GSF Report: The State of Early Stage Investing in India

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Introduction

The Indian early stage ecosystem is evolving fast and is at the tipping point. But by no stretch is it a perfect evolution. At best, it's a bumpy ride forward like everything else in India. It has already had its share of bubbles and busts, highs and lows. It has seen a rush of investor money, and subsequent stretches of drought. It has been regarded as the "hottest" new market and also rejected as the one to be wary of. Whatever be the outlook, one fact is undeniable - there is forward momentum.

In such an uneven evolution, there is bound to be a lot of noise and fog. Every year sees a few new "flavors of the day" investment themes. A few work, most don't. It is essential to put together different pieces of the puzzle and illuminate the bigger picture. There is a need to make sense of it all and put a finger on the pulse of the ecosystem. How was this year different from the last? How different could the next year be? How confident are key investors about the future?

This report is our attempt to separate noise from reality. We looked at a number of reports and data, post GSF2012 held on Nov 26-27. We discovered conflicting signals from the early stage investors in India, both VCs and Angels. So, we decided to speak to the leading VCs and Angels directly to uncover their intentions for 2013 and share our findings with the world. This report is an effort to throw light on the state of early stage investing in India using the voice of its key players as input.

Methodology

The insights presented here are based on self-reported information by the opinion leaders and influencers in the early stage Indian entrepreneurship ecosystem. The leading 40 VCs and Angels were surveyed through a structured online questionnaire (questions provided in the Appendix).

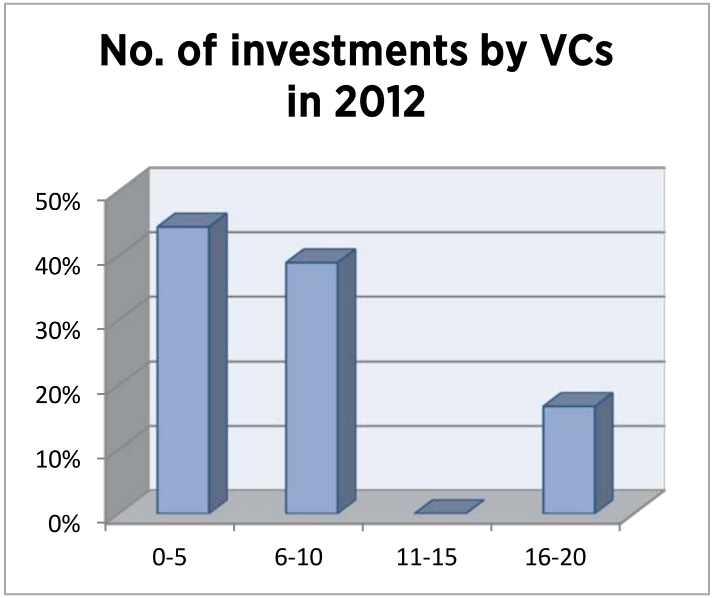
We have also been conscious of the fact that to gauge the forward state of the industry, getting a handle on the outlook and comfort level of investors is as important as collating their deal flow.

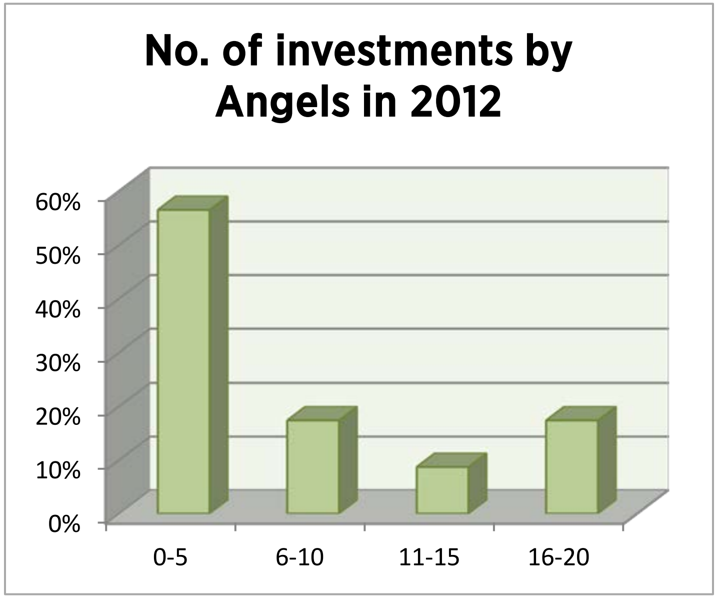
The output is thus a combination of a quantitative and qualitative analysis of the information provided by investors, along with our inferences based on GSF's work with startups and its extensive network of advisors and partners.

Insights – Investment Volume

A) VCs are "Cautiously Optimistic" while seasoned Angels are "Wearily Cautious"

The year 2012 saw a moderation in early stage investing after the excesses of 2011, with most VCs making less than ten investments and most Angels restricted to less than five. Several erstwhile active Angels didn't invest at all in 2012 – a sign of high caution. In the deals that did happen, a growing amount of participation by VCs in Seed rounds was observed. In fact, there was more Seed level participation than Series A participation by VCs (in number of deals). This again reflects high caution on the part of the VCs – an inclination to take multiple smaller bets, and play the wait and watch game.

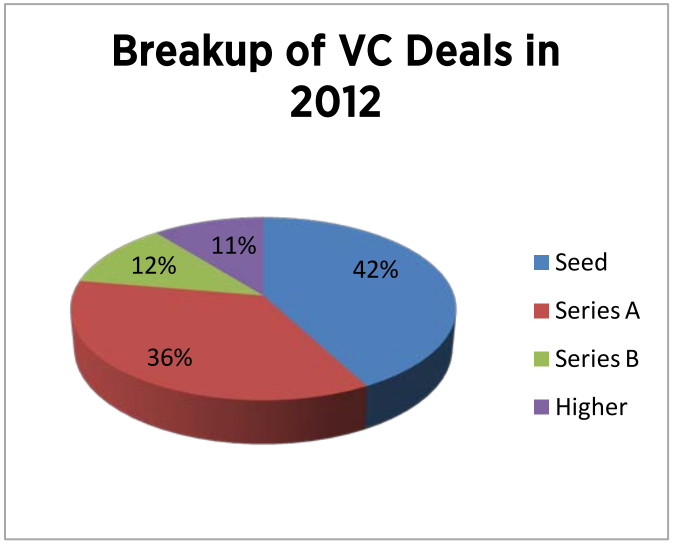


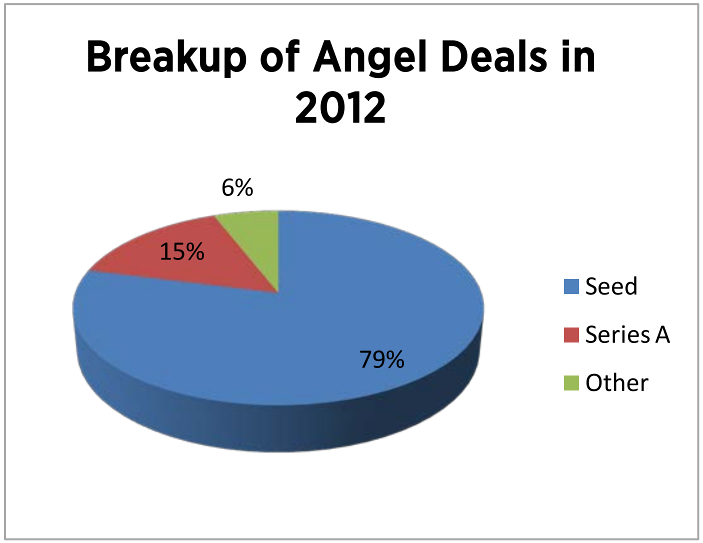


Insights - Collaboration

B) VCs and seasoned Angels are investing across stages now, and are collaborating in deals

These findings also uncover the ongoing disruption of the previously well-defined norms of early stage investing. Both Angels and VCs are investing across "stages", thus breaking the old paradigm of sequential entry – Angels before VCs. In fact, a growing collaboration between Angels and VCs further corroborates this paradigm shift. 61% of Angels surveyed said there was greater collaboration in 2012 than in 2011. They sense that this collaboration will keep increasing as VCs continue to move down the "value chain" of investing. These behaviors are indicating the emergence of a new hybrid investment paradigm for early stage, with inter-dependent players. VCs will develop strong partnerships with select angels and participate in their deals, thus gaining low risk exposure to multiple industries, without the cost of intensive diligence. Angels, on the other hand, gain from these partnerships by developing high quality exit options. The days of investing in silos are gone for good.

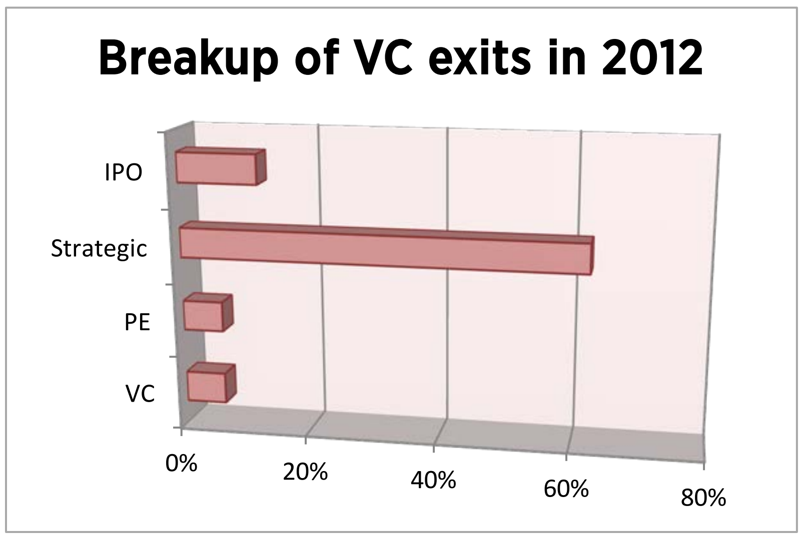




Insights - Exits

C) Lack of exits/ insufficient exit options is the key concern for VCs and seasoned Angels

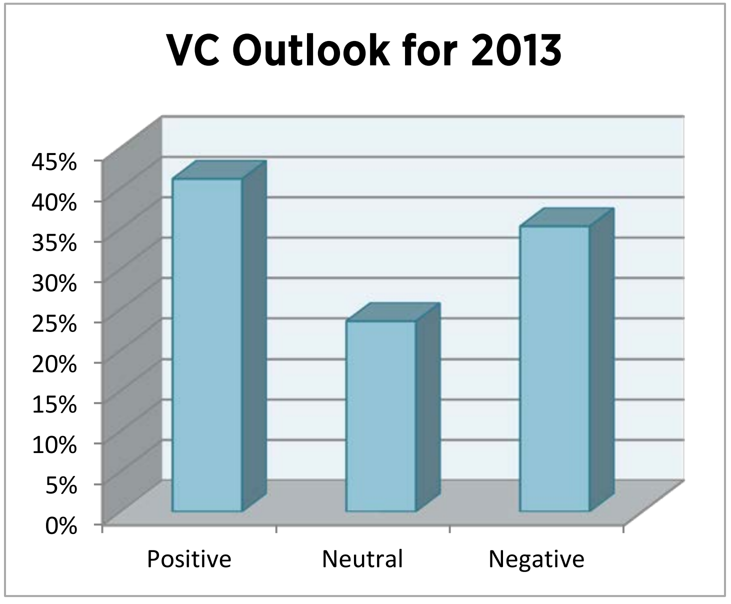
One of the biggest concerns of VCs and Angels alike is the continued lack of exit opportunities in India. Angels saw very few exits in 2012, pointing again to caution on part of VCs with more and more VCs choosing to "wait and watch". VCs too felt exits were highly constrained, with strategic divestments forming the bulk of their exits in 2012. They expect this lull to continue in 2013, with strategic exits remaining the vast majority despite their sub-optimal returns.

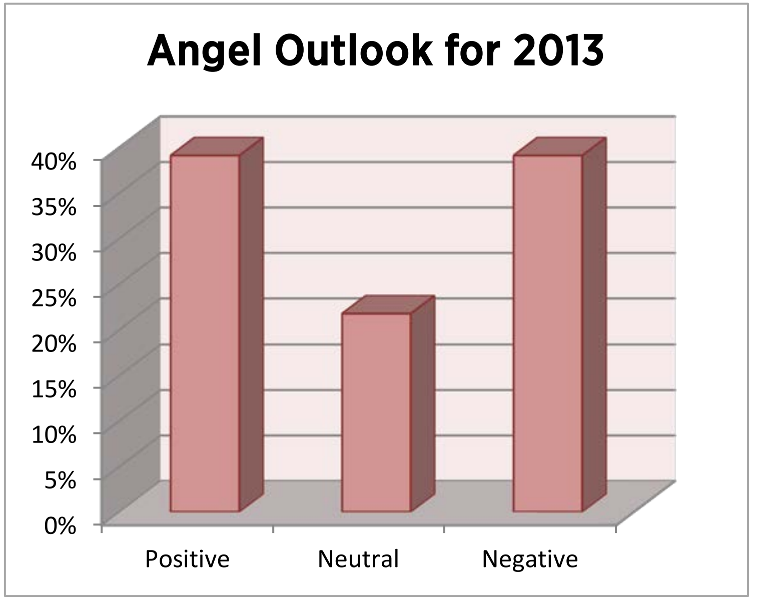


Insights – Investor Sentiment

D) Investor sentiment indicates slow recovery after a muted 2012 for most VCs and seasoned Angels

Looking ahead toward 2013, the investor sentiment seems neutral to slightly positive at best. Investors are very wary of ecommerce investments, which comes as no surprise, as they watch the bubble burst and wait for the industry to stabilize. The bumpy ride of 2012 has tightened their purse strings but at the same time, they are keen on non-ecommerce sectors in 2013 and getting the investment momentum back on track. The only exceptions to this general outlook are Seed Funds, who are extremely bullish and are contributing a significant chunk of early stage investments in India.





Investor-speak

"There seems to be a little bit of slowdown, but not much. Future is hard to predict. I think that 2011 was an exception for the industry, not 2012. So if we can hold up at 2012 levels, I am happy."

- Leading VC

We remain very bullish in our outlook for the year 2013 and ahead. Would like to point out though that we see exits and up rounds coming from global strategics / M&A / VCs - more than just Indian corporates.

– Seed Fund

VCs appear to have become more cautious and in many ways are behaving like PE players. They want to take little risk and true 'venture' style investing seems to have taken a backseat as execution challenges in India are significant. I expect it will take another 12-18 months for Series A investments to start flowing again.

- Leading Angel

I think we are certain to see a general slowdown in Series A investments in 2013. I think exits / trade sales will be even harder to come by in this period. I actually think there will be a flight to higher quality, more complete/mature teams with a proven ability to build/scale/exit companies in 2013 as opposed to greenfield teams of very immature albeit talented founders.

Also I believe eCommerce will be hit the hardest in 2013 - both at the seed level and Series A rounds. In that segment, companies should plan to go much leaner, slow down burn significantly and focus on refining their offerings, supply chain, internal marketing/service processes rather than burning fast to build top line.

- Leading Angel

Yes there is (a slow down) and there will be more of a slowdown in 2013. VC funds are reducing in number and dollars so this slowdown will remain till exit activity improves.

- Leading VC

Yes. The slowdown is evident. But there is enough gunpowder that is dry. Things should get better in 2013.

- Leading VC

Conclusion

It appears that 2013 will be a watershed year for India. Mobile Internet is building up rapid momentum with 3G and 4G network rollouts. Driven by global tailwinds, smart phone prices are dropping by the day. The combination of these two powerful forces is unleashing a huge swathe of the Indian population on the internet.

New Angel investors are providing fresh capital to early stage startups (while seasoned ones are becoming weary, as our survey reveals), and a few accelerators and incubators have announced aggressive plans for 2013.

We would characterize the mood in early 2013 as one of "Cautious Optimism" amongst VCs and one of "Weary Caution" amongst seasoned Angels. While VCs are just about recovering from the impact of "E-commerce Exuberance" in 2011, seasoned Angels find that they need to dig deeper to keep their companies going and are facing a situation where their resolves are being tested.

However, in this time of caution, fresh liquidity is being provided to the market by GSF and a few other accelerators, new Angels and clubs like Mumbai Angels, Indian Angel Network, Chennai Angels, etc. While Angel clubs continue to invest in a sustained manner, a few nascent seed funds are making aggressive bets.

About the Authors

Rajesh Sawhney [rajesh@gsfindia.com]

Rajesh Sawhney is the founder of GSF Accelerator, India's first multi-city Tech Accelerator, backed by 20 iconic digital founders and 5 leading venture funds from across the world. Rajesh is also the founder of GSF Superangels network and curator of the Global Superangels Forum. He is the co-host and curator of Founders Forum India. Rajesh has made over 12 investments as an active and engaged angel investor.

His journey has been a continuum of re-invention waves. In the first wave, he brought private radio (Times FM) to India in early nineties, and redefined Indian youth culture. In his second wave, he was at the cusp of early Internet culture in India and built Indiatimes.com, the most valuable Internet business in India in 2005 (funded by Sequoia). In the third wave, Rajesh was at the centre of a massive transformation of the Indian film industry, where he oversaw (as President, Reliance Entertainment) the corporatization of mom and pop Bollywood businesses into a multi-billion dollar enterprise. At Reliance, Rajesh found himself at the centre of cross-border investment and alignment between Hollywood and Indian Film Industry and one of the biggest investment deals (DreamWorks) in Hollywood.

Currently in his fourth wave, Rajesh is building the vital building blocks of a nascent early stage startup ecosystem in India, and sees this as his biggest and most exciting challenge. Rajesh is an alumnus of Harvard Business School (AMP), and has a fellowship from London School of Economics. Twitter @rajeshsawhney

Esha Tiwary [esha@gsfindia.com]

Esha's strength is building new businesses. She is currently the Chief Marketing Officer at Cloudnine, the pioneer of healthcare facilities focused on woman and child care in India. Here she is a critical part of the organization's growth phase, leading their efforts to build a national brand. Esha is closely associated with GSF, and was part of the core team that set up the GSF Accelerator in Bangalore. Earlier, Esha was Vice President, Marketing and Business Development at Embrace, a start-up developing affordable medical devices. She built strong partnerships in the US, helped raise funds and was instrumental in the launch of the product in India. Before Embrace, Esha headed product development as part of a small team that launched the personal care product business for ITC in India.

Esha has an MBA from Harvard Business School and a B.Tech. in Computer Science and Engineering from IIT Kanpur. Twitter @etiwary

About GSF

GSF Superangels

GSF Superangels is a network of 20 iconic founders and investors dedicated to providing seed funding to the most promising Indian startups. As former and current founders themselves, this team of Superangels is particularly well equipped to identify opportunity and nurture talent in the Indian startup ecosystem. Last year GSF Superangels funded 3 companies: Autowale, Biosense and Chotu. Their goal this year is to fund between 5-6 out of the multiple companies showcased at GSF2012. The GSF selection criteria is threefold: exceptional founders, substantial market opportunity, and an innovative product.

GSF Accelerator

GSF Accelerator is India's largest and most successful tech accelerator, founded by Rajesh Sawhney, and backed by 20 iconic Indian digital founders and 5 leading funds from across the world. It is a 9-week program designed to foster innovation in India's fast-growing digital economy. It aims to provide select promising startups in the mobile, social, local and cloud spaces with unparalleled access to venture & business networks, personalized & intensive mentoring, and initial capital. The program runs simultaneously in Delhi, Mumbai, Chennai and Bangalore, with each location hosting 5 startups. Extensive coaching is provided to each startup by a mentorship pool of over 200 leading co-founders and digital masterminds from across the world. The GSF Accelerator startups attend 25 intensive and proprietary workshops conducted by global experts. 20 startups receive initial funding from GSF. This is the single largest funding event for Indian startups by number. GSF Superangels provide further funding to a few startups at the end of the program.

GSF2012 - Forum

GSF2012 was the most innovative two-day hiatus in the calendar of the Indian start up scene. At the core of the second GSF Forum were 37 startups. During these two days, GSF brought 400 investors and founders from across the world to the doorsteps of innovation and entrepreneurship, Indian style. The conference featured a dynamic program, including 3 keynotes, 4 power packed panels, 3 master classes, entertainment Indian style and an art auction for charity.

Appendix

Survey Questionnaire - Angel

1.What is the name of your fund?
2.How many investments did you make in 2012?
3.Of these, how many were at Seed stage?
4.How many were in Series A?
5.In how many of your investments from 2012 did you collaborate with a VC fund?
6.Was this number more or less than in 2011?
7.How many exits did you have in 2012?
8.What entity did you exit to?
9.Do you think there is a slowdown of Series A investment in India? How do you see it panning out in 2013?

Survey Questionnaire – VC

1.What is the name of your fund?
2.How many investments did you make in 2012?
3.Of these, how many were at Seed stage?
4.How many were in Series A?
5.How many were in Series B?
6.In how many of your investments from 2012 did you collaborate with an Angel?
7.Was this number more or less than in 2011?
8.How many exits did you have in 2012?
9.What entity did you exit to?
10.Do you think there is a slowdown of Series A investment in India? How do you see it panning out in 2013?