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VENTURE CAPITAL FINANCING ENVIRONMENT IN INDIA DURING COVID-19

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ABSTRACT

Venture capital financing plays a significant role in fostering the start-up ecosystem. In India, the venture capital industry has been evolving continuously over the years. It has played a huge role in the promotion and development of entrepreneurial environment. However, the advent of covid-19 pandemic has disrupted not only the start-up ecosystem, but also the venture capital financing environment in India. This paper is an attempt to understand the transformations caused by covid-19 pandemic within the Indian venture capital industry. Using a cross-sectional descriptive research design, the focus of this paper has been to study the venture capital investment landscape and the major sectors receiving venture capital finance in India during the pandemic.

INTRODUCTION

Entrepreneurship is the backbone of an economy. Strong entrepreneurial environment facilitates creation of jobs, thereby bringing a rigorous growth in the economy. To accelerate and facilitate this entrepreneurial activity in the economy, government plays a pivotal role in the upliftment and development of start-up ecosystem. However, start-ups are often faced with challenges related to finance and know-how (Đalić *et al.*, 2017) in order to sustain themselves within the ecosystem in the long run. To curb this problem, various sources of finance are now available to start-ups. The recent years have witnessed a development in several alternative sources of entrepreneurial finance which are transforming the entrepreneurial ecosystem (Bonini and Capizzi, 2019).

Among these different sources of finance, venture capital (VC) financing plays an important role in the promotion and development of start-ups (Hellmann and Puri, 2002). It acts as a vital source of finance for early-stage companies with a faster growth rate (Baeyens and Manigart, 2003). Venture capitalists (VCs) are interested in investing their money in risky enterprises managed by entrepreneurs (Barry, 1994). They not only provide financial resources, but also play a role in managing their portfolio companies (Fried and Hisrich, 1995) and providing value-added services to them (Hellmann and Puri, 2002), thereby taking an entrepreneurial firm to a professionally managed condition (Meglio *et al.*, 2017). Thus, VC financing plays an important role in supporting business continuity (Rosa *et al.*, 2019).

In India, the VC industry was formalised in 1988 by the Indian government (Kaushik, 2014), however, compared to other countries like the US, UK, Israel and Europe, the Indian VC industry is relatively young (Shah, 2020). The Indian VC industry entered its growth stage from 2016 onwards (Shah, 2020) and has been thriving ever since by fostering entrepreneurship and paving the way for economic growth and development. VC finance has accelerated the growth rate in start-ups, which has further led to creation of more than 3 million jobs in the past 8 years (Sheth *et al.*, 2021, p. 38). According to a report published by the Indian Private Equity & Venture Capital Association (IVCA) and Ernst & Young (EY) (IVCA-EY, 2021), the period 2011–2020 is regarded as a significant decade for Indian VC industry, which witnessed the growth of the industry from a state of infancy to a state of maturity. In particular, the year 2019 was considered as a milestone year for the Indian VC industry with US $10B capital deployed—approximately 55% higher than 2018 (Sheth *et al.*, 2020, p. 5). Approximately 80% of all the VC investments in 2019 was associated with sectors like consumer tech, software as a service (SaaS), fintech and business to business (B2B), with consumer tech getting the most investment (Sheth *et al.*, 2020, p. 5).

Right when the Indian VC industry hit its milestone year in 2019, the end of that year also marked the advent of covid-19, which spread rapidly to all parts of the world, rendering it a global pandemic. The onset of covid-19 caused many disturbances within the economy. Each industry suffered tremendously during the pandemic phase. Continuous

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lockdowns and other measures to curb the covid situation caused huge impact on different sectors. There was an uncertainty and negative impact on sales of many businesses (IVCA-EY, 2021). Further, the start-up ecosystem also suffered negatively with many start-ups compelled to shut down their operations (Sheth *et al.*, 2021). The VC industry has not been an exception to this impact. There was some decline in the VC investments in the year 2020 relative to the milestone year 2019 (Sheth *et al.*, 2021). Although there was a slight decrease in the VC fundraising in the previous year, but that year also witnessed some favourable fundraisings (Mint, 2021).

In the light of the above discussion, it is interesting to understand how the Indian VC industry has performed during the pandemic. Therefore, this paper is an attempt to fulfil the following objectives:

(i) to study the landscape of VC investment in India during the pandemic
(ii) to identify the major sectors receiving VC investment in India during the pandemic.

METHODOLOGY

This study follows a cross-sectional descriptive research design by utilising secondary data sources. Statistical data available in various reports published by Indian Private Equity & Venture Capital Association (IVCA), Ernst & Young (EY) and Bain & Company have been used in the study. Further, data available from other research studies and newspaper articles have also been considered for this study.

RESULTS AND DISCUSSION

The landscape of VC investment in India during the pandemic

An overview of the total VC investments (deal value) in India is shown in Figure 4.1. The IVCA report (Sheth *et al.*, 2021, p. 10) highlighted the years 2012–2015 as the years of growth. The start-up environment was continuously growing during this period and new VC investments were growing in India (Figure 4.1). There was a slight decline in the years 2016–2017 (Figure 4.1). Investing remained cautious due to less clarity on exits (Sheth *et al.*, 2021, p. 10). These years have been characterised as the years of maturity, where the investments are few but of high-quality (Sheth *et al.*, 2021, p. 10). Further, investments started increasing again in the years 2018–2019 (Figure 4.1)—period marked as the period of optimism. Investors also started showing interest in sectors like fintech and SaaS (Sheth *et al.*, 2021, p. 10). The year 2019 showed the highest level of VC investments of $11.1B (Figure 4.1). The investments in the year 2020 highlight the impact of covid-19. There was a slight decline in investments from $11.1B to $10.0B, however it continues to remain the second highest value in the decade (Figure 4.1).

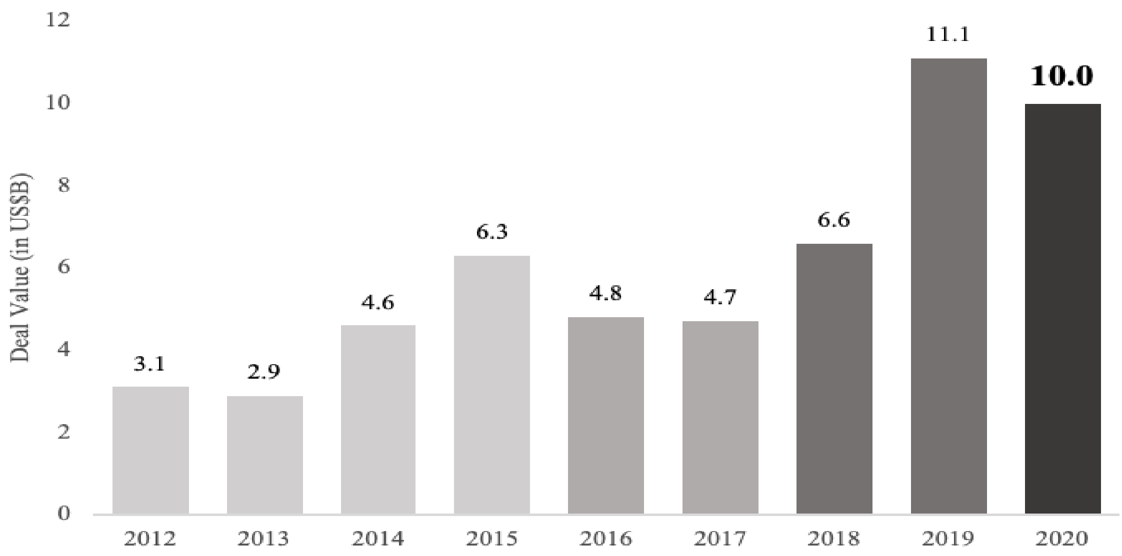

Figure 4.1 Total VC investments (deal value) in India ($B)
Source: India Venture Capital Report 2021, IVCA | Bain & Company

The deal volume, i.e., the number of VC investments in India is depicted in Figure 4.2. The years 2012–2015 (the years of growth) showed a continuous increase in the number of VC investments (Figure 4.2). During this period, the prime attention of VCs was directed towards building more portfolios (Sheth *et al.*, 2021, p. 10). Beyond 2015, the number of deals declined till the year 2018, post which they continued to rise again (Figure 4.2). The year 2019 showed a tremendous growth in deals by approximately 1.324 times (Figure 4.2). The year 2020 depicts the impact of covid on the deal volume. Although the deals have increased by only approximately 1.07 times since 2019 (Figure 4.2), but the momentum is accelerated (Sheth *et al.*, 2021, p. 10).

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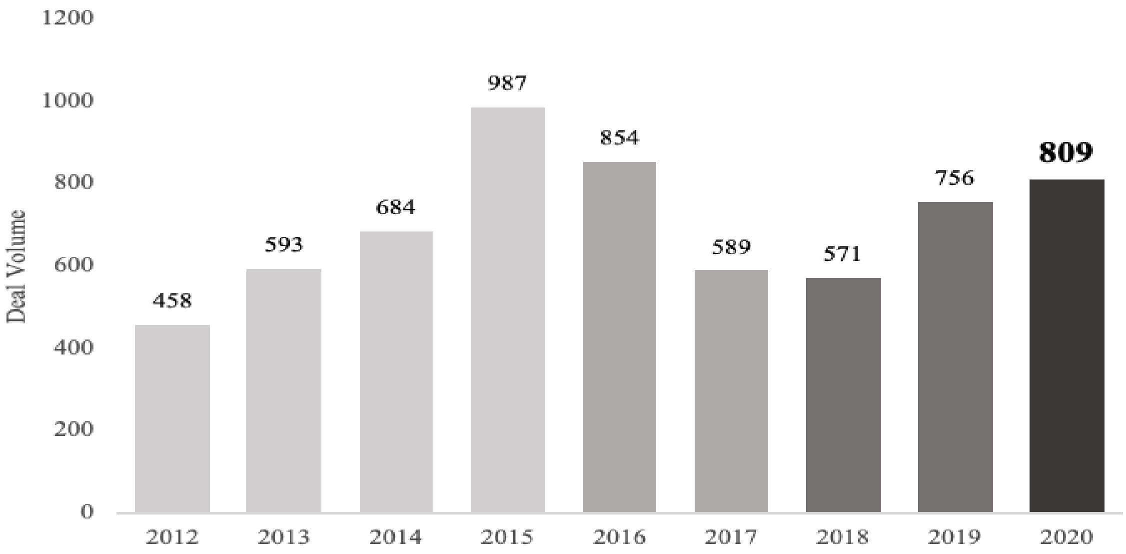

Figure 4.2 Number of VC investments (deal volume) in India
Source: India Venture Capital Report 2021, IVCA | Bain & Company

Besides the deal value and deal volume, it is also interesting to look at the number of active VC funds in India. Since 2017, this number has increased unceasingly, with a high of 516 in the year 2020 (Figure 4.3). The new top VC investors in 2020 were Inflection Point Ventures, Avataar Venture Partners, Coatue Management, Beyond Next Ventures, Titan Capital and Arkam Ventures (Sheth *et al.*, 2021, p. 24).

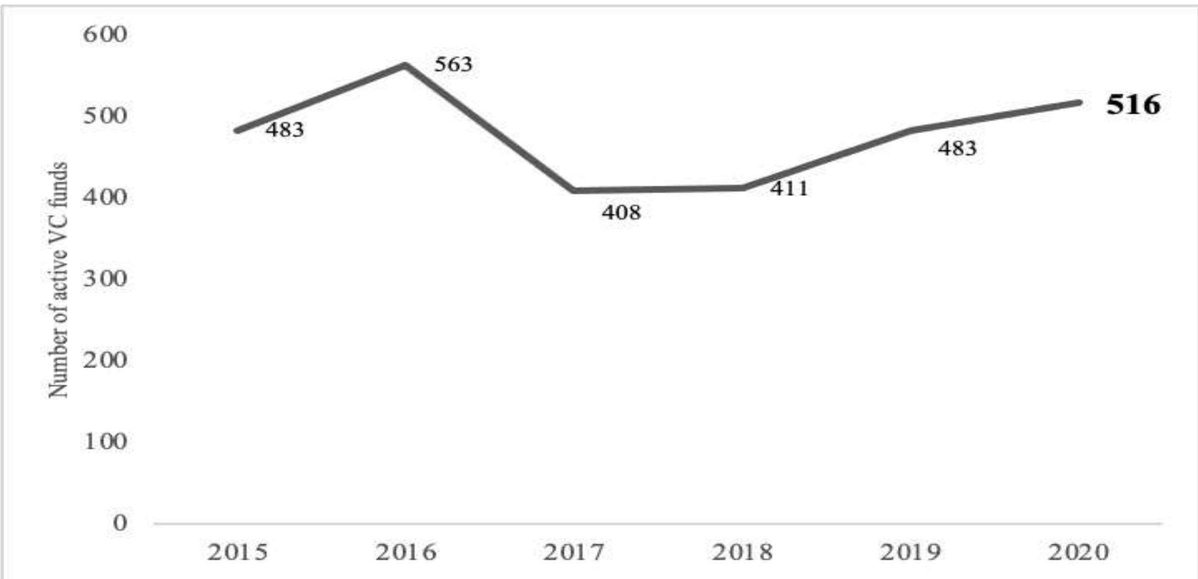

Figure 4.3 Number of active VC funds in India
Source: India Venture Capital Report 2021, IVCA | Bain & Company

A detailed analysis of the year 2020—the pandemic year—is shown in Figure 4.4. It revealed that the pandemic and other lockdown conditions had a severe impact on the deal value as well as volume—causing a decline in both during the months Apr–Jun (Figure 4.4). Although the hit was quite severe, but the momentum picked up again in the second half of the year with an increase in both deal value and volume (Figure 4.4). Despite the setbacks due to the pandemic, the year 2020 also witnessed the rise of several new unicorns and a shift in investments towards SaaS, fintech and different subsegments of consumer tech as well (Sheth *et al.*, 2021, p. 13). In VC industry, a unicorn is a privately held start-up that reaches $1B valuation (The Economic Times, 2021; Sahni, 2019).

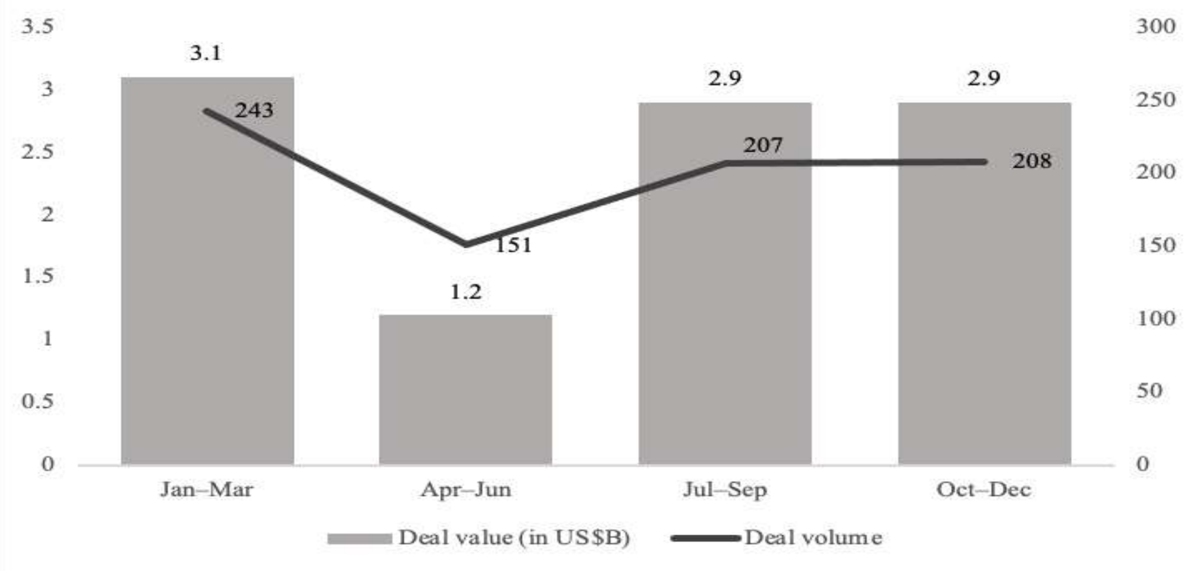

Figure 4.4 The pandemic year at a glance
Source: India Venture Capital Report 2021, IVCA | Bain & Company

Major sectors receiving VC investment in India during the pandemic

The year 2020 saw maximum amount of investment being made in three sectors—SaaS, fintech and consumer tech—consumer tech getting the highest amounts of funding (Sheth *et al.*, 2021, p. 15). Within the consumer tech sector, the subsegments like edtech, gaming and foodtech witnessed an upsurge in investments (Sheth *et al.*, 2021, p. 16). The VC investments in SaaS sector have grown by approximately 10% in 2020 (Sheth *et al.*, 2021, p. 19). Further, VC investments within the fintech sector have also shown an increase in 2020 with UPI payments subsegment being the most attractive (Sheth *et al.*, 2021, p. 20).

However, the rise in VC investments within the consumer tech sector is worth discussing in detail since it has received the highest amounts of funding. An analysis of deal volume within consumer tech subsegments over the years 2018–2020 is shown in Figure 4.5. A continuous rise in deal volume in the edtech segment can be observed over the three years (Figure 4.5). The year 2020 witnessed an approximately 1.72 times higher deal volume in the edtech sector (Figure 4.5). This can be understood as an impact of covid. The constant lockdowns as one of the measures to curb the pandemic impacted the education industry heavily leading to shutting down of in-room classes at the institutes, colleges, and schools. In order to adapt to the changing times, these educational institutions have shifted the teaching-learning environment online leading to a rise in demand for digital learning, testing and tutoring platforms (Sheth *et al.*, 2021, p. 17). Furthermore, foodtech segment showed an increase of approximately 1.28 times in the number of deals in 2020 (Figure 4.5). The pandemic affected the food industry negatively by causing many restaurants to shut down their operations completely shifting the trend more towards online food ordering. This has led to a boost in VC investments in such start-ups along with businesses in cloud kitchen segment (Sheth *et al.*, 2021, p. 17). Verticalised e-commerce witnessed a decline in deal volume in the year 2020 (Figure 4.5), however, the areas that attracted the maximum investments were baby merchandise, home decor and furniture, used cars and beauty brands (Sheth *et al.*, 2021, p. 17). The gaming segment observed a hike in the deal volume by approximately 1.2 times in 2020 (Figure 4.5). The pandemic resulted lockdowns caused a change in the gaming industry as well since more people resorted to games as a means of entertainment during the lockdown. Deal volume in the healthtech segment showed an incessant growth over the three years with approximately 1.09 times growth in 2020 (Figure 4.5). The major segments within healthtech that attracted substantial investments were wellness, online consultation and digital therapeutics (Sheth *et al.*, 2021, p. 17). Lastly, the deal volume within media & entertainment segment has depicted a rising trend with 1.25 times increase in 2020. There have been several investments in short-video social networking apps (Sheth *et al.*, 2021, p. 17).

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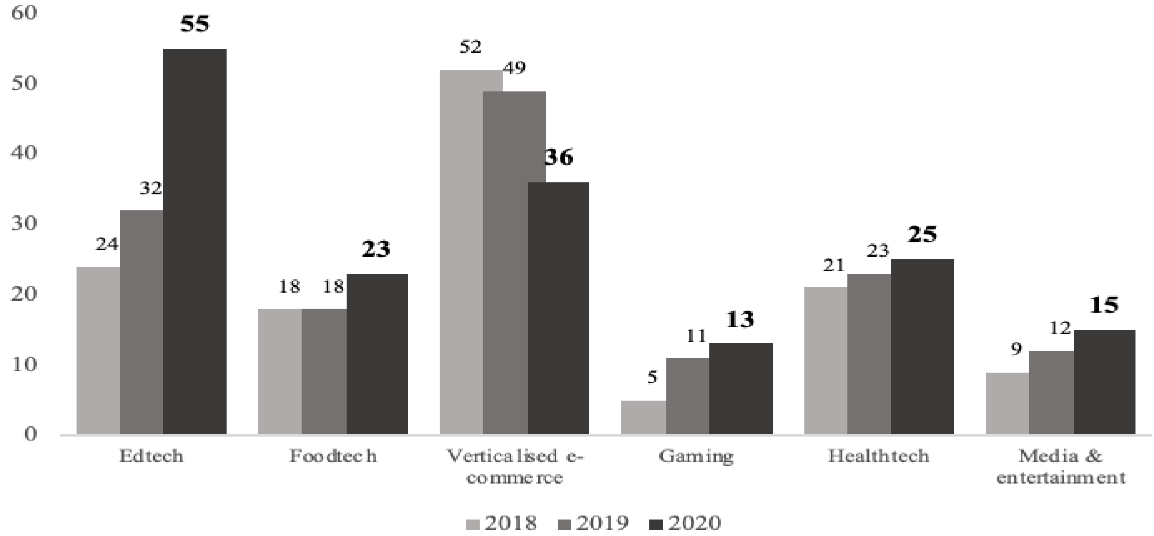

Figure 4.5 Deal volume of consumer tech subsegments
Source: India Venture Capital Report 2021, IVCA | Bain & Company

CONCLUSION

The VC industry in India has been growing and evolving incessantly over the recent years, with 2019 being the milestone year for the industry with highest ever capital deployed. However, the advent of covid in the later part of 2019 disrupted the whole economy causing negative impacts on several industries and sectors. Many start-ups were forced to shut down their operations leading to disturbance in the start-up ecosystem. The VC industry was also impacted by the pandemic leading to a slight decline in the investments in 2020 relative to 2019. In spite of this decline in the investments, the VC industry still witnessed some favourable fundraisings. Therefore, the present study was an attempt to understand the transformations caused by the pandemic in the Indian VC industry. For this purpose, secondary data sources like journals, newspapers and reports were examined. It was revealed that VC investments were the highest in the year 2019. The pandemic situation caused the investments to drop by a small amount, but the momentum of investment activity picked up in the second half of the year. Besides, the year 2020 witnessed an increase in the number of active VC funds as well. Three sectors—SaaS, fintech and consumer tech—received major VC attention for funding. Among these three sectors, consumer tech sector attracted the maximum investment. Within consumer tech sector, edtech, gaming and foodtech subsectors witnessed an increase in investments. It is evident from the discussion that despite the disruptions caused by covid, the Indian VC industry continues to grow. With sustained recovery of the Indian economy post covid, the prospects for Indian VC industry seem highly optimistic.

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