

An empirical study of venture capital scenario in India with reference to Gujarat State

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Abstract

Increase in GDP is an important objective for any government. For the purpose it is very essential that the economic activities in form of business and industries are increasing. To start with any economic activity, fund is required. Without fund it is not possible to arrange other factors of production. It will be just like a fuel without which the machine would not operate. However, at the initial stage getting fund is difficult for the entrepreneurs as traditional sources of finance such as banks and financial institution would be reluctant as at this stage return is uncertain and risk is very high. In such a case, venture capital would be solution of the problem. Venture capitalist would be the fund provider to new startups and will go for taking more risk with an anticipation of making more return. However, different sector or industry would have different risk – return profile and as a result different degree of attractiveness to the venture capitalist. This paper is prepared based on amount of fund invested in various sectors by venture capitalist over last three years with special reference to Gujarat state. The findings suggest that all sectors are not having same attractiveness for the venture capitalist. It is also discussing some of the reasons for such behavior.

Key Words:

Entrepreneur, Venture Capital, Startups, Venture Capitalist



Introduction:

Growth and development of any country is measured in terms of increase in economic activities which in turn is judged by its GDP. Increase in business and trades is very important for rise of GDP. Every government is concerned about this and as a result is also trying to provide conducive environment for growth of businesses. However, the situation is not so good. The following table shows quarter wise GDP for the year 2016-17 and 2017-18.

Table – 1
Quarter wise GDP of India

| Items | 2016-17 | | | | 2017-18 | |
|--------------|----------------|------------|------------|------------|----------------|------------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 |
| GDP | 7.9 | 7.5 | 7.0 | 6.1 | 5.7 | 6.3 |

Source: CSO

The GDP in FY 2016 – 17 has shown a growth rate of 7.1 percent (Y-o-Y). Q4 of 2016 – 17 showed 0.9% decrease over previous quarter. Q2 of 2017 – 18 showed 1.2% decrease as compared to Q2 of previous year. The World Bank has downgraded India's economic growth forecasts to 6.7 percent and 7.3 percent for 2017 and 2018 respectively and it's a big concern.

Our country is having second largest population of the world and perhaps the highest population of young age i.e. between 18 to 35 years. Every year lakhs of students are completing their graduations in our country in the field of commerce, science, management, engineering etc. Most of them are seeking meaningful employment after their studies. However, some of them have great ideas which if executed properly can make wonders. They have huge potential to be entrepreneurs as they are having necessary skills and knowledge for business. What they mainly required to start with their own venture is necessary funds. They are generally lacking funds in their own capacity and hence they seek funds from others. At this juncture, the traditional sources of financing such as banks, are not easily giving them helping hand as they lack collateral. This is a situation which can result into huge gain but there is uncertainty which is viewed as high risk. So, in short it is a situation of high risk and high return. In such a situation, venture capitalists come into picture.

Venture Capital:

So, who are the venture capitalists? In simple words those entities who are ready to take high risk and are willing to invest in new ventures in form of capital with an expectation of earning a great return. The meaning of venture capital fund and venture capital undertaking as given by SEBI is reproduced below as per SEBI Venture Capital Funds (VCFs) Regulations, 1996:

A Venture Capital Fund means a fund established in the form of a trust/company; including a body corporate, and registered with SEBI which (i) has a dedicated pool of capital raised in a manner specified in the regulations and (ii) invests in venture capital undertakings (VCUs) in accordance with these regulations. A Venture Capital Undertaking means a domestic company (i) whose shares are not listed on a recognized stock exchange in India and (ii) which is engaged in the business of providing services/production/manufacture of articles/things but does not include such activities/sectors as are specified in the negative list by SEBI with government approval-namely, real estate, nonbanking financial companies (NBFCs), gold financing, activities not permitted under the industrial policy of the Government and any other activity which may be specified by SEBI in consultation with the Government from time to time. So venture capital is type of financing which is quite different than traditional financing. It is risk financing.

Evolution of Venture Capital in India:

The growth of venture capital industry in India is not very phenomenal as compared to other developed countries even developing countries. The history of evolution goes back to year 1973. Till this time, organised form of venture capital industry was not existing. The important development of venture capital industry can be highlighted as follows:

In 1973 a committee was constituted by Government of India for giving recommendation on Development of Small and Medium Enterprises. It has highlighted the need to foster venture capital as a source of funding new entrepreneurs and technology pursuant to which some public-sector funds were setup which were mainly financing high-technology projects.

In 1988, the Government of India announced first guidelines for venture capital funds. This was a policy initiative based on a study undertaken by the World Bank to examine the possibility of developing venture capital in the private sector. As per these guidelines, only banks and financial institutions were only allowed to set up venture capital funds.

In 1995, the Government of India issued guidelines for overseas venture capital investment in India. In 1996, Securities and Exchange Board of India framed SEBI (Venture Capital Funds) Regulations. As per these regulations, all domestic and overseas venture capital funds are required to register with SEBI and to provide necessary information on timely basis.

In 1999, SEBI constituted a committee headed by K. B. Chandrasekhar, to identify the impediments and suggest suitable measures to facilitate the growth of venture capital activity in India. The committee was consisting of industry participants, professionals and representatives from financial institutions and the Reserve Bank of India.

In 2000, Chandrasekhar committee submitted its report suggesting important policy improvements such as harmonizing the multiplicity of regulations, flexibility in investment and exit etc. In this year SEBI has also issued SEBI (Foreign Venture Capital Investors) Regulations.

In 2003, Securities and Exchange Board of India (SEBI) has set up an Advisory Committee on Venture Capital under the Chairmanship of Dr. Ashok Lahiri, Chief Economic Advisor, Ministry of Finance, Government of India for advising SEBI in matters relating to the development and regulation of venture capital funds industry in the country. No significant changes have taken place in forms of rules and regulations after above time period.

Number of registered venture capital funds with SEBI over the years is given in table – 2 below. We can see that there is no significant change in number of registered venture capital funds over the years 2010 to 2016. The number of registered venture capital funds in Gujarat State is only 7. The list is given in table – 3. This shows that Gujarat is far behind in terms of providing venture capital funds to new start-ups as compared to other states of the country such as Maharashtra, Delhi etc. Maximum start-up investments are financed in the city of Bangalore, Mumbai, Delhi around 97%.

Table – 2

No. of registered Venture Capital Funds

| Market Intermediaries | 2010- 11 | 2011- 12 | 2012- 13 | 2013-14 | 2014-15 | 2015-16 |
|-----------------------|----------|----------|----------|---------|---------|---------|
| Venture Capital Funds | 184 | 207 | 211 | 207 | 201 | 200 |

Source: SEBI

Table – 3

List of registered Venture Capital Funds of Gujarat State

| Sr. no. | Name of the Venture Capital Fund | City | Year of Registration |
|---------|---|-----------|----------------------|
| 1 | Gujarat Venture Capital Fund 1995 | Ahmedabad | 1997 |
| 2 | Gujarat Information Technology Fund | Ahmedabad | 2000 |
| 3 | Gujarat Infrastructure Development Fund | Ahmedabad | 2006 |
| 4 | Kaizen Venture Capital Private Ltd. | Ahmedabad | 2006 |
| 5 | GVFL Venture Capital Fund | Ahmedabad | 2007 |
| 6 | I3E Trust | Ahmedabad | 2009 |
| 7 | Access India Fund | Ahmedabad | 2011 |

Source: SEBI

The above table make it clear that after 2011, no new venture capital fund has been registered with SEBI from Gujarat State. All registered VCFs are located in Ahmedabad city only. The above is an updated list taken from website of SEBI on February 27, 2018.

Literature Review:

A limited amount of the research on VC has been carried out. So, the scope for the data is secondary surveys and reports of various private agencies like EY and KPMG. The limitation of the study is that the data available especially regarding the state of Gujarat is very limited. The venture capital activities were started with fewer regulations by SEBI after the liberalization era. SEBI described various regulations in order to streamline the VC activity to be carried out in the country. (SEBI, 1996). There were committees who recommended the minimization of the prevailing regulations of both tax and foreign investment. (Chandrasekhar K.,2000; A. Lahiri, 2003). A working paper studied the patterns of operation of VC firms which emphasized both government and private players to support in the VC-ecosystem. Several measures were taken for FDI (Foreign Direct Investments) in order to boost the VC & PE funding activities for VCFI and domestic VC firms. (Dossani& Desai, 2001). Till the year of 2013, the VC & PE funds invested majorly into technological sector (Katyal, 2014).

Objective of the study:

- To get an overview of the venture capital investment in the country over last few years.
- To understand sector wise investment by venture capitalist over the years from 2014 to 2016
- To get an idea about venture capital investment in context of Gujarat State

Research Methodology:

Research design:

The research design used was mainly exploratory.

Sources of information:

The study is mainly carried out based on secondary data. The data was mainly obtained from the website of SEBI which is nodal agency for venture capital industry. Apart from that various reports of committees on venture capital are also referred to. The data regarding Gujarat state was not available from SEBI website. This data is obtained from a private organisation website named as trak.in

Statistical tools:

For judging level of investment by venture capital funds in various sectors of economy, single factor ANOVA is used. Using this tool, the hypothesis is tested for sectorial investment.

Data Analysis:

The table – 4 below gives figure of total investment by Venture capital funds over year 2010 to 2016. From the table it is clear that VC investment has increased over year 2010 to 2015 but in the year 2016, it has decreased to an extent. Based on the below figures table – 4 CAGR is calculated which is coming 7.88%. Moreover, the increase in the years from 2010 to 2015 was also at a decreasing rate.

Table – 4
Total investment by VCFs

| Year | Total Investment (Rs. Crore) |
|-------------|---|
| 2010 | 85,773 |
| 2011 | 106,286 |
| 2012 | 119,638 |
| 2013 | 129,380 |
| 2014 | 144,088 |
| 2015 | 147,084 |
| 2016 | 135,250 |

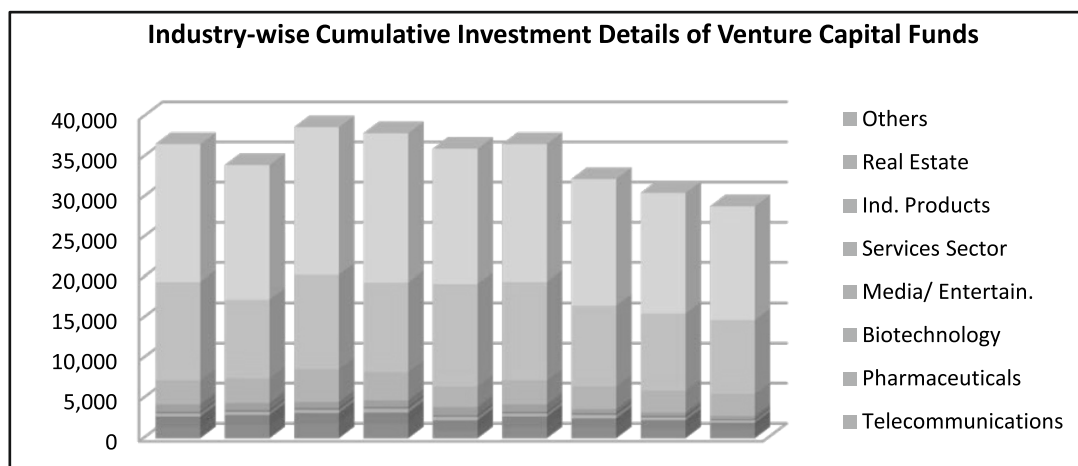
Source: SEBI

Table - 5
Industry-wise Cumulative Investment Details of Venture Capital Funds
(All figures in Rs. Crores)

| Sectors of Economy | As on Mar 31, 2015 | As on Jun 30, 2015 | As on Sep 30, 2015 | As on Dec 31, 2015 | As on Mar 31, 2016 | As on Jun 30, 2016 | As on Sep 30, 2016 | As on Dec 31, 2016 | As on Mar 31, 2017 |
|---------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|---------------------------------------|
| Info. Technology | 1,335 | 1,599 | 1,806 | 1,839 | 974 | 1,335 | 1,326 | 1,224 | 1210 |
| Telecommunications | 1,351 | 1,289 | 1,333 | 1,350 | 1,255 | 1,351 | 1,131 | 1,016 | 707 |
| Pharmaceuticals | 387 | 382 | 382 | 476 | 411 | 387 | 439 | 345 | 313 |
| Biotechnology | 204 | 220 | 255 | 241 | 223 | 204 | 226 | 218 | 150 |
| Media/ Entertain. | 930 | 874 | 717 | 812 | 1,011 | 930 | 494 | 399 | 391 |
| Services Sector | 3,008 | 3,087 | 4,085 | 3,520 | 2,553 | 3,008 | 2,827 | 2,712 | 2738 |
| Ind. Products | 1,287 | 1,214 | 1,265 | 1,065 | 1,273 | 1,287 | 1,041 | 1,023 | 1018 |
| Real Estate | 10,924 | 8,560 | 10,458 | 10,056 | 11,486 | 10,924 | 9,015 | 8,574 | 8190 |
| Others | 17,137 | 16,727 | 18,364 | 18,544 | 16,800 | 17,137 | 15,713 | 14,977 | 14096 |
| Total | 36,563 | 33,951 | 38,667 | 37,903 | 35,987 | 36,563 | 32,212 | 30,488 | 28813 |

The above table shows industry-wise cumulative investment details of venture capital funds. The figures show quarterly investment in various sectors of economy such as information technology, telecommunications, pharmaceuticals etc. We can get an idea about the trend of investment in various sectors by VCFs. The graphical presentation of the above table is shown in fig. 1 below, which gives us quick overview of comparative investment across the industries and quarters:

Fig. - 1



Based on the above table, proportionate investment is calculated in each sector over nine quarters which is shown in the table – 6 below. The table shows that over the nine quarters the proportionate investment in various sectors of economy has remained the same. There is no significant change in the investment made by VCFs and maximum investment is made in Real Estate sector which is around 30%.

Table – 6
Sector wise and quarter wise proportionate investment by VCFs

| Sectors of Economy | As on Mar 31, 2015 | As on Jun 30, 2015 | As on Sep 30, 2015 | As on Dec 31, 2015 | As on Mar 31, 2016 | As on Jun 30, 2016 | As on Sep 30, 2016 | As on Dec 31, 2016 | As on Mar 31, 2017 |
|---------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Info. Technology | 0.04 | 0.05 | 0.05 | 0.05 | 0.03 | 0.04 | 0.04 | 0.04 | 0.04 |
| Telecommunications | 0.04 | 0.04 | 0.03 | 0.04 | 0.03 | 0.04 | 0.04 | 0.03 | 0.02 |
| Pharmaceuticals | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| Biotechnology | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| Media/ Entertain. | 0.03 | 0.03 | 0.02 | 0.02 | 0.03 | 0.03 | 0.02 | 0.01 | 0.01 |
| Services Sector | 0.08 | 0.09 | 0.11 | 0.09 | 0.07 | 0.08 | 0.09 | 0.09 | 0.10 |
| Ind. Products | 0.04 | 0.04 | 0.03 | 0.03 | 0.04 | 0.04 | 0.03 | 0.03 | 0.04 |
| Real Estate | 0.30 | 0.25 | 0.27 | 0.27 | 0.32 | 0.30 | 0.28 | 0.28 | 0.28 |
| Others | 0.47 | 0.49 | 0.47 | 0.49 | 0.47 | 0.47 | 0.49 | 0.49 | 0.49 |
| Total | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |

Source: authors' calculation

To check statistically whether venture capital investment across the sector of economy is the same or not, a hypothesis is tested using single factor ANOVA.

Null Hypothesis (H0): There is no significant difference in the investment made by venture capital funds in various industries named as information technology, telecommunications, pharmaceuticals, biotechnology, media/entertainment, service sector, industrial products and real estate

Alternative Hypothesis (H1): The investment made by VCFs across the sectors are significantly different.

The ANOVA table is shown as table – 7

Table - 7
ANOVA (single factor)

| Source of Variation | SS | df | MS | F | P-value | F crit |
|-----------------------|-----------------|----|----------------|----------|---------|--------|
| Between Groups | 2285816696.0000 | 8 | 285727087.0000 | 627.4798 | 0.0000 | 2.0698 |
| Within Groups | 32785676.8889 | 72 | 455356.6235 | | | |
| Total | 2318602372.8889 | 80 | | | | |
| Level of significance | | | | | | 0.05 |

For $v_1 = 8$ and $v_2 = 72$, the tabled value of $F_{0.05}$ (5% level of significance) is 2.07. Since the calculated value of F is greater than the tabled value, the null hypothesis is rejected. Thus, there is a significant difference in the volume of investments by Venture Capital Funds and in the various sectors of Indian economy such as Information Technology, Telecommunications, pharmaceuticals, biotechnology, media/entertainment, service sector, industrial products and real estate

Table – 8
Change in the cumulative investment by VCFs over previous quarter

| Sectors of Economy | As on Jun 30, 2015 | As on Sep 30, 2015 | As on Dec 31, 2015 | As on Mar 31, 2016 | As on Jun 30, 2016 | As on Sep 30, 2016 | As on Dec 31, 2016 | As on Mar 31, 2017 |
|---------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Info. technology | 1.20 | 1.13 | 1.02 | 0.53 | 1.37 | 0.99 | 0.92 | 0.99 |
| Telecommunications | 0.95 | 1.03 | 1.01 | 0.93 | 1.08 | 0.84 | 0.90 | 0.70 |
| Pharmaceuticals | 0.99 | 1.00 | 1.25 | 0.86 | 0.94 | 1.13 | 0.79 | 0.91 |
| Biotechnology | 1.08 | 1.16 | 0.95 | 0.93 | 0.91 | 1.11 | 0.96 | 0.69 |
| Media/ Entertain. | 0.94 | 0.82 | 1.13 | 1.25 | 0.92 | 0.53 | 0.81 | 0.98 |
| Services Sector | 1.03 | 1.32 | 0.86 | 0.73 | 1.18 | 0.94 | 0.96 | 1.01 |
| Ind. Products | 0.94 | 1.04 | 0.84 | 1.20 | 1.01 | 0.81 | 0.98 | 1.00 |
| Real Estate | 0.78 | 1.22 | 0.96 | 1.14 | 0.95 | 0.83 | 0.95 | 0.96 |
| Others | 0.98 | 1.10 | 1.01 | 0.91 | 1.02 | 0.92 | 0.95 | 0.94 |

Table – 8 above shows change in cumulative investment in various sectors as compared to previous quarter and minimum and maximum change over nine quarters have been highlighted. Major change across the period is in Real Estate sector. Moreover, except investment in industrial products, investment in all other

sector has declined as compared to March 2015.

Table – 9 below shows the details of start-ups financed by venture capital funds in Gujarat State over year 2015 to 2017. The said detail has been obtained from a private website named as trak.in as the date for state wise investment is not available on the website of SEBI or in handbook published by SEBI. It shows that number of deals and value both are very less as compared to other states such as Maharashtra, Delhi, Karnataka etc. Moreover, most of the investment is made in Ahmedabad city only across Gujarat state.

Table – 9
List of Start-ups financed by Venture Capital Funds in Gujarat State over 2015 to 2017

| Year – 2015 | | | | |
|--------------------|----------------------------|------------------------------------|-------------|---------------------|
| Sr. no. | Name of the Venture | Type of Industry/Vertical | City | Amount (USD) |
| 1 | Awaaz De | Enterprise Communication Platform | Ahmedabad | N/A |
| 2 | Gingercrush | Custom Merchandize platform | Ahmedabad | 1,000,000 |
| 3 | Myonsto | Online Grocers | Ahmedabad | 320,000 |
| 4 | Trukky | Logistics service platform | Ahmedabad | 245,000 |
| 5 | Jolly Food Fellow | Food Customer analytics platform | Ahmedabad | 300,000 |
| 6 | EzySolare | Solar products and services | Ahmedabad | N/A |
| 7 | Gridle | Cloud Based Collaboration platform | Ahmedabad | 100,000 |
| 8 | AlmaMapper | Online Student & Campus Social | Ahmedabad | 400,000 |
| 9 | Boibanit | Online Food Ordering Marketplace | Vadodara | 150,000 |
| 10 | Gingercrush | Product Customization Platform | Vadodara | N/A |
| Year – 2016 | | | | |
| Sr. no. | Name of the Venture | Type of Industry/Vertical | City | Amount (USD) |
| 1 | WIMWI Foods | Food & Beverage | Ahmedabad | N/A |
| 2 | PlexusMD | Consumer Internet | Ahmedabad | N/A |
| 3 | Salebhai | eCommerce | Ahmedabad | N/A |
| 4 | HealthKumbh | Consumer Internet | Ahmedabad | 73,000 |
| 5 | JollyFoodFellow | Technology | Ahmedabad | N/A |
| 6 | eSwasthya | Consumer Internet | Ahmedabad | N/A |
| 7 | CityShor | Consumer Internet | Ahmedabad | N/A |
| 8 | Oneway.cab | Consumer Internet | Vadodara | 450,000 |
| 9 | The Indian IRIS | Consumer Internet | Ahmedabad | N/A |
| 10 | Locanix | Technology | Ahmedabad | 300,000 |

| | | | | |
|----|-------------------------|-------------------|-----------|---------|
| 11 | Don't Scratch Your Head | Technology | Ahmedabad | 250,000 |
| 12 | PurpleDocs | Consumer Internet | Vadodara | N/A |
| 13 | eQuickies | eCommerce | Ahmedabad | 298,000 |
| 14 | Beardo | eCommerce | Ahmedabad | 500,000 |
| 15 | RoboVac | Technology | Ahmedabad | 450,000 |
| 16 | Hubilo | Consumer Internet | Ahmedabad | N/A |
| 17 | Math Buddy | Consumer Internet | Vadodara | 440,000 |

| Year – 2016 | | | | |
|-------------|---------------------|---------------------------|-----------|--------------|
| Sr. no. | Name of the Venture | Type of Industry/Vertical | City | Amount (USD) |
| 1 | KreateKonnnect | Technology | Vadodara | N/A |
| 2 | ShilpMIS | Technology | Surat | N/A |
| 3 | Trukky | Consumer Internet | Ahmedabad | 500,000 |
| 4 | Cerebroz | Consumer Internet | Vadodara | 734,000 |

Source: trak.in

Limitations of the study:

- The study is based on secondary data only. Besides, data related to Gujarat State is not available on SEBI website. So, it is taken from private website, and some data are missing in that.
- Investment made by Venture Capital Funds is only considered. Investments made by Foreign venture capital investors are not considered.
- Investment made in form of private equity is also not taken into account.
- The data for the year 2017 was available for the first quarter only hence to that extent only the data is taken for analysis.

Parameters for success of Venture Capital:

Following parameters are to be considered (and not limited to) critical for the success of the Venture Capital.

- A. The regulatory, tax and legal environment plays an important role as such entities have been evolved in structural flexibility and tax-beneficial eco-system.
- B. The VC should be institutionalized in order to protect and sustain the investors and investee firms, operating in an environment where the fund raising can be channelized for the innovations and disruptions in the market.
- C. The global exposure and investment opportunities.
- D. The infrastructure and support in form of incubators Government as well as private sectors' management. This was successfully done in the countries like US, Israel and Taiwan.

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