<u>Introduction to Venture Capital</u>

1. What are the general Financial Problems Faced By emerging SME s which makes venture capital option more attracting?

- <u>Non-availability of equity for expansion</u>
  Lack of knowledge about the fund houses such as venture capital, private equity lenders, investors and procedures for availing the same.
- <u>Difficulty in availing long term loans</u>
  Risk aversion by banks on new project- while trying to be risk neutrals banks observe in scrutiny regarding the risk aspects involved in the new projects.
- <u>Working capital problems</u>
  High debtors age-higher credit period granted to the debtors
  Low creditors age- lower credit period granted by creditors.
  Unaware about various collateral options (Fixed deposit, Insurance, KVP/IVP, Mutual Fund units)
- <u>Non-availability of non-fund based facilities</u>
  Not able to provide Personal guarantee, high margin

2. Why do I need venture capital (VC) in spite of the availibity of aids from banking sector?
   As banks and financial institutions enquire for corresponding collaterals and securities for the loan amount raised, it becomes impossible for some of the most deserving companies despite having a brilliant concept of a business model to meet to the requirements. So it is the venture capitals who come to rescue and add value to such business models without demanding any collateral however it takes stake in the equity of the company.

3. What is venture capital? How is it different from seed capital and angel investment?

Feature	Venture capital	Angel investment and seed capital
Investment	Investment made into the equity shares of the growth stage companies who don't have sufficient tangible assets to pledge and borrow from conventional sources like banks and other financial lending institutions	Investment is made from the initial stage of the business when it survives merely on a concept.
Stage of venture	Implementation stage	Idea stage
Existence of company	Already in growth stage and had a successful record of product launch anticipating for huge target market in future.	Company may still not be in existence and stands on a idea which seems to be promising
Range of Fund	Rs 2crore to Rs 15 crores	Rs 25 lakhs to Rs 3 crores

4. What is the scope of venture capital in India being still in infant stage as compared to foreign nations?

   India being an emerging economy reflects a huge scope for the small and medium scale entrepreneurs. There are around 40 actively participating venture capitalists funding for various sectors thus boosting the growth of small and medium scale enterprises. For instance the country's largest private sector lender, ICICI Bank, is evaluating its options to launch a $100 million (about Rs 460 crore) dedicated venture capital fund for small and medium enterprises (SMEs) and mid-market companies.

   The "Emerging India Fund" is an ICICI group initiative to provide growth capital to Indian companies in the SME and mid-market segment. The Emerging India Fund, which is expecting its first close in the next few weeks at $50 million, has already received firm commitments from several reputed institutions.

   It is believed that private equity funds are in the midst of raising a $48 billion for the Indian market by 2010.

5. What are the credentials VC will expect in the investee company?

   Investors keenly look at the integrity of the management, as they are betting on people involved in the actual operational level. They also look at fundamental strength on business plan (is it solving any problems faced by people, **opportunity and capability to expand**), Passion towards providing solution to the problem, and qualification/ experience of the key personnel in the relevant area.

6. What is the benefit of venture capital funding for companies ?Are there any tax benefits out of such funds ?

   Private equity funding or venture capital add lot of value to the investees company like

   - Management experience – predominant small and medium scale companies lack experience in expanding / managing on challenging times.
   - Brand value – Companies require brand when they expand out of their territory which they lack. The investor brings in international brand which will even to tap the overseas market. For eg Blackstone invested in Gokaldas which helped in tapping overseas clients.
   - Industry experience – Board members of the funds come with rich experience in the respective field and from different geographies. This will help companies in making strategic decisions.
   - Tapping financial market – PE / VC funds are well connected to the financial market. They will help in companies to tap the financial market as well as increase their valuation.

   There are no tax benefits for in getting investment from venture capital.

7. What are expectations of the investor towards the investee? Are there any specific guidelines to apply for venture capital?

   The venture capitalists have huge expectations from the investee company as they bear relatively higher risk than the investee company. It is better to understand the implications of bringing in the investor;

   So the following points must be kept in mind before approaching investors

   - Exit – PE / VC funds have fixed life. Normally a fund life will be 8 years. They need to invest, manage, and exit from their investments during this period. This may put undue pressure to the investee company unless it is planned for it.
   - Return in multiples – Funds will expect their return in multiples over the period of their investment. Fund managers will put lot of pressure on the management to get the results for an exponential hike in the returns .
   - Involvement in operational issues-There is few funds which get in to the level of operational issues of the companies. Though they may add value, companies may find it uncomfortable.
   - Threat of losing business secret-Many funds is focused on particular sector and they invest in many companies in the same sector. This may pose a threat of losing sensitive information to the competitor. However many reputed funds adhere to strict non-disclosure policy on whatever the information they get at any stage.

   There are **no specific guidelines** as such to apply for the venture capital.

8. How to identify the most appropriate investor?

   Suitable investor needs to be approached for every proposal since closure of the deal is very much dependant. The following points can be considered to evaluate the suitability of a particular investor for a proposal

   - Experience in the industry / sector – It includes experience of investors in personal capacity as well as the through prior investment made into different avenues .
   - Track record – Analyze how they guided the young companies to scale up, diversify, identify the potential opportunity.
   - Fund availability – Lot of fund houses in the current situation does not have cash to invest. Check their recent investments and if they have sufficient back up of assets.
   - Life of the current fund – as the investors in turn have a specified life period for the fund of 8 yrs as mentioned by their investors such as third party private equity , proprietary funding etc , it is better to get funded in earlier days of a fund, to avail more for exit.
   - Disclosure of information – Check the policy and effective implementation of the same towards non-disclosure of sensitive information as in case when the investor is investing in similar business models which might be a competitor to the investee company.

9. Which are thrust areas requiring the aid of venture capital?

   Though VCs are major focused on technology, lot of funds are emerged out to invest in manufacturing industry esp in SME sector. The major thrust areas are manufacturing, textiles, life sciences, food processing to agriculture.

   Some of the venture funds raised are as follows:

Fund manager	**Size**	**Industry**	**Invested in**
Avigo capital partners	$165 mn	manufacturing, engineering, retail	Tecpro systems, Privi organics, G.E.T construction, Spykar, renac india,comac, bharat box factory
Rabo equity advisors		Pharma, bio-tech, agriculture	Geepee agri pvt ltd, Sri biotech laboratories pvt ltd
Motilal oswal	$125 mn	Sector agnostic	Power mech projects, gowardhan milk, dixon technologies, financiers, resurgence mines & minerals, effort bpo, rt outsourcing, IMP power, time technoplast
Forum synergies	$250 mn	Engineering, manufacturing, power, infrastructure	
BTS india advisors	$75 mn	manufacturing, engineering, pharmaceuticals and related businesses, IT/ITES,media & telecom	Reliable auto tech, Microqual
SIDBI SME fund	Rs 500 cr	life sciences, retailing, light engineering, food processing, information technology, infrastructure related services, healthcare, logistics and distribution	Carzonrent, basil,pwercon, centaur pharmaceuticals, digibee micro systems, direct logistics, Dynaspede integrate systems, expressit logistics, flash electronics, hhv solar, indo shell mould, mudra lifestyle, naturol bio energy, stovekraft, prateek apparels, shriram foundry
Zephyr peacock	$75 mn	financial services, education, consumer related businesses, high value-added manufacturing and infrastructure related services.	Time technoplast, wlc, maxop engineering, miles software solutions

10. How much VC funds like to take as equity in the investee companies? What it is the ratio of profit sharing between the investee and investor?

    VC fund does not like to be a minority stake holder in the company neither like to have majority ownership. It expects promoter should have fair amount of interest in the business, while having control over the operations. It expects to take a stake of 20%- 40% of the total ownership. The investor normally anticipates the board seat to steer the investee company. The ratio of profit sharing over the revenues remains proportionate to the ratio of investment or the stake of ownership in the investee company.

11. What are the procedures of raising venture capital?

a) Initial Financial health check up of the investee company – the company should be well prepared from the financial and legal aspects enduring in the business. A clean financial statements maintained by the company attracts the investors attention.
b) Preparation for fund raising
    - Preparation of information memorandum –Information memorandum speaks about the company background, its promoters, track record and the future outlooks that the company urge for. Preparing an attractive IM is important as the investor should get convinced about the project and its viability, as well as the credentials of the management.
    - Valuation of the company – preparing the financial model which should be simple and flexible, where in all the assumptions related to the revenue and expenses are entered in a master sheet and the valuation of company in terms of numbers is reflected in the other sheets linked to the master sheets.
    - Preparing industry report – the industry overview gives an idea of the size, growth, demography of the industry and the favorable policies coming in the industry which adds value to the business .It also compares the performance of different competitors engaged in the similar business and the status of the company among its competitors.
c) Choosing the right investor .-as explained in Q4

d) Deal closure –
    - Negotiation of share purchase agreements - share purchase agreement will contain customary representations, warranties, covenants and conditions precedent in consideration with the structure of the proposed transaction and the executed due diligence.
    - Due diligence- it is the detailed financial and legal investigation about the company .

12. How much time it takes to raise funds from VC?
    Time required to raise funds depends upon the ability to provide information quickly. If the company has all systems and procedures in place, it may take 3 months to get the funds.

A case study on VC investment

Sector: Pharmaceuticals
Investors: Swisstec, ICICI Ventures, IIML
Transaction Summary: Has raised $36 million in four rounds in as many years.

Arch Pharma was founded by a group of professionals in 1999. The founders identified Hyderabad-based Merven Drug Products, a company that was under bankruptcy protection (under the Indian Government's Board for Industrial and Financial Reconstruction, BIFR), for the manufacture of pharmaceutical intermediates. Arch manufactures various drug intermediates and APIs – 70% of which is exported to reputed multinational pharma companies - at six locations across India. Three of these manufacturing facilities came in through acquisitions – an activity for which Arch has creatively leveraged Private Equity financing.

VC Investment

In late 2003 and early 2004, Arch quickly raised two rounds of Private Equity funding – $2 million in October 2003 from Swisstec and $3 million in January 2004 from ICICI Ventures – that helped it acquire Merven Drugs (through a reverse merger). In January 2005, Arch raised another round – $9 million from IIML. The new funds were used to finance the acquisition of the pharmaceuticals business of a larger company.

Success of VC funding

Ajit Kamath, Arch Pharma's Chairman & Managing Director "ICICI Venture was willing to back us to acquire a sick company. Please remember that this was at a time when there was no asset reconstruction company in India and the financial landscape was very different."

In November 2006, Arch raised $22 million from existing investor, ICICI Ventures. Interestingly, the company chose to go in for another round of PE financing when it had the option of going to the public markets. Apart from providing strategic direction and financial advice, PE investors have helped Arch improve its systems and corporate governance standards very significantly.

Kamath feels another key benefit of PE financing is the enhanced visibility that it provides for the company – especially in the media. "Thanks to our PE-backing, we get more visibility in the media compared to other companies of our size," he says. Importantly, this positive rub-off also increases the confidence of various stakeholders – including customers – in the company.

For any queries on raising fund from VCs please contact

Sankara Srinivasan A
Founder and MD – SS Halcyon Investment Advisory Pvt Ltd
Mobile – 9379918449, Email – sankara@sshalcyon.com