India

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"To build a global company, we believe that we need a three-pronged approach to the three largest markets: the US, India and China."

Ernst & Young: What's your outlook for the Indian VC industry, and what have been the key growth drivers?

Sudhir Sethi: We believe that from 2010 to 2015, total venture investments will be US$10 billion. From 2004 to 2009, total venture investments were US$3.3 billion; from 2004 to 2009, total technology investment was US$2.4 billion. We expect this to grow in the next five years to approximately US$7.5 billion. This is where the opportunity lies.

The number of VC exits is very good, the multiples on return on technology investment have been excellent and, more importantly, the majority of the exits were in valuations of US$100 million to US$500 million.

From 2004 to 2010, there were 142 venture-based exits in India. Out of those exits, 100 were technology companies, including IT services, software products, business process outsourcing/knowledge process outsourcing and the internet. Most importantly, the average multiple on invested capital was 5.9, and in non-technology, it was 3.3.

M&A made up 63% of exits, while 14% were through IPO. The rest was secondary market offerings. On strategic sales, the average multiple of invested capital was 6.5, and on secondary markets it was 4.1.

The supply chain of risk capital investors and the ecosystem of venture have matured significantly in the last three years. We have high net worth individuals, or super angels. We have institutional angel funds between US$20 million and US$60 million. And the majority of the angel investments are in pre-revenue companies. In the completion ecosystem, we have more key players coming into venture B and C rounds.

Ernst & Young: Have exits in India been mainly domestic or international?

Sudhir Sethi: Foreign corporations made up half the M&A. The exit multiple for foreign corporations was 7.6, while for Indian corporations the multiple was 3.0. When we raise capital as a technology fund today, we are in a US$7.5 billion market with over 100 exits in the last five to six years and a 5.9 multiple on return through M&A, secondary offerings and IPOs. I think that's a great mix to have.

Ernst & Young: Of the technology deals between 2004 and 2010 leading to an IPO, what proportions were in the various aspects of technology?

Sudhir Sethi: Out of the 100 deals, 22 were in software products. The greatest opportunities are in digital consumers, software products, medical devices, high-tech manufacturing, cleantech and energy. These are some of the niche services for security, business intelligence and analytics.

I think e-commerce is very visible because lots of capital is going there, but there is more to technology investing than e-commerce alone. There are software products, medical devices — you will see more medical device companies coming from India.

India is skipping the PC revolution and hopping onto the mobile bandwagon with approximately 750 million mobile users. You will see a lot of new mobile companies on the consumer side and some on the enterprise side still riding this wave.

One challenge India faces today is the lack of local limited partners investing in the rupee. More rupee investment would encourage international LPs to invest more in the country.

Ernst & Young: Do you think technologies created to solve emerging-market problems will be exported to other emerging markets, or do you think it will be a smaller, venture-financed portion?

Sudhir Sethi: To build a global company, we believe that we need a three-pronged approach to the three largest markets: the US, India and China. If our companies are able to grow in these three markets, then we believe they will be successful.

This three-pronged approach is especially important in India because, unlike China, most Indian entrepreneurs are used to being global entrepreneurs. They built global companies themselves because in the past it was very difficult to build companies only in India. Today, we can build a US$75 million to US$100 million company in anywhere from four to six years.

Ernst & Young: In India, there are more than 110 incubators, some university-related, some government-related and some private, with about 1,600 companies. How does the Indian VC industry engage with incubators?

Sudhir Sethi: I think the success rate through incubators could be less than what we find through angels. That's the nature of the business. We have engaged with incubators, but we've found nothing so far.

Ernst & Young: What is your advice to entrepreneurs wanting to form an international company?

Sudhir Sethi: You must be adequately capitalized. In the India venture market, 60% of the companies in series A that were funded for less than US$2 million failed. Also, you must be local. Don't have Indian professionals heading up your US operations — hire locally.

Q&A