

# Value Creation by Venture Capital Investors: The Experience of IDG Ventures India

India has risen as a key emerging market destination for global venture capital (VC) investing over the last few years, with an economy that has been consistently growing at more than 8% per annum due, in part, to vibrant domestic consumption. In this article, Mr. Sudhir Sethi, Founder, Chairman and Managing Director of IDG Ventures India—a US\$150 million venture capital fund focused on early-stage investments in technology and technology-enabled companies—discusses the state of the venture capital industry in India and considers how venture capital investors can work with local entrepreneurs to create significant value in Indian companies, thus generating strong returns for VC firms as well as their LPs.

## Industry Overview: Technology Dominates

Technology—defined as enterprise software products and services, digital consumer (internet, mobile and new media), engineering and electronics—has been the critical growth engine of Indian venture investing. Venture capital funds invested close to US\$3.3 billion in 625 deals in India from 2004–2009, with the technology sector absorbing US\$2.3 billion over 418 deals during this period. We at IDG Ventures India believe that total venture investments in India will be close to US\$10 billion between 2010 and 2015, out of which approximately US\$7.5 billion will be in technology companies.

In addition, technology has also dominated the venture-backed exit landscape in India, both in terms of number of exits and return multiples for investors. Between 2004 and 2011YTD (as of the end of August), there were 152 venture-backed exits in India, with 111 (73% of the total) tied to technology companies (see Figure 1).

In terms of returns, the average multiple on invested capital for technology exits was about 5.2x, compared with 3.4x

for non-technology exits. In fact, close to 30% of technology exits resulted in return multiples in excess of 4.0x to investors (see Figure 2). Further, approximately 32% of these exits were larger than US\$100 million in deal size, indicating the presence of high-quality technology exits in the Indian venture eco-system.

Within the technology sector, Indian venture capital investors have utilized a variety of exit modes to realize value from their portfolio companies, including IPOs and strategic sales (M&A) to both foreign and domestic acquirers. Between 2004 and 2011YTD, strategic sales dominated technology VC exits, followed by IPOs and buy-backs. In terms of average returns on invested capital, both strategic sales and IPOs were at par, thus indicating the attractiveness of Indian startups for both companies and public investors.

Within strategic sales, Indian companies have increasingly become valuable to foreign acquirers, primarily due to India's growing domestic markets and the country's emergence as a global innovation hub. Between 2004 and 2011YTD, foreign acquirers comprised about 61% of total

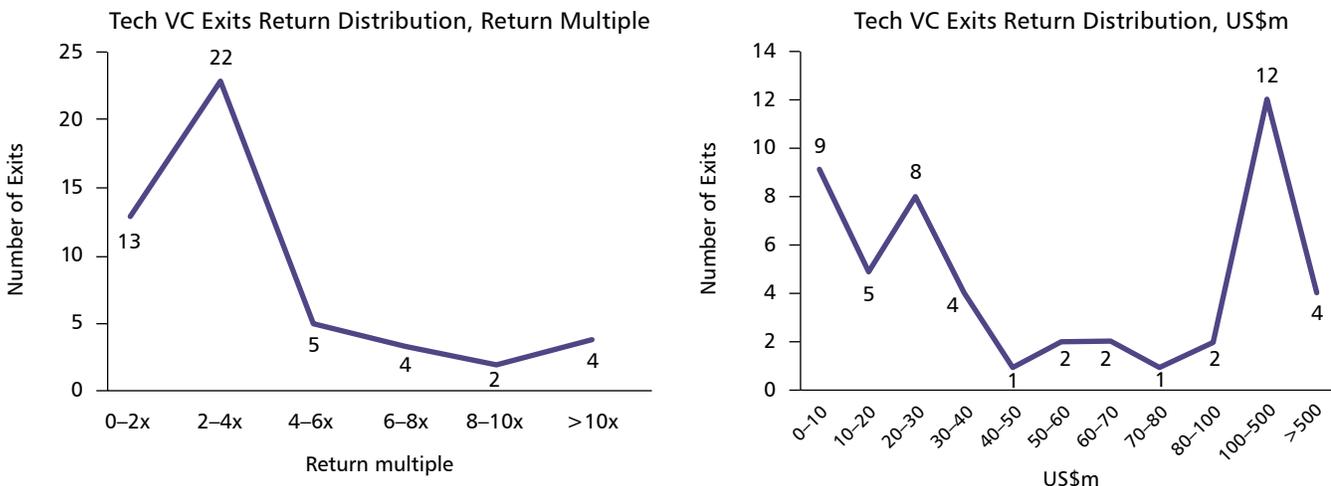
Figure 1: Number of Technology VC Exits (2004–2011YTD) and Average Multiples on Invested Capital (2004–2010) by Exit Routes



Source: Venture Intelligence (India).

Note: Average returns have been calculated only for exits where this data is disclosed and available.

Figure 2: Technology VC Exit Returns and Valuation Distributions (2004–2011YTD)



Source: Venture Intelligence (India).

technology exits (by number) via strategic sales (see Figure 3). On average, foreign acquirers paid a multiple of 7.0x on invested capital compared to 4.1x for domestic acquirers.

### Vibrant Value Creation

The strong exit environment for VCs in India is the result of a concerted focus on value creation by venture capital investors across multiple levels in Indian businesses. In our estimation, there are four ways venture capital investors can create value in their portfolio companies: scaling operations; professionalizing management; accessing quality follow-on investors; and, strengthening corporate governance.

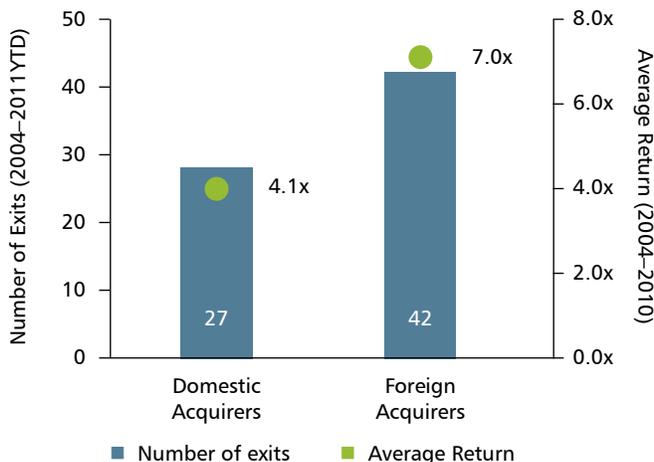
One of the key value additions by funds such as IDG Ventures India has been the ability to engineer rapid global and domestic scaling of young companies through deep operating experience. By partnering with VC firms, entrepreneurs can benefit from decades of experience in building large companies across multiple sectors and dealing with diverse business situations.

IDG Ventures India has believed in the potential of disruptive ‘technology product’ companies that create high quality intellectual property, rather than plain-vanilla services. Our portfolio companies such as Manthan, Perfint, Agile, iViZ, iCreate and 3DSoc have built successful innovative products with global penetration, thus validating this investment thesis.

### Scaling Operations

Indian venture-backed companies have found it easier to go global, given the broad reach and networks of their investors. Indian entrepreneurs are faced with a set of challenges that require them to innovate to cater to domestic requirements at optimal price points. Several of these conditions, such as high growth economies, relatively large low- to mid-income

Figure 3: Number of Technology Exits and Average Multiples Paid on Invested Capital via Strategic Sales (2004–2011YTD)



Source: Venture Intelligence (India).

populations, cost-conscious clients and sizable government intervention, also exist in other comparable emerging markets such as those in Africa, Latin America and East Asia. Knowledge of how to operate in these environments has led to India’s emergence as a hotbed of emerging markets innovation that Indian VCs are increasingly taking global.

IDG Ventures India has consciously worked with its portfolio companies to help them penetrate international markets. In the case of Manthan, which provides business intelligence solutions to global retailers, we realized the criticality of targeting developed global markets, given the nascent state of organized retail in India. We worked with the company to ramp up its international sales force and hire key overseas sales personnel. As a result, Manthan has emerged as one of the foremost international enterprise

software companies to be built out of India. It now serves retailers in 19 countries and has been covered by Gartner Industry Research as a leading global vendor for end-to-end business intelligence solutions for the retail sector.

Another instance of going global can be seen in Perfint, an IDG Ventures India portfolio company in the medical devices space. Perfint is an example of an Indian medical devices manufacturer whose products conform to global standards. As investors, we were confident that the company could target both emerging and developed markets with equal ease, and we worked with the founders to align the corporate strategy with this thesis. Perfint started out by serving more than 50 hospitals in India, and is now seeing strong traction in the Middle East, Eastern Europe, Southeast Asia and Africa. It has the largest installed base of image-guided oncology devices for interventional biopsy, with more than 100 installations globally. The company is already in the midst of obtaining regulatory approvals for developed markets, and will be entering them soon.

### Professionalizing Management

Another critical value addition from VC funds in India has been in senior-level management hiring, as investors can utilize their deep networks to hire the best talent for portfolio companies. In the case of Apalya, an IDG Ventures India portfolio company that has now emerged as India's flagship Mobile TV player with 100% market share, we identified and hired a stable of senior management to support the founding team as a key value creation activity. We actively worked with the founder to build a robust layer of managers in the company, utilizing the combined networks of the general partners, and also helped establish its brand as a top recruiter in some of the best engineering and business schools in India. We played a similar role in Ozone, a portfolio company that has now become a top performing advertising network.

### Accessing Quality Follow-on Investors

VC investors also ensure that the company remains adequately capitalized. In the Indian venture market, 60% of the companies involved in Series A financings of less than US\$2 million failed. VCs attract both high quality co-investors as well as follow-on investors, thus ensuring that entrepreneurs don't run out of fuel. IDG Ventures India, in particular, has played an active role on this front. At Manthan, we worked actively to get Fidelity International on board as an investor, while at ConnectM, a telecom tower power management company, we invited IBM to be a strategic investor.

In the case of Perfint, we attracted follow-on investment from Norwest Venture Partners, which has global expertise in medical devices. IDG Ventures India has actively worked with several other portfolio companies as well to attract follow-on rounds, including Myntra, an Indian e-commerce player that has since gone on to attract follow-on

investment from Tiger Global and become India's largest sports fashion and lifestyle e-commerce player within a span of two years. An increasing number of private equity players are showing interest in scaled venture-backed companies in the technology space given the clutter in India's growth investing environment.

### Strengthening Corporate Governance

Indian venture capital investors have ensured that Indian start-ups are on the path to sustainable and high quality growth by enforcing high standards of corporate governance and financial prudence. In the case of Aujas, a company in the information risk management space, we worked actively to institute governance structures within the company, and streamlined both operating and financial data capture and reporting. Specifically, we brought Dr. N. Balasubramanian, who is a renowned academic, practitioner and author in the field of corporate governance, as an Independent Director on the Aujas Board. He has played an active role in setting up robust corporate governance structures and processes in the company, and has proactively guided the management on issues related to regulatory compliance.

## Conclusion

Venture capital has seen vibrant growth in India, with technology dominating the landscape in terms of both number and quantum of investments, as well as exit returns to investors. Venture capital investors have created fundamental value in Indian portfolio companies, through activities ranging from taking companies global and strengthening management teams, to enforcing robust corporate governance and financial reporting standards. As India moves along the path of sustained and vibrant economic growth in the coming years, technology segments such as enterprise software, digital consumer and engineering will drive the VC investment landscape, and venture capital investors will continue to play a key role in the Indian entrepreneurial eco-system.



*Sudhir Sethi has over 30 years of technology industry and venture investment experience. He was previously the Country Head of Walden India, and is one of the earliest venture investors in India, having invested in marquee deals such as Mindtree Consulting since 1998. Prior to Walden, Sudhir served at various leadership positions in Wipro and HCL. He has been recognized as one of the leading technocrats and venture capitalists in the country by Red Herring, Dataquest and Bloomberg UTV. He presently serves on the Boards of Indian Venture Capital Association (IVCA) and Ascent Capital. Sudhir has a B. Tech in Engineering and MBA. He may be reached at [sk@idgvcindia.com](mailto:sk@idgvcindia.com).*