CHAPTER VI

Data Analysis and Observations
DATA ANALYSIS AND OBSERVATIONS

A primary investigation was carried out to find out the problems of venture capitalists as well as venture capital backed companies. A web survey was conducted for select companies. 45 venture-funding companies were chosen and 10 new entrepreneurs funded by venture capitalists were surveyed. Out of the 45 companies only ten replied, that too without the financial data and out of 10 entrepreneurs only 5 responded. Efforts have been made to maintain the accuracy while interpreting the results but the process was difficult as the data was insufficient. The percentage calculation was done to reach the conclusion. The data analysis for the venture capitalists follows:

(I) FINDINGS: PROBLEMS OF VENTURE CAPITALISTS (QUESTIONNAIRE-1)

1. Stage of venture capital financing: (figure-1)
   Early stage financing  53%
   Expansion financing  37%
   Acquisition/buyout financing  10%

2. Participation area of the firm: (figure-2)
   Board of directors  73%
   Technical expertise  20%
   Advisory board  7%

3. Area, the firm looks for, before providing VCF: (figure-3)
   Young entrepreneurs  30%
   Technical expertise  10%
   Past experience  4%
   All  66%
4. Type of venture capital assistance provided by the company: (figure-4)

- New Product Development: 58%
- Product Modification: 29%
- Research and Development: 10%
- Others: 3%

5. General size of venture capital assistance:

- New Product development: High
- Product Modification: Moderate
- Research and Development: Moderate
- Manufacturing/Production: Low

6. General mode of financing: (figure-5)

- Equity: 50%
- Debt: 40%
- Both: 10%

7. General size of the mode:

- Equity: High
- Debt: Moderate
- Both: Low

8. Type of projects financed: (figure-6)

- Technological (IT): 80%
- Philanthropic: 2%
- Insurance: 7%
- Pension funds: 5%
- Technological (Biotech): 6%
9. Level of investment:

The level of investment in India is mostly in the technological field that too in the
Information and Technology sector.

10. Types of problems: (figure-7)

Governmental 73%
Individual 7%
Entrepreneurial 20%

11. Rating of Indian venture capital funds as compared to the foreign/private/NRI
venture capital funds is at low stake.

12. The most popular exit route was IPO. Approximately 80% opted for IPOs.

(II) FINDINGS: PROBLEMS OF VENTURE CAPITAL BACKED COMPANIES
(QUESTIONNAIRE-2)

1. Financial alternative the firm has opted for: (figure-8)

Venture Capital 63%
Angels 27%
Term loans 5%
Others 5%

2. Venture capital scheme availed: (figure-9)

Early stage capital 75%
Expansion stage 20%
Acquisition/buy-out stage 5%
3. Form of assistance: (figure-10)
   - Equity: 29%
   - Income notes: 14%
   - Conventional loan: 14%
   - Conditional loan: 43%

4. Scale for going in for a particular scheme on the basis of following factors: (1 is for least important and so on)
   - Awareness: 2
   - Promoters' contribution: 6
   - Terms/conditions of finance: 8
   - Timely disbursal of funds: 7
   - Less documentation: 1
   - Speedy appraisal: 5
   - Repayment schedule: 3
   - Mode of financing: 4

5. Type of assistance provided by venture capitalists: (figure-11)
   - Insufficient: 77%
   - Sufficient: 33%

6. Promoters' contribution by venture capitalists: (figure-12)
   - High: 29%
   - Reasonable: 42%
   - Negotiable: 28%
7. Problems regarding appraisal procedure by venture capitalists:

Procedure: (figure-13)

- Lengthy: 62%
- Cumbersome: 12%
- Slow: 26%

Level of documentation: (figure-14)

- Satisfactory: 10%
- Dissatisfactory: 55%
- Normal: 35%

Percentage Stake of royalty: (figure-15)

- High: 25%
- Reasonable: 65%
- Low: 10%

8. Level of profits in the formative years as compared to the normal business:

(figure-16)

- High: 60%
- Reasonably high: 20%
- Medium: 10%
- Low: 10%

9. Investment of earnings: (figure-17)

- IT sector: 55%
- R & D sector: 20%
- Insurance sector: 10%
- Pension funds: 10%
- Others: 5%
10. Reasons for unpopularity of venture funds in India: (figure-18)

Government policies 64%
Risk factor 30%
Others 26%

OBSERVATIONS

1. FINANCING BY INVESTMENT STAGE (Figure 19)

As compared to other financing options, it is observed that there is a positive relationship between the stages of companies' development and both the total and the average value of the venture capital investment. Even though the preferences of VCs for different kind of stages differ, they specialize in one or more stages but rarely all. The following table gives a view to investments made in different stages. The data pertains to 1999.

FINANCING BY INVESTMENT STAGE (1999)

<table>
<thead>
<tr>
<th>INVESTMENT STAGES</th>
<th>RS IN MILLION</th>
<th>NUMBER OF VENTURE FUNDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>START-UP</td>
<td>3,813.00</td>
<td>297</td>
</tr>
<tr>
<td>LATER STAGE</td>
<td>3,338.99</td>
<td>154</td>
</tr>
<tr>
<td>OTHER EARLY STAGES</td>
<td>1,825.77</td>
<td>124</td>
</tr>
<tr>
<td>SEED STAGE</td>
<td>963.2</td>
<td>107</td>
</tr>
<tr>
<td>TURNAROUND STAGE</td>
<td>59.5</td>
<td>691</td>
</tr>
</tbody>
</table>

TABLE- 3

SOURCE: www.indiainfoline.com

From the table it is clear that start-up stage gets a large number of funds and the amount invested is high in comparison to other stages. Seed stage in the early stage cycle gets very less amount of funds though the number of funds is quite reasonable. The average investment is made in early stage financing. Turnaround financing gets maximum number of funds but the amount invested is quite low. The reason for this can be attributed to the risk factor associated with different
stages. For e.g. seed capital has less investment as compared to the start-up stage due to high risk of casualty. Another reason can be because of the number of years involved in realization. Higher number of years for realization, larger amounts of funds blocked in for a longer period.

Though early stage financing is still popular among the venture capitalists, the later stage financing is also gaining momentum. The reason for this can be the availability of the exit routes. It is easier to exit from a company, which has been in the market for a longer period with a growth record than to exit from a start-up company. The other stage like MBOs are becoming popular but the need of the hour is awareness amongst the investors about the advantages and disadvantages about the different stages of financing.

2. METHODS OF FINANCING (Figure 20)

To structure a deal, different financing options are used in venture capital financing. The following table gives a view to different instruments used and their percentage out of the total investments made.

<table>
<thead>
<tr>
<th>INVESTMENTS</th>
<th>RS IN MILLION</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>EQUITY SHARE</td>
<td>6,318.12</td>
<td>63.18</td>
</tr>
<tr>
<td>REDEEMABLE PREFERENCE SHARE</td>
<td>2,154.46</td>
<td>21.54</td>
</tr>
<tr>
<td>NON-CONVERTIBLE DEBT</td>
<td>873.01</td>
<td>8.73</td>
</tr>
<tr>
<td>CONVERTIBLE INSTRUMENT</td>
<td>580.02</td>
<td>5.8</td>
</tr>
<tr>
<td>OTHER INSTRUMENTS</td>
<td>75.85</td>
<td>0.75</td>
</tr>
<tr>
<td>TOTAL</td>
<td>10,000.46</td>
<td>100</td>
</tr>
</tbody>
</table>

TABLE- 4

SOURCE: www.indiainfoline.com

Observing the above data, it is quite clear that equity financing is the most popular mode of financing among the venture capitalists with more than 50% stake. This is contrary to the mentality of
the Indian investor who believes in high profitability with minimum risk. The reason of high equity base (supported by the primary data) may be because of availability of large number of foreign/private funds. The Indian funds being more conservative in nature go in more for debt instruments as compared to equity/quasi-equity instruments. The government regulations also hinder the popularity of equity base.

3. **SECTORWISE FINANCING (Figure 21)**

Venture capital investment now is not restricted to the InfoTech or Internet domain alone. VCs are very slowly moving into other high growth areas where "mind ware" has a big role to play—media, telecom and health and pharma are some of them. These sectors are under hot list because of their tremendous growth potential. Though these sectors are still in their infancy but it is believed that after the dot.com bubble these sectors have more ability to survive in the volatile markets. Other sectors like services and retail are also the future targets. As a matter of fact, the service sector accounts for more than 45% of India's GDP. The following table gives an insight to the different sectors and their financing by VCs till 1998.

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>RS IN MILLION</th>
<th>NUMBER</th>
</tr>
</thead>
<tbody>
<tr>
<td>INDUSTRIAL PRODUCTS</td>
<td>2956.67</td>
<td>219</td>
</tr>
<tr>
<td>COMPUTER SOFTWARE</td>
<td>2506.87</td>
<td>100</td>
</tr>
<tr>
<td>CONSUMER RELATED</td>
<td>1381.49</td>
<td>52</td>
</tr>
<tr>
<td>MEDICAL</td>
<td>817.48</td>
<td>47</td>
</tr>
<tr>
<td>COMPUTER HARDWARE</td>
<td>735.41</td>
<td>30</td>
</tr>
<tr>
<td>FOOD PROCESSING</td>
<td>718.56</td>
<td>50</td>
</tr>
<tr>
<td>TEL &amp; DATA COMM</td>
<td>471.89</td>
<td>18</td>
</tr>
<tr>
<td>BIOTECHNOLOGY</td>
<td>448.77</td>
<td>27</td>
</tr>
<tr>
<td>OTHER ELECTRONICS</td>
<td>426.06</td>
<td>40</td>
</tr>
<tr>
<td>ENERGY RELATED</td>
<td>229.56</td>
<td>18</td>
</tr>
<tr>
<td>OTHERS</td>
<td>1865.09</td>
<td>127</td>
</tr>
</tbody>
</table>

*Table - 5*

4. GDP GROWTH

Gross Domestic Product is the money value of all final goods and services produced in the domestic territory of a country during an accounting year. Similar to national income, domestic income consists of collection of different types of goods and services. GDP can be measured at current market price, factor cost (constant market price), gross domestic formation, and private capital formation and public sector capital formation.

Fiscal 2001-02 was India’s most difficult year since the crisis of 1990-91 in spite of the higher growth in real GDP recorded. Industrial growth declined to 2.7%. Exports declined by one percent. The corporate sector recorded a decline in sales and profits for two consecutive quarters ending September and December 2001.

According to the CMIE report the economic scenario would change in 2002-03 for the worse. The real GDP growth in 2002-03 would be about 4.5% as against 5.7% in 2001-02. The industrial sector is likely to register a growth of only four percent and the services sector is projected to grow by 6.5%. The following data of the past seven years gives a view to the changing scenario of India’s economy.


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</tr>
</thead>
<tbody>
<tr>
<td>GDP AT CURRENT MARKET PRICES (Fig. 22)</td>
<td>RS IN BILLION</td>
<td>8592</td>
<td>10128</td>
<td>11880</td>
<td>13682</td>
<td>15224</td>
<td>17416</td>
<td>19296</td>
<td>20880</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP AT FACTOR COST (CURRENT PRICES)</td>
<td>RS IN BILLION</td>
<td>9171</td>
<td>10733</td>
<td>12435</td>
<td>13900</td>
<td>15975</td>
<td>17556</td>
<td>18958</td>
<td>22200</td>
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<tr>
<td>GDP AT FACTOR COST (CONSTANT PRICES) (Fig. 24)</td>
<td>% CHANGE</td>
<td>5.9</td>
<td>7.3</td>
<td>7.3</td>
<td>7.8</td>
<td>4.8</td>
<td>6.5</td>
<td>6.1</td>
<td>4.0</td>
<td>5.7</td>
<td>4.5</td>
</tr>
<tr>
<td>CROSS DOMESTIC CAPITAL FORMATION (Fig. 25)</td>
<td>% OF GDP</td>
<td>23.1</td>
<td>26.0</td>
<td>26.8</td>
<td>24.5</td>
<td>25.0</td>
<td>23.2</td>
<td>24.3</td>
<td>24.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PRIVATE CAPITAL FORMATION (Fig. 26)</td>
<td>% OF GDP</td>
<td>14.8</td>
<td>17.3</td>
<td>19.2</td>
<td>17.4</td>
<td>18.4</td>
<td>16.8</td>
<td>17.2</td>
<td>16.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PUBLIC SECTOR CAPITAL FORMATION (Fig. 27)</td>
<td>% OF GDP</td>
<td>8.2</td>
<td>8.7</td>
<td>7.7</td>
<td>7.0</td>
<td>6.6</td>
<td>6.4</td>
<td>7.1</td>
<td>7.1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table - 6


The data shows that the gross domestic capital formation has recorded the growth in first three years, and then declined with a slight increase in 97-98 and 99-2000. The private capital
formation recorded highest growth in the year 95-96 but then declined without giving a uniform trend for the next five years. The public sector capital formation also showed lot of variations. These fluctuating trends determine that the market conditions are volatile with lot of uncertainty, which leads to the fluctuations in the nations' economy.

5. INDIA: A VIABLE OPTION

India is still a viable option. The dot.com experience has made the industry wiser. The estimates of 2008 show that venture capital and angel investment in hi-tech firms in India is going to touch U.S. $ 10 billion. The following data gives a view to the trends in the venture capital industry.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>$ IN MILLION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>20</td>
</tr>
<tr>
<td>1997</td>
<td>80</td>
</tr>
<tr>
<td>1998</td>
<td>150</td>
</tr>
<tr>
<td>1999</td>
<td>320</td>
</tr>
<tr>
<td>1999</td>
<td>950</td>
</tr>
<tr>
<td>2001</td>
<td>1200</td>
</tr>
<tr>
<td>2008</td>
<td>10000 (PROJECTED)</td>
</tr>
</tbody>
</table>

Table - 7

Adapted from: DATAQUEST, February 15,2001

The trends in different areas show that due to the fluctuating market conditions, the stability in particular financial pattern is not maintained. Because of this the changes shown in the data are more.
Different Stages of Venture Capital Financing

Figure - 1

Participation Area of Financing

Figure - 2
Venture Capital Scheme Availed

Figure - 9

Forms of Assistance

Figure - 10
Types of Assistance provided by Venture Capitalists

Figure - 11

Promoter's Contribution by Venture Capitalists

Figure - 12
Problems Regarding Appraisal Procedure by Venture Capitalists

Figure - 13

Level of Documentation

Figure - 14
Methods of Financing

**Figure - 20**

- **Equity Share**: 6318.12
- **Redeemable Preference Share**: 2154.46
- **Non-Convertible Debt**: 873.01
- **Convertible Instrument**: 580.02
- **Other Instruments**: 75.85

**Legend**
- RS in Million
- Percentage
Sectorwise Financing

Figure - 21
GDP at Current Market Prices

Figure - 22
GDP at Factor Cost (Current)

Figure - 23
GDP at Factor Cost (Constant)

Figure - 24
Public Sector Capital Formation

Figure - 27