Sai Kumar (name changed) could not understand what was happening. He thought that he had all the right credentials and was there at the right time. An alumnus of one of the IITs, he had spent a decade and a half abroad, working on prestigious software projects. He then came back to India and set up a software firm with his own money. Unlike the many that opted for project and body shopping setups, Sai decided to go the product route. Five years later, there he was, with a product that he believed was as good if not better than what was available elsewhere and even a few marquee clients. And there were more clients to be had if only he could set up a good sales and servicing infrastructure. That was why he could not understand why VC after VC that he approached for funding was refusing to bite.

Many approach VCs at the concept stage, VCs are more liable to fund projects under execution with a ready prototype or product

Sai Kumar is not the only one caught in this predicament. Take the case of Ganesh (name changed), who again was working on a product idea with teams in India and Singapore when he approached a well known VC firm for funding. The advice he got has put him off from approaching any other VC. "I was told that we will get a serious valuation only if we show sizable income and growth potential or if we can become a real threat to existing players or big competitors." Or of Stanley (name changed), who gave up after talking to a few, discovering that they were just not interested in the sector he was oper-

You have been one of the pioneers of venture capital in India. Why do you think a lot of small companies find it difficult to attract funding?

I have lots of hope and am very optimistic about the future of venture capital in the country. One area which is neglected is low-end funding, that is, early stage funding since not too many players are around. Only a few of us who started earlier are now around. I have been in since 1990. We have always focused on early-stage technology startups. However, for a fund like ours, even fund raising is difficult. It is easy for large private equity players to go abroad, raise the money and invest in a bullish capital market; it shows the expected returns also.

In the market, you won't find many who are focused on small, medium, or early-stage companies since the returns are not that great. The gestation period is also very long – 7 years or so – with the exception of IT. IT is the only area where the company starts to get profitable, starting from the third year or the fourth year.

So, IRR (Internal Rate of Return) gets affected, thereby making it very difficult to make good money. In India, there are not too many buyers of such companies. So, exit from such companies has become very difficult. Of course, we have had some very good exits where the companies were actually bought over. IPOs for small companies like the ones where I invest in is again very difficult since the companies are small and their market capitalization is comparatively low.

I look at companies which are in niche areas and are exceptionally good. Considering the mortality and vulnerability of a small entrepreneur, there are not too many funds who want to get into it. They would like to get into where money can be made. I just invested in two incubatees of Indian Institute of Management, Ahmedabad (IIMA) and one of Nirma University. One company is in RFID (Radio Frequency Identification) business, Rapid Radio and another company is Ceon Solutions.

When I raised Rs 60 crore in 1995, I raised it in six months. Now, I'm raising Rs 250 crore and in about six months I am almost nearing my first closure of Rs 50 crore. It has been far more difficult for me than it was in 1995. That is because people say that they have other avenues and other private equity funds to invest and hence feel no need to invest in early-stage companies where they get smaller returns.

We performed well, have survived and are willing to take a risk with a startup whereas private funds are usually risk-averse since they would like to keep showing results. They usually opt for ventures from which they can exit within 2-3 years. We normally

Vishnu Varshney, MD, GVFL

go for building a company. So, even if our investment needs to be there for 7 - 8 years, we continue. For instance, recently I divested from Neilsoft, a CAD/ CAM company based in Pune. I got almost five-and-a-half times of what I invested but it was after 7 years.

At what stage do you think a business should start looking for VC funding?

When they come out of incubation, unless it becomes a must for them, they should try to raise their own money from friends, relatives, and other people. Once their product prototype is ready, and they are ready to get their technology validated, they should come to someone like us. Like say for example, in case of Ceon, the product was ready.

'I am ready to look at projects at concept stage'

In the past, we used to invest when the guy would come and just sit down with a piece of paper and say this is what I want to do. We just asked them to put it down on a piece of paper, got some experts to evaluate it and when the expert said that it looks like a workable idea, we went ahead and invested. I am not averse to that kind of investment even now, but in such cases where you start at a concept stage, risks are very high.

So you mean, even if somebody comes up to you today without any estimation of cash flow and the likes you are still willing to look at the business plan?

I am willing to look at it provided the idea looks convincing, the product looks convincing, what the promoter wants to do looks convincing; and then he is able to articulate his entire idea. Our board also has experienced people from the industry like Harish Mehta, Pawan Kumar, Dr Madhu Mehta. These people look at it.

As a VC, what are the key things that you look for in a prospective investment?

We look at the promoter or the founder. We look at how passionate he is, how knowledgeable he is, his background and whether he is a team-man or not. Whether he gets along well with people and what kind of team he has gathered. For example, in Ceon, not only was the promoter very knowledgeable; his partners where equally good and committed to the company. We look at the promoter and see how committed he is and whether in the first shock will he run away or hang in there. After making 51 investments, I have developed the kind of intuition that I can easily make it out. Our experience helps us decide whether these people will work or not. So, the promoter and the team matter a lot. In addition to this, the technology and its stage matter too.

There are two things to be considered in technology startups – stage of technology, whether it can be scaled up or not and finances.

What would you advice to an entrepreneur on making and presenting a case to a VC?

First, they should have a very clear idea about what they want to do and they should develop a proper business model and see how they are going to build a team immediately after they get the money. They would need to see how they are going to build a team of key persons in key areas. There is no need for a large organization but at least two to three people should be there to help in building the company.

Secondly, VCs get many proposals and they have very little time to go through them. Hence, entrepreneurs should be very articulate and should be able to make a proper business plan at the time of presentation. Try to think about all possible questions that experts can ask. In the meantime, if they can come to a stage where there is a working prototype available, things become more convincing. If the technology gets validated and they have even a little proof of the market, it will be accepted very quickly.

ating in, even though his idea may be path breaking.

On the one side, we have reports of millions being invested daily into virtually unknown companies with seemingly me too ideas. Where is the disconnect? How do you as an entrepreneur looking for funds find the right VC? What else can a VC offer you other than funds?

Are you ready for a VC?

As an entrepreneur or a would-be entrepreneur looking for funding, the first question you need to ask yourself is whether you are ready for VC funding. The bad news is that your project may just not be in the stage or size to get a VC interested.

A VC may not be your best funding option if your projects scale or growth plan is not large or fast enough

Different stages of a business idea require different levels and types of funding. Unfortunately, a profusion of business model competitions have lumped all these funding options under the umbrella of the VC leaving may entrepreneurs confused in the process. From a funding angle, a business can be divided into four stages – the seed or concept stage, the venture capital (VC) stage, the Private Equity (PE) stage and the initial public offering (IPO) stage.

The seed stage is when the business is pretty much an idea. You do not have a product or clients. Possibly you do not even have a team or a business plan. Perhaps a prototype is ready. And you know that you need more funds than can be organized by borrowing from friends and immediate relatives.

This is **NOT** the stage to approach a VC.

Laura Parkin has been on all three sides of the table. She has set up two entrepreneurial ventures with funding, has worked in a VC firm and now, as Executive Director of the National Entrepreneur Network regularly acts as an interface between budding entrepreneurs and various funding entities. According to Parkin, VC funding is really not for startup stage companies. "Other than seed fund, most VCs are looking for a proven business model and customers and would like to see their funds used to scale up the operations, rather than test a business model. Even Angels in India would like to see working prototypes".

Unfortunately, many entrepreneurs choose to approach a VC at this stage; and get badly burnt.

This is the stage at which you should look for seed funding or Angel funding. Your funding requirements are smaller and more importantly your company is probably a long, long way away from value realization (IPO, acquisition etc.). Angels will also probably give you more of their time and expertise, which is very critical and important at this stage.

But, there are VC funds that do look at concept stage companies. GVFL (Gujarat Venture Finance) started by Vishnu Varshney, who is considered to be the father of the Indian venture capital industry is one who invests into concept stage companies. Varshney says that "if you are a startup or an early stage company, private funds will not give you the money. Most of them will ask you to go get the money from somebody else and bring it to some stage where they see fit to invest in. We don't do that. We will be looking at even early-stage companies. More than 30% of my investees are at the concept stage. We do not wait for them to scale up. If the promoter is good, the concept believable and credible, we do not mind giving money to start-ups".

The second stage, where you have a prototype, if not a product ready, have bagged a few customers or at least have a few customers interested and have a realistic business plan ready is when you should approach a VC for funding. Here again, too many business plan contests have spoilt it. You can make a great business plan in Excel, but what about market realities? Remember that a good VC like Varshney, who in seventeen years has received over 5,000 proposals, and has invested in 61 companies comes with experience across many companies and many, many business plans.

Will you scale?

Some projects may just not attract VCs because they are not scalable in size or scope. If your end objective is a company that employs ten mechanics making plastic buckets, for example, then you are unlikely to attract the attention of any VC. Like Varshney points out, most VCs look to exit the project in about four years and by then the project has to reach a scale where a PE fund gets interested in them or they become the target of an acquisition. Only very few startups go directly from VC funding to IPO. The message coming from the VC community is very clear. They are not investing in any company for keeps. The entrepreneur has to be clear about this and has to include exit options in his planning and even in his initial presentations. Selling back the stake to the entrepreneur is not a preferred option because as Alok Mittal of Canan Partners puts it, that does not maximize the returns for the investor.

A VC gets hundreds of proposals by email every month. Your project is likely to be considered favorably if you are introduced by someone known to them

Finding the right VC

Once you are ready for VC funding, comes the next question. Who is the right VC for you and more importantly, how do you approach them? Again, many entrepreneurs make the wrong move here. They just email across a proposal to all VC email ids they can get. An average VC today gets anywhere around ten proposals a day by mail. The better ones get many more. Put yourselves in the shoes of the VC. Do you read every mail that you get in your mail box?.

According to Sundaresan Natarajan, a Washington DC area entrepreneur who also advices other startups on getting funding, the name of the game is networking. The best way to get noticed by VCs is to get recommended by someone known to them. If you can afford it, you should get a merchant banker to advise and introduce you. But most entrepreneurs looking for funding may not be that lucky. That is where networking comes in.

Natarajan recalls his own experience in organizing funding for his first startup. "We went through the presentation process. But it really didn't come out of that presentation or that breakfast meeting. Somebody who attended liked our concept and he forwarded it to another friend who had a similar portfolio. And then it happened that someone in my team knew that person and so it's all kind of networking again".

According to Natarajan, organisations like TiE provide networking opportunities that entrepreneurs should make the most out of.

Finding the right VC is not just about finding someone with money. You need to find someone who can understand what you are talking about, who can understand your language and technology. That is you need to find VCs who have experience in your area and are funding entrepreneurs in the same space. Someone who understands biotechnology is more likely to get excited by a biotech concept than say someone who funds BPOs.

A fair bit of Google search and some networking should help you unearth this information.

Laura Parkin , Executive Director, National Entrepreneurship Network

You have been on all three sides of the table (as described above). What are the most common points of disconnect between VCs and potential investees? Where is it that things go wrong most often, during the pitch?

In India, more so than US, a fundamental disconnect is that many people who approach VCs have businesses that would simply not work for VC funding; usually because the companies are not scalable. I presume this happens because VC-backed entrepreneurship is relatively new in India and entrepreneurs are not as familiar with the VC investment model.

Otherwise, obvious though it may sound, if the VC is comfortable with the opportunity and market size, the disconnect is simply that the VC can't get comfortable with the team. Either they think the team will not be able to execute, or they feel that they would not be able to work with the team.

Is there any difference in the way Indian VCs act compared to western ones?

Indian VCs and US VCs are becoming one and the same! With the advent of Matrix, NEA, Sierra, Canaan and other US firms, differences in behavior are fading. However, I would say that perhaps the average US VC may be able to add more value to portfolio companies, and may be able to realize value through exits more effectively, simply because more US VCs have had the advantage of decades of experience in building and selling companies. Even the young VCs in the US have more opportunity to "apprentice" with experienced VCs.

VC firms in India seem to be looking at investments in later stage companies than VC firms in the US. That's probably driven by several dynamics: one, the amount of funds that VC firms invest – VC firms in India seek to invest between $2-5 million per deal. In India, that is a very large amount of money, though in the US it's a startup amount. Another driver is simply that the opportunity exists to invest in later stage deals that have not previously received institutional funding.

Smaller number of savvy entrepreneurs here in India - though that is changing with more experienced senior managers stepping out to start companies. But generally, there's just a much larger pool of experienced entrepreneurs and senior managers available in Silicon Valley and Boston/Cambridge and other entrepreneurial "hot spots" in the US.

In the US, it certainly helps to be part of the network. Business plans that come in "over the transom" - or without connection - have basically no chance of getting funding.

In India, perhaps the entrepreneur or the team doesn't have to know the VC, but they should be known in the industry, or to someone the VC trusts. It's a relatively small world, so if you're operating in an industry, and a VC is investing in that industry, there should be some connection, if not directly then atleast one or two hand-shakes away. Given that VCs are really not looking to fund raw young entrepreneurs, it's even more likely that they would at least know of the entrepreneur or part of the founding team that they are considering funding.

Once the investment is made, what are the key milestones in the relationship? Any advice to entrepreneurs on handling these?

As long as the company is hitting targets and milestones, then it's pretty easy to have a good relationship with your investor. The true test comes when the company misses some targets - almost inevitable in a start up with aggressive goals. Best advice is to keep the investors informed. As soon as something looks like it's not going as planned, bring the VC into the picture. Don't wait. Make the VC part of the solution.

Of course, the biggest potential source of conflict between an investor and an entrepreneur comes when the VC feels that the company has "out grown" the entrepreneur and would like to bring in more seasoned management. The VCs probably discuss this eventuality with the entrepreneur during the due diligence process - but at that time the entrepreneur usually thinks, "let's just get the cash, and I'm sure we can work things out..." When the reality hits, it's a whole different thing and can result in real conflict.

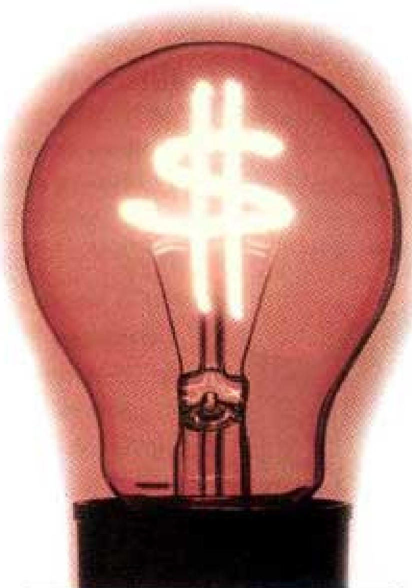
At some level, the entrepreneur must understand that by taking funds from institutional investors, he or she has lost independence and control of the company. A VC's ultimate control, in most cases, is the ability, as part of the Board of Directors, to fire the entrepreneur.

Where's your team?

All the VCs we spoke to emphasized on one point – the team. Venture capitalists do not seem to be too thrilled with one man shows. They are looking for well rounded teams that complement each other. Again, according to Natarajan, "If they have an idea, people kind of jump up and say: okay, I have a great idea. Now I should be able to make this work and make this a profitable business. But the person may be really a technology person and having a great idea but not all great ideas transform into viable businesses. That's where I see a gap and I am sure when you take this to a VC they will just say, hey, how are you going to execute it and who is going to do the sales and the like?"

A number of VCs do work with projects that they have invested in, to being in the right senior management team. And this is another area of potential conflict. It is difficult for many who are owners of the original idea to being in someone else as a CEO. It takes a lot of guts to, like Steve Jobs did to identify a John Scully and to challenge him whether he wants to "sell sugared water all his life or whether he wants to change the world"? But again, there was a board (of investors) behind Jobs who made him ask that historic question. And then Scully did do Jobs what every entrepreneur fears an outsider he brings in will do – oust him. It is another story all together that Jobs "won back" Apple. Like Parkin says, "At some level, the entrepreneur must understand that by taking funds from institutional investors, he or she has lost independence and control of the company. A VC's ultimate control, in most cases, is the ability, as part of the Board of Directors, to fire the entrepreneur".

To cut a long story short, whether there is a team that pulls together and shares the passion or whether it is a one-man show may be all that stands between your dream project and the funding it deserves.



Just because you came up with the idea, you need not be the CEO. A competent management team in imperative to a project's success, and to investors becoming interested

How much equity?

Now comes the deal breaker. This question plays both ways. How much equity are you willing to give the VC in return for the funds? From the other side of the table, the VC will question how much salary the entrepreneur is paying himself.

Nitin Paul of Evangelists was not looking for too much funding. He wanted about half a million dollars, and in return was willing to give a 5% share in the company. Unfortunately, no VC was interested. For most, the money being asked for was too little and the stake being offered was too less. Typically, VCs look for what they call an influencing stake; a percentage that lets them have a say in the board. This typically works out to anywhere upwards of 15% upto about 50%. In the real estate business, for example, we found funds asking for 50:50 joint ventures.

Sometime back, I was called in by an investor to advise him about a project seeking investment. This was a team of three people, two of them fresh out of college, who had an interesting concept for a technology product. One of the points of disagreements was the salaries that the lead entrepreneur wanted. The investor felt that given the experience of the team and the chances of success, the salary being asked for was exorbitant. He instead offered to incubate the project out of his premises, provided the entrepreneur took a much lesser salary. The entrepreneur on the other hand felt that the investor was trying to shortchange him. Obviously, no deal could be worked out.

Paul says that he worked out his stake in the company after considering his own years of experience, current salary and ESOPs and future earning potential on the same job, including growth and market value of ESOPs. Finally, he opted for financing at 18% interest instead of the VC route. Looking back he says that looking for funding is a full time job that requires a lot of bandwidth and that perhaps single entrepreneurs are going to be challenged taking their projects forward as well as looking for funding.

Is the chemistry right?

That brings us to the final frontier you need to cross. Unfortunately, this is an intangible one. Everyone we spoke to highlighted this one, but none could quantify it – the chemistry between the VC and the Investee.

Ultimately, what the VC is doing is an act of faith; faith that what you the entrepreneur is promising will come through. Like Varshney says, "often we offer tough love". So, the chemistry has to be right. Like Parkin sums it up — A deal could be lost just because "the VC thinks that the team will not be able to execute, or they feel that they would not be able to work with the team." DARE