 deals

There is a strong variation between different investors. PRIV and CORPVEN investor groups have lower average number of investments as compared to other three groups of investors. This could indicate that these investors spend more time in due diligence and investment decision making before making an investment. Both these investor groups account for 61% of the total investors who have invested in more than 15 deals. Further studies are needed to identify the reasons behind the higher average investments made by IBANK and GOVT investor categories.

6.6 Analysis of duration between deals

The previous sections focused on analyzing the total number of deals made by different investors. To get further insights we did an analysis on the duration between deals for different investors. Since 117 investors had made only one investment, this analysis was done on the remaining 211 investors who had done more than one investment. These 211 investors comprised of 66 domestic and 145 foreign investors. Table 6.3 shows the average time period between deals for the domestic and foreign Investors. The average time period was calculated by taking the duration between the first and last investment and dividing by the number of investments made.

Table 6.3: Distribution of investors based on average number of days between consecutive deals

Days between deals	Domestic investors		Foreign investors		Overall	
	No. of investors	As a % of number of investors	No. of investors	As a % of number of investors	No. of investors	As a % of number of investors
<30	0	0.00%	6	4.10%	6	2.80%
30-90	30	45.50%	43	29.70%	73	34.60%
90-180	26	39.40%	59	40.70%	85	40.30%
180-270	8	12.10%	16	11.00%	24	11.40%
270-365	2	3.00%	8	5.50%	10	4.70%
>365	0	0.00%	13	9.00%	13	6.20%

The highest proportion of domestic investors makes an investment between one to three months. The next highest proportion of investors makes an investment between three to six months. On an average, the time between two investments for a majority of the domestic investors is between one to six months. The same trend can be seen for foreign investors as well. However, the highest proportion of foreign investor falls in the category of three to six months. Our data also showed that around six investors made subsequent investments within a month of making the previous investment. The reasons behind this need to be further examined. Since this analysis is based on the date the VCPE investor makes an announcement about its investment, it is possible that the investor had bunched several of its investments in a single announcement. We also recognize that the actual date of investment may be different from the date the investment is made public. However, we assumed that the VCPE investor would make the investment public sooner than later, and therefore the announced date may not significantly differ from the date of investment. The overall trends by and large reflect realistic investment patterns. Around 75% of the investors take one to six months between two investments.

6.7 Investment during the downturn

To analyze whether there has been a flight of investors during the economic downturn 2008 – 09, we broke down the investors into two categories, those who made investments during 2008 and 2009, and those who made investments only in the years 2004-2007. The results are given in Table 6.4.

World over, the VCPE investments were significantly affected during the economic slowdown. The trend was very similar in India as well. VCPE investments in India fell from a peak of $21 billion in 2007 to $2.5 billion in 2009. This was an 88% reduction in the investments made within a span of 2 years. While the amount of investments had reduced, the number of investors making those investments, i.e., investor participation has increased. 63% of the total investors have either continued to invest during the 2008 – 09 period or made their first investment in India during this period. Only 38% of the total investors did not make any investments during 2008 - 09.

Separating the investors by origin indicates that the trend is similar across both domestic and foreign investors. 68.75% of the domestic investors and 60.33% of the foreign investors have continued to invest during 2008 – 09. It can also be seen that the number of investors who have invested in at least 7 deals is significantly larger during 2008 – 09 as compared to the 2004 – 07 period.

Table 6.4: Break down of investments by domestic and foreign Investors

No of deals	2008 - 09			2004 - 07		
	No. of investors (as a % of total no. of investors within the segment)					
	Domestic	Foreign	Total	Domestic	Foreign	Total
7 or more	21 (21.87%)	50 (20.66%)	71 (21%)	2 (2.08%)	4 (1.65%)	6 (1.77%)
less than 7	45 (46.87%)	96 (39.66%)	141 (41.71%)	28 (29.16%)	92 (38.01%)	120 (35.5%)
Total	66 (68.75%)	146 (60.33%)	212 (62.72%)	30 (31.25%)	96 (39.66%)	126 (37.27%)

VCPE investments are sensitive to changes in economic cycles. During the global economic crisis, there was a drastic reduction in the number and amount of VCPE investments made. Our analysis indicates that though the investments have decreased, the number of investors investing in India has increased. Investors seem to believe in the India story even in tough situations. On the other hand, this also indicates the increasing competition among the VCs in the marketplace. While the competition is beneficial in the long run leading to consolidation in the industry and exit of poorly performing investors, in the short term this can lead to an increase in valuations.

6.8 Deal size

We also used the deal size in our analysis of the investor characteristics. The deals were classified into six categories, based on the amount of investment. The results are given in Table 6.5.

Table 6.5: Investors and deal sizes

Deal size ($, million)	Domestic investors			Foreign investors			Overall	
	Partici-pation %	No. of deals	Invested amount ($, million)	Partici-pation %	No. of deals	Invested amount ($, million)	No. of deals	Invested amount ($, million)
0-20	94%	362	2,363.35	80%	662	5,601.01	1,024	7,964.36
20-40	26%	64	1,800.92	36%	184	5,212.44	248	7,013.36
40-60	13%	20	1,046.02	18%	68	3,490.72	88	4,536.74
60-80	6%	8	579.35	10%	34	2,360.18	42	2,939.50
80-100	7%	7	671.70	13%	32	3,011.16	39	3,682.85
>100	4%	5	701.15	15%	65	19,386.94	70	20,088.08

The results are given separately for domestic and foreign investors, as well as for the overall investments. Participation indicates the number of investors in that category who have made at least one investment in that deal size. This attribute can be seen as a measure of the preference of a particular segment of investors to invest in the respective deal range. For example, a participation of 94% for domestic investors in the 0 – 20 $million category indicates that 94% of the total domestic investors have made an investment in that range. As it can be expected, participation reduces as deal size increases. There are fewer investors who participate in deals of higher value.

It can also be observed that the participation of foreign investors is higher at larger deal sizes. On the other hand, the participation of domestic investors is highest in the 0 – 20 million range. This further confirms that foreign investors tend to invest more in larger deals. Another interesting feature that can be observed is the variability in the investments made by investors. Investors tend to invest in deals where the investment amount varies widely. Given the large variation, an analysis based on average deal sizes may not completely capture the investor trends.

Figure 6.6 provides a graphical view of the results. It can be seen that at higher deal sizes, the participation of foreign investors is consistently higher than that of domestic investors. 20% (or 45) of the foreign investors have no deal less than $20 million, whereas for domestic investors, this figure is only 6%. In deal sizes greater than $100 million only 4% (or 3) domestic investors have participated as compared to 15% (or 34) foreign investors. The deal sizes above $100 million have brought investments as much as $20 billion over the last 6 years and constitutes nearly 41% of the total VCPE investments. Since a majority of these large deals are invested by foreign investors, they in turn account for a major proportion of the VCPE investments in India. Though there are 1024 deals (68% of the total deals) less than $20 million, they account for less than 17% of the total investments.

Table 6.6 provides details of the number of deals and investment made in the six different categories for investors classified on the basis of the promoters. PRIV category investors invest in more deals in each of the deal size categories. They also invest the highest among all investors across deal sizes. But the point to be noted is that 15% of the PRIV investors have not invested in deals less than $20 million. This figure is in the same range for other investor categories, except IBANK, where the proportion of investors who have not invested in deals less than $20 million is significantly higher at 29%.

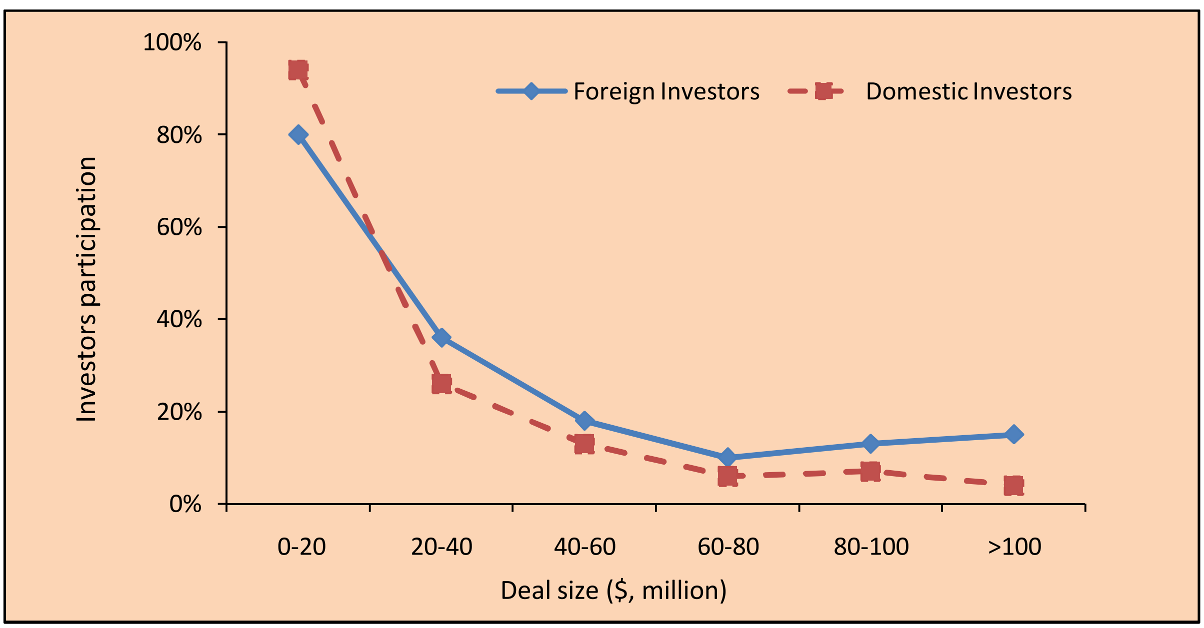

Figure 6.6: Participation of investors in different deal sizes

Interesting trends were observed for deals than $100 million. The IBANK category accounts for the highest proportion of those investors (33%) who have invested in deals greater than $100 million. This is followed by GOVT category (27%), and FINCORP category (19%) of investors. In the PRIV category, only 8% of the investors have invested in deals greater than $100 million. This indicates that the funds managed by PRIV investors might not be large enough for them to invest in very large deals. The trend for the CORPVEN category of investors is also as expected. The highest percentage of investors in CORPVEN invests in deals less than $20 million. The results also indicate that as the deal size increases, the proportion of investors falls dramatically. While this is true of all investor categories, the proportion of investors investing in larger deal sizes do not fall as much in the IBANK category as in other investor categories. IBANK has the highest proportion of investors for deals greater than $20 million. This indicates their comfort in investing in large deals. Figure 6.7 graphically maps the proportion of PRIV and IBANK investors for different deal sizes.

Table 6.6: Investor participation in various deal sizes based on type of VCPE firms

Investor type	Deal Size ($, million)	0-20	20-40	40-60	60-80	80-100	>100
CORPVEN	Participation (%)	88%	29%	7%	7%	2%	7%
	No. of deals	107	21	3	4	1	4
	Investment ($, million)	815.67	580.6	149.63	284.36	100	1673
FINCORP	Participation (%)	86%	43%	30%	16%	16%	19%
	No. of deals	150	57	20	8	7	12
	Investment ($, million)	1,283.89	1,651.56	1,049.29	539.92	647.7	1,780.61
GOVT	Participation (%)	82%	36%	27%	18%	9%	27%
	No. of deals	131	16	5	4	1	6
	Investment ($, million)	750.27	488.48	249.8	276.2	100	3,084.36
IBANK	Participation (%)	71%	58%	38%	13%	25%	33%
	No. of deals	54	45	23	5	7	19
	Investment ($, million)	568.1	1265	1189	340.3	652.7	4774
PRIV	Participation (%)	85%	29%	13%	7%	11%	8%
	No. of deals	582	109	37	21	23	29
	Investment ($, million)	4,546.4	3,027.5	1,898.65	1,498.7	2,182.43	8,776.48

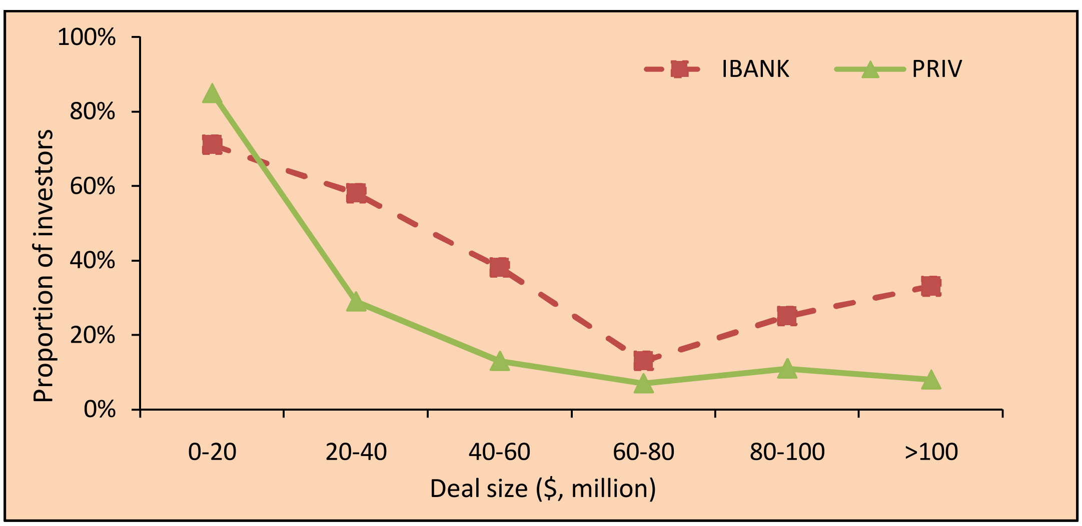

Figure 6.7: Participation of PRIV and IBANK investors in different deal sizes

6.9 Investments in different industries

For this analysis, the number of deal slabs to three from the earlier six. This helps to understand the key underlying trends while keeping the analysis simple. With a limited category of deal sizes, it would be interesting to analyze the characteristics of investors investing in different industries. The investments made by both domestic and foreign investors in the three different deal slabs in each of the 9 industry categories were tabulated. The results are given in Table 6.7.

Table 6.7: Industry wise investment for different categories of deal sizes

	Domestic investors			Foreign investors		
Deal size ($, Million)	0-20	20-40	>40	0-20	20-40	>40
IT & ITES	286.2 (12.1%)	169.6 (9.4%)	51 (1.7%)	1,704.3 (30.4%)	555.1 (10.6%)	3,968.1 (14.0%)
Healthcare & Life Sciences	276.8 (11.7%)	217.2 (12.0%)	50 (1.6%)	587.1 (10.4%)	380.1 (7.2%)	953.7 (3.3%)
Manufacturing	455.7 (19.2%)	176.8 (9.8%)	170.9 (5.7%)	969.5 (17.3%)	908.4 (17.4%)	1,667.9 (5.9%)
Engineering & Construction	391.6 (16.5%)	519 (28.8%)	846.5 (28.2%)	464.5 (8.2%)	1079.5 (20.7%)	3,980.2 (14.0%)
Telecom & Media	120.3 (5.0%)	55 (3.0%)	430 (14.3%)	197.7 (3.5%)	382.6 (7.3%)	6,839.4 (24.2%)
Transportation & Logistics	141.9 (6.0%)	331.4 (18.4%)	213 (7.1%)	283.5 (5.0%)	310.8 (5.9%)	1106.1 (3.9%)
BFSI	214 (9.0%)	97.7 (5.4%)	1,066.3 (35.5%)	611.5 (10.9%)	839.1 (16.0%)	7,892.2 (27.9%)
Non-Financial Services	99.4 (4.2%)	30 (1.6%)	114.4 (3.8%)	262.3 (4.6%)	289 (5.5%)	880 (3.1%)
Other Services	376.9 (15.9%)	204 (11.3%)	56 (1.8%)	520 (9.2%)	467.4 (8.9%)	961.1 (3.4%)

- Though all deals lower than $20 million accounted for just 17.22% (or $7,964.36 million) of the amount of investment, they constituted 68% (or 1,024) of the deals during 2004-2009. This can lead to the inference that deals less than $20 million is commonly preferred by the investors.

- In investments of deals than $20 million, foreign investors have 30% of their investments in IT and ITES in contrast to just 12% by domestic investors. In the same deal slab, Manufacturing, and Engineering & Construction sectors seemed to be one of the favorites for domestic investors. These sectors received 19.2% and 16.5% of all domestic investments respectively. Our analysis indicates a strong differentiating factor between domestic and foreign investors. Domestic investors have a high preference to invest in more core engineering sectors with tangible assets whereas foreign investors seem to have a preference for investing in technology led sectors like IT and ITES, which is a major constituent of the services sector. It needs to be noted that the services sector contributes about 55% of India GDP.

- Number of deals between $20-40 million was 248 and this accounted for a total investment of $7,013.33 million. In terms of proportion, the number of deals in this slab accounted for 16% of the total deals. No specific trend could be observed between the two investor groups in this deal slab.

- Number of deals that were greater than $40 million was 239, accounting for 16% of the total deals. But what strikes most is that these 239 deals brought investments amounting to $31,247.22 million, accounting for 68% of the total investments. However, the total investments made by domestic investors were just $2,998 million in this deal category. This just goes to show how aggressively foreign investors have participated in high value deals in India.

- An interesting aside that can be observed is the 80:20 principle in the Indian VCPE investments. 16% of the deals accounted for 68% of the investments, and 68% of the deals accounted for about 16% (the exact number that we get from the analysis is 17.2%) of the investment.

- In the deals greater than $40 million category, Engineering and Construction (28%) and BFSI (35%) accounted for a large proportion of deals invested by domestic investors. In contrast only 1.7% of these investments came to IT and ITES sector from domestic investors. Foreign investors on the other hand have invested a healthy $3.98 billion (or 14%) in the IT and ITES sector though Telecom and Media (24.2%) and BFSI (27.9%) received the bulk of the Investments. In a way, the trend in this deal segment is also very similar to the one observed in the less than $20 million deal segment. Domestic investors seem to have a preference for 'brick and mortar' industry sectors, whereas foreign investors seem inclined to invest in technology sectors.

Since the large deals contributed significantly to make India as one of the fastest growing VCPE investment destinations, we decided to study this in more detail. We plotted two graphs for this purpose. In the first graph, we plotted the number of deals invested by both domestic and foreign investors, where the investment was more than $40 million in each of the years 2004 – 09. The results are given in Figure 6.8. In the second graph, we plotted the investments made by domestic and foreign investors in these deals for each of the years. The results are given in Figure 6.9.

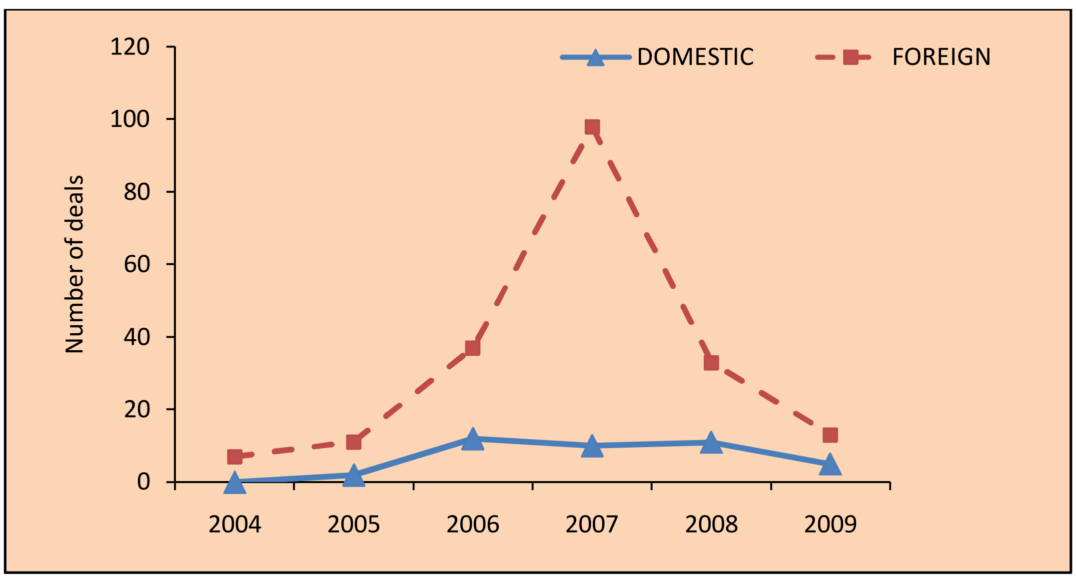

Figure 6.8: Number of investments in deals greater than $40 million

The results, as can be seen, from the two graphs are striking. While the trend line for domestic investors did not change significantly throughout, the trend line for the foreign investors show a strong spike between 2005 and 2009, with a peak in the year 2007. The steady trend from the domestic investors is a picture of contrast when compared with the trend of the foreign investors.

Foreign investors, who had a comparable number of deals with that of domestic investors in 2004, grew substantially in the years of global expansion, 2005-2007. Following the global financial crisis, the gap in the number of deals between the domestic and foreign investors reduced and reached a level that was close to what was seen during 2004. The year 2005 was the inflection point from where the number of deals of foreign investors took off especially in the deals greater than $40 million. Favorable macroeconomic conditions, global economic boom, robust domestic GDP growth resulted in large amounts of private equity funding in India especially in deal sizes greater than $40 million.

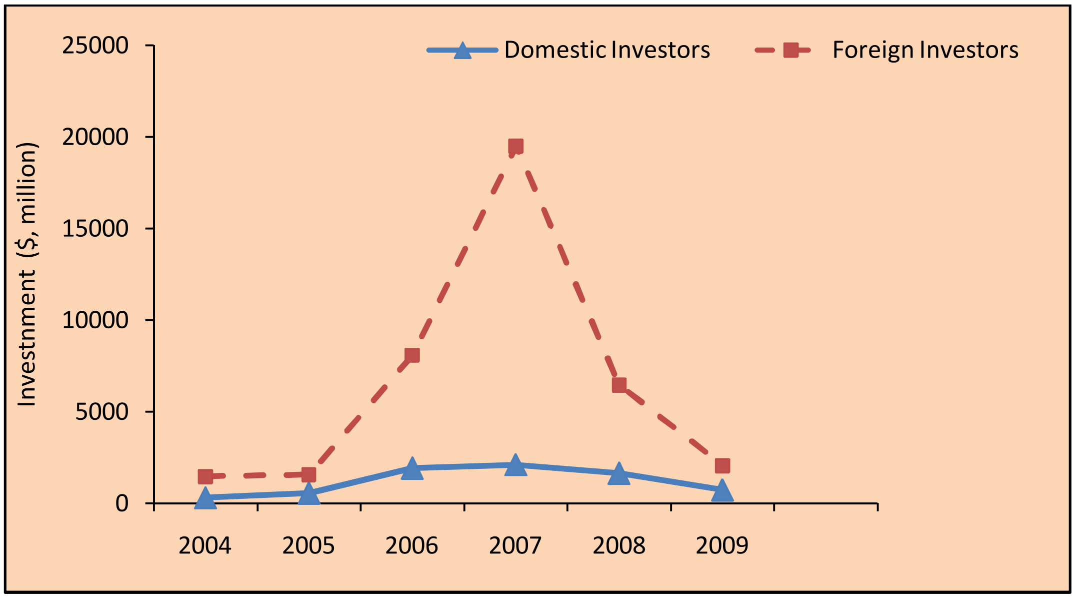

Figure 6.9: Investments in deals greater than $40 million

The finding indicates that the huge growth in investments in India were primarily because of foreign investors who heavily invested in much larger deal sizes that was not observed earlier in the Indian VCPE industry. The growth in number of deals in higher deal sizes of foreign investors also signifies the higher risk taking capability and the larger fund sizes of foreign investors compared to that of domestic investors. This can be clearly observed in growth of deals greater than $40 million. Deals by foreign investors grew from a mere 20 to 100 within a short span, whereas it hovered around 10 to 12 per year for domestic investors.

The impact of the high value investments on the growth of the Indian VCPE industry was statistically analyzed using a bivariate regression and ANOVA. The results indicate a strong cause and effect relationship between the growth in the number of deals greater than $40 million and the total investments over the years 2004-2009. The R-square for the regression, indicating the goodness of fit of the regression was very high at 0.9957. ANOVA results also showed a very high significance between these two factors. In sum, the engine of growth for the Indian VCPE investments during 2004 – 09 has been the large investments by foreign investors.

6.10 Shareholding acquired by investors

The percentage shareholding acquired by investors in their investments was also analyzed. Since most companies or investors do not provide information on the stake acquired in an investment, the information on shareholding acquired was not available for all the investments. Data was available only for 667 deals. The analysis done on these 667 deals is given in Table 6.8.

Table 6.8: Percentage of shareholding acquired						
Shareholding	Domestic investors		Foreign investors		All investors	
	Number of Deals	% of deals	Number of Deals	% of deals	Number of Deals	% of deals
<10%	62	34.25%	187	38.47%	249	37.33%
10-20%	52	28.72%	125	25.72%	177	26.54%
20-30%	36	19.88%	78	16.04%	114	17.09%
30-40%	12	6.62%	38	7.81%	50	7.50%
40-50%	9	4.97%	26	5.34%	35	5.25%
>50%	10	5.52%	32	6.58%	42	6.30%
Total	181		486		667	

The analysis indicates that there is no significant difference between domestic and foreign investors in terms of shareholding acquired. In more than one-third of the total deals the percentage shareholding acquired by the investors has been less than 10%. The percentage shareholding acquired is less than 20% in more than 50% of the deals that have been analyzed. While there is scope to increase the depth of analysis with more information on the round of investment as well as the stage of investment, our finding indicates that the overall trend for VCPE investors in India is to invest in smaller stakes.

6.11 Investment consistency

Investment consistency has been defined as the regularity in which the investor makes investments. We have tried to capture the dimension of investment regularity by analyzing whether the investor has made investments in each of the years, 2004 – 09. Even if an investor has made significant number of investments in the six year period, we feel that it is important that these investments occur regularly rather than in spikes. Sustainable long term growth of the industry depends not only on the number of the investments but also on the consistency of the investments.

Table 6.9 provides our findings on investment consistency for both domestic and foreign investors. It indicates the number of years out of the six year period 2004 – 09 in which the investors have made at least one investment. For example, there are 28 domestic investors who have at least one investment in two of the six years. Similarly, there are 42 foreign investors who have made at least one investment in three of the six years.

Table 6.9: Investment consistency		
Number of years in which there is at least one investment	Domestic investors	Foreign investors
1 Year	40	115
2 years	28	46
3 years	10	42
4 years	7	27
5 Years	7	6
All 6 Years	4	6
Total	96	242

The analysis indicates that only a handful (exactly 10) have invested in each of the six years. If we assume that investors who invest in less than three of the six years as inconsistent investors, then we can find that 71% of the domestic investors can be considered as inconsistent investors. Similarly, 67% of the foreign investors can be considered as inconsistent investors. It is surprising that there has not been any large difference in the degrees of consistency between the two investors. If at all, foreign investors can be considered to be marginally more consistent as compared to domestic investors.

We also analyzed the year in which the investors made their last investment. The results are indicated in Figure 6.10. The graph indicates that a total of 117 investors, about 35% of the investors in our sample, have not made any investments since 2007. The proportion of foreign investors who have not made any investments since 2007 is marginally higher than that of the proportion of domestic investors. The proportion of foreign investors who have not made any investment since 2007 is about 36%, whereas the same proportion for domestic investors is about 30%. Since they have not made any investments in the last two years, it is reasonable to assume that these investors might have withdrawn from making further VCPE investments. It would be interesting to study the reasons behind the withdrawal by various investors.

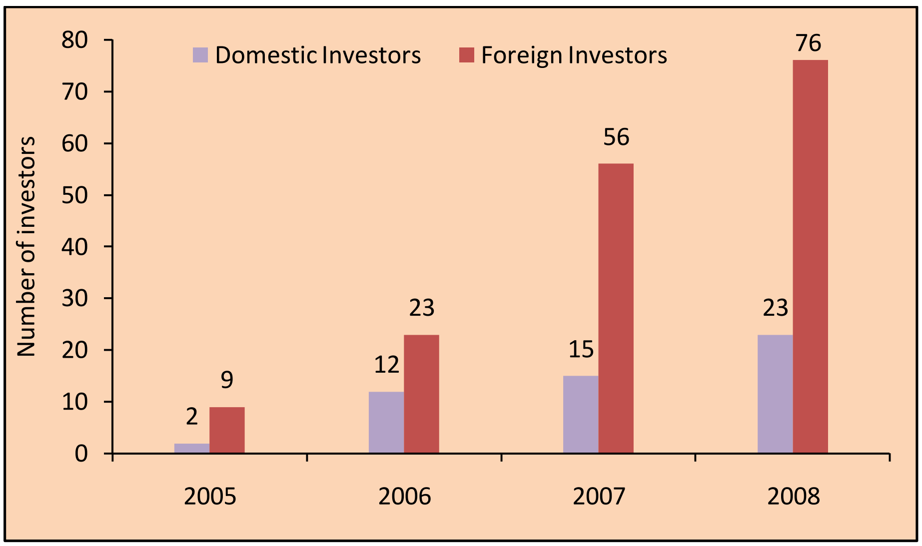

Figure 6.10: Number of investors and the year in which they made their last investments

Simultaneously, we also analyzed the number of investors who have made first their investments in various years (Figure 6.11). This indicates the number of new VCPE investors who have entered during the study period. It can be seen that the number of new investors, both domestic as well as foreign investors have steadily declined since 2006. The number of investors who entered substantially increased in 2006 as compared to 2005, but after that there has been a steady decline. In the steady state, the number of new investors should number more than the number of investors exiting. For achieving growth, the number of new investors should be more than the investors who are exiting. If we consider Figure 6.10 as an indicator of investor exit, then there is a concern for the long term growth of VCPE industry in the country. The number of investors who are withdrawing has an increasing trend, and the number of new investors has a declining trend. While the period under study is not very long to make definitive conclusions of this trend, this certainly highlights the need for detailed study on the factors that can impact the long term growth rate of the industry.

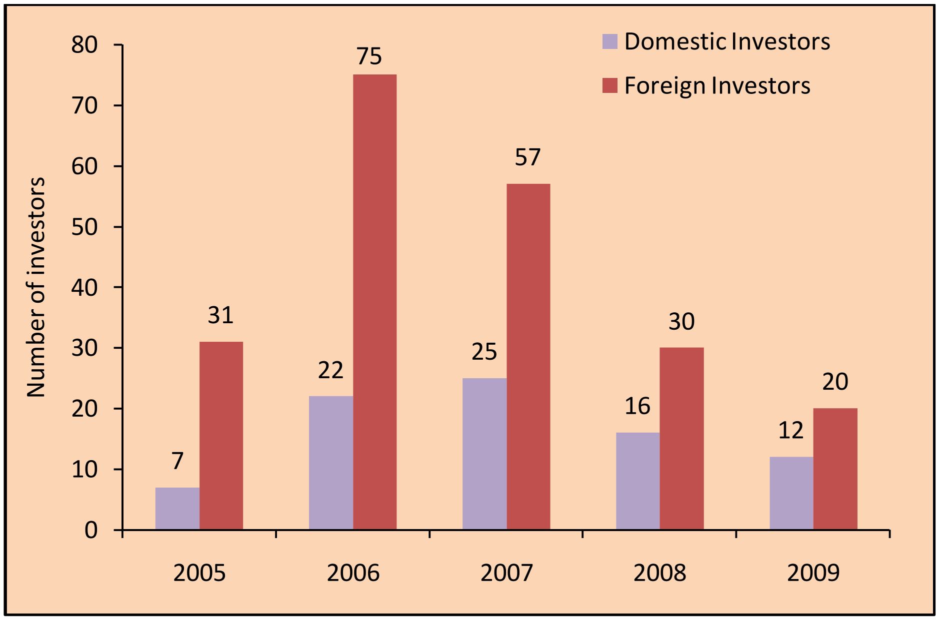

Figure 6.11: Number of investors who made their first investments in different years

6.12 Summary

This chapter supports the findings of the earlier chapters that most VCPE investment has been from foreign investors. It has been found that though there are a large number of VCs operating in India, only a few of them are active and continue to make investments on a sustained basis. 35% of the investors had invested in only one deal. Foreign investors account for a substantial number of those investors who have made only one investment. However, the average number of investments made by foreign investors and domestic investors does not vary significantly. This indicates that foreign investors are not making investments faster than domestic investors. But the number of investments by foreign investors is higher because of the higher number of foreign investors. Analysis of investment duration indicates that for most of the domestic investors the time duration between two investments is between 1 – 3 months, whereas for foreign investors it is between 3 – 6 months. In more than one third of the investments, the percentage shareholding acquired by the investors has been less than 10%. An analysis of the investment consistency indicates that only 10 of the 338 investors have made at least one investment in each of the six years.

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7.0 Profiling the Angel Investors and VCPE Fund Managers

7.1 Introduction to angel investors

Non promoter early stage equity funding for entrepreneurial companies can come from broadly two sources: institutional and formal sources such as the VCPE funds and informal sources such as angel investors. We have seen the strong growth of institutional funding sources in India in the last few years. Simultaneously, the informal funding sources such as the angel investors have also grown. For example, the Chennai Fund (www.chennaifund.com) and Indian Angel Network (www.indianangelnetwork.com) are some of the attempts to formalize angel investments in India.

Simply put, angel Investors are generally High Net-worth Individuals (HNI's) who provide capital to small start-up companies in return for an ownership stake in the company. This form of investment can also be perceived as a scaled down version of VCPE investment discussed in earlier sections. Though VCPE investors are more professional and sophisticated structuring than angel investors, the angels provide value to the portfolio companies in terms of their prior business experience.

Funding by angel Investors is a lifeline to many small startup firms who require funding at seed stage. Since VCPE investors do not normally fund such small amounts, angel investments remain a very important source of funding for entrepreneurs. In most circumstances, the angel investors are the first non promoter investors in entrepreneurial firms and they make their investment before investment from VCPE funds.

7.2 Sample used for the study

The objective of this chapter is to present an analysis of the background of the angel investors and VCPE fund managers in India. It is felt that such an analysis would help the entrepreneur to understand better the requirements of the investors and the value addition that they can provide to the portfolio companies. Two sets of analysis are presented in this chapter – on angel investors and on VCPE fund managers.

The analysis on angel investors was based on the secondary data available on the background and experience of 49 angel investors from various angel networks that operate in India. The analysis of VCPE fund managers was based on the analysis of background and experience of 100 fund managers from various VCPE funds that are active in India. In both the cases, the samples for inclusion in the analysis were chosen randomly but it was ensured that the profile chosen represented a typical investor in the segment to avoid outliers influencing the analysis. While we admit that the sample used in the analysis is not very large, it nevertheless helps getting a broad picture of a typical angel investor or VCPE fund manager in India.

7.3 Profile of angel investors

Table 7.1 presents the results from our analysis on the background of angel investors. It shows the distribution of the angel investors on various parameters: their industry expertise, type of company they have worked or currently working for, their education, and whether they have many years of international experience. The industry expertise was classified into 8 categories, and the nature of work experience in each of the industries was also recorded. The nature of work experience was divided into four types: entrepreneurial, operational, investment, and operational and investment. If the angel investors had expertise in more than one industry or nature of work experience, each was captured separately. The main findings are summarized below.

Table 7.1: Analysis of the profile of angel investors in India						
Angel attributes	Nature of work experience				Total	As a % of angels analyzed
	Entrepreneurial	Operational	Investment	Operational and investment		
INDUSTRY EXPERTISE						
IT & ITES	3	14	1	3	21	42.9%
Healthcare	0	2	0	0	2	4.1%
Engineering and Construction	3	19	13	5	40	81.6%
Manufacturing	1	11	0	0	12	24.5%
Telecom and Media	0	4	0	3	7	14.3%
Transportation and logistics	0	1	1	0	2	4.1%
BFSI	0	5	14	5	24	49.0%
Others	0	9	1	0	10	20.4%
WORK EXPERIENCE						
Private Equity Firms	0	2	5	1	8	16.3%
Corporations	0	19	6	4	29	59.2%
Entrepreneur	3	4	0	1	8	16.3%
Investment Banks	0	0	3	0	3	6.1%
BACHELOR DEGREE						
Engineering	1	10	1	4	16	32.7%
Commerce	0	3	8	0	11	22.4%
Sciences	1	0	0	0	1	2.0%
Humanities	1	5	4	1	11	22.4%
Law	1	0	1	0	2	4.1%
MASTERS' DEGREE						
MBA	1	17	9	5	32	65.3%
Technology	1	0	0	0	1	2.0%
Humanities	0	3	2	0	5	10.2%
INTERNATIONAL EXPERIENCE						
International experience	1	14	5	0	20	40.8%

- It can be noted that a majority of angel investors had expertise in the Engineering & Construction sector. In a way this is a surprising finding as one would have expected that angel investors would be largely from the technology and other services sectors. Angel investors who have expertise in Banking and the IT & ITES sectors account for only 49% and 42.9% respectively of the investors profiled. This is substantially lower than those who had experience in the Engineering & Construction sector. Since business angel investors tend to invest in sectors in which they have expertise, there is a need for further analysis on the investments made by angel investors. If they are investing in a sector in which they have expertise, then they are able to add a lot of value to their investee companies. If they are investing in a sector in which they do not have any prior experience, then their investments can be considered as pure financial investments.

- Information about the type of companies that the angel investors have worked for was available for 48 of those who were profiled. Nearly 60% of the angel Investors have experience of working in large corporations, 16% for Private Equity firms and 6% were from Investment banks. Again it is a bit surprising to note that not many of those who have been profiled have entrepreneurial backgrounds. The highest proportion has been those with operational experience.

- Of the 38 investors where information was available on their Masters' degree, a majority of them had MBA degrees. This indicates that most of the angel investors have an educational background in management and business and they are not just technocrats.

- Less than half of those profiled had international experience. Given their experience in domestic markets, it is felt that angel investors would be better equipped to evaluate and invest in opportunities that have a strong relevance for the Indian markets. Given the imperative to promote domestic funding sources for entrepreneurial companies, having policies that encourage angel investment can benefit both investors and entrepreneurs alike. Angel investors can provide the much needed seed and early stage funding and this would increase the deal flow to VCPE investors who make larger investments in later stages.

7.4 Profile of VCPE fund managers

A sample of 100 fund managers from various VCPE firms operating in India was used in this analysis. The sample was chosen from those firms who are currently operating in India. The fund managers whose profiles have been used in this analysis are at the level of General Partners (GPs) and the profile data was taken from the websites of the respective firms.

Analysis was done on the professional experience of the fund managers. The work experience was broadly classified into four domains: financial management, operational management (which includes roles that are other than financial management such as marketing, manufacturing, human resources, CEO, etc.), both financial and operational management, and those who have been entrepreneurs. Each fund manager was classified in any one of the four categories depending on the major area in which they had experience. Figure 7.1 presents the results from the analysis of their work experience.

The findings support what has generally been felt in the industry i.e., VCPE industry in India is dominated by fund managers having expertise in financial management. This probably is the reason why most investments are PE type investments rather than VC type investments. A VC investor is expected to invest in early stages and spend a higher proportion of their time with the investee companies after investment. Fund managers with operational experience or entrepreneurial experience are better equipped to make early stage investments as they would be able to contribute to the operational aspects of the business in addition to capital. Therefore the impetus to early stage financing can happen in India when more fund managers have operational experience. While the report has not done a comparative analysis of the experience that fund managers have in other countries like the US, it is felt that fund managers with operational experience would account for a higher proportion of fund managers as compared to what is seen in India. Our analysis also indicates that fund managers in India are seasoned professionals having many years of professional experience. On an average they have about 18 years of work experience. VCPE investors add a lot of value in areas such as strategy formulation, recruitment of senior management, putting in place systems and processes, etc. In addition, they also become members of the board of companies in which they invest. Prior work experience and the networks that the VCPE investors have developed over the years can be very helpful in the post investment involvement with the portfolio companies.

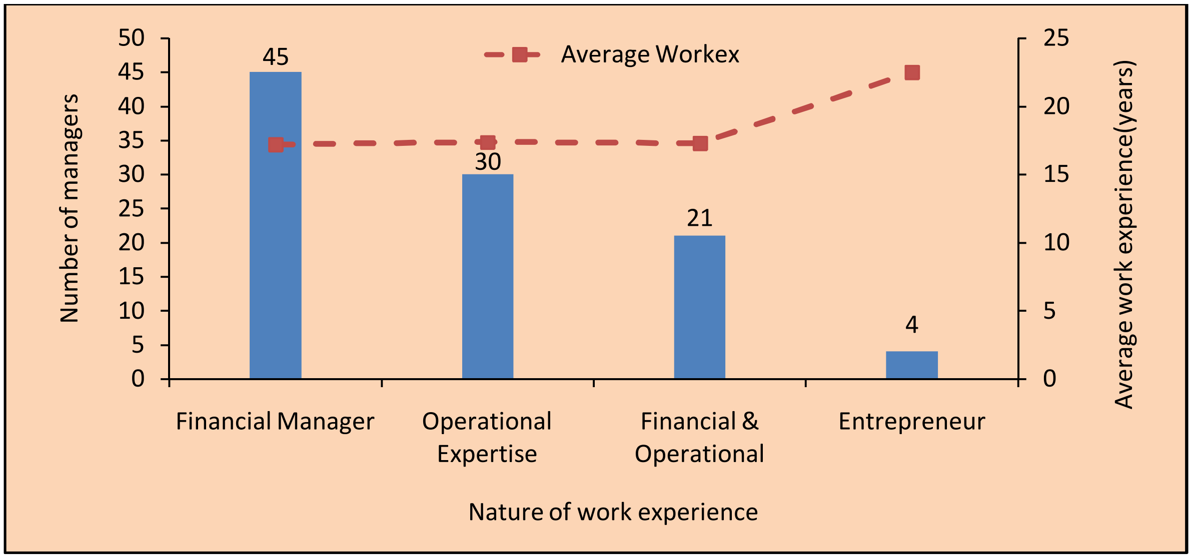

Figure 7.1: Experience of VCPE fund managers (Nature of work as well as number of years)

In terms of the educational background, that 62% of the fund managers had their bachelors' degree in engineering subjects, and 69% of them had a masters' degree in business administration. 48% of the fund managers had the classical combination of being an Engineer – MBA. Chartered accountants did not account for a large proportion, with only 17% of the fund managers being professional chartered accountants.

Table 7.2 provides an indication of the GPs work experience in different sectors as well as the nature of their experience. In this analysis, all the work experience of the fund managers was captured. For example, if the fund manager had operations experience in the IT & ITES sector and later became an entrepreneur in the Healthcare sector, both the experiences were included in the analysis. Main findings are:

- 87% of those profiles that was used in the analysis had experience in financial management. This was followed by those with operations experience – 66% of the sample had operations experience. Only 7% had entrepreneurial experience. This further highlights the dominance of financial management expertise among VCPE fund managers in India.

- 66% had experience in the BFSI sector. Taken together with the previous finding, this indicates that a majority of the fund managers in India were those who have worked in financial management roles in the BFSI sector.

- 42% had experience in the IT & ITES sector. What is interesting to note is that most of the GPs who had experience in this sector, had operational experience. The same trend can be seen among those who have had experience in the manufacturing sector.

Table 7.2: Analysis of the profile of VCPE fund managers in India						
Fund manager attributes	Nature of work experience				Total	As a % of those analyzed
	Financial management	Operations	Financial Management and Operations	Entrepreneur		
INDUSTRY EXPERTISE						
IT & ITES	11	16	13	2	42	42.0%
Healthcare	5	3	1	1	10	10.0%
Engineering and Construction	13	10	5	2	30	30.0%
Manufacturing	9	12	4	0	25	25.0%
Telecom and Media	5	4	4	0	13	13.0%
Transportation and logistics	3	4	0	0	7	7.0%
BFSI	37	11	17	1	66	66.0%
Others	4	6	4	1	15	15.0%
As a % of those analyzed	87%	66%	48%	7%		

7.5 Summary

A comparison of the profiles of angel investors and fund managers is quite interesting. A majority of angel investors had experience in the engineering and construction sector. There was a significant percentage with experience in the manufacturing sector too. In terms of the functional experience, most of them had operational experience. While the trends on functional experience is as expected, the trend of more of the angels having experience in the traditional sectors was not quite on expected lines. One would have expected that most of them to have had experience in the technology or services sectors. Most GPs in the VCPE firms on the other hand have experience in financial management and not as much in operational areas. This probably explains the reason behind why most VCPE investments are late stage and PE type investments rather than early stage VC type investments. There is a need to do such an analysis on a larger sample size to confirm the patterns seen in this exploratory study.

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