

'Lesser angels' troop into PE turf

Small Investors Cut Deals With Start-Ups, Assign Higher Valuations For Stakes Vs PEs

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THE gainful investment phase that began in March this year has sprouted a new breed of 'smaller' angel investors. Rich investors who have excess money — after regular asset allocation — are directly investing into start-up ventures and growth-stage companies. The trend, of late, has caught on so much that 'small angel investors' are competing directly against mid-size private equity (PE) funds and top angel investors to buy stake in promising start-ups.

Small investors (or lesser angels, as they are known among PE experts), who are either professionals or small businessmen, are reported to be cutting deals with early-stage promoters by assigning high valuations to the start-up, much more than what a private equity or a venture capitalist (VC) would have agreed to pay for a stake.

Supposing a VC fund has agreed to provide Rs 10 crore for a 20% stake in a start-up, the 'lesser angel' will elbow in and turn the deal tables by offering Rs 10 crore for a 10-12% stake in the company. The start-up, in most cases, will opt for the individual investor, as the promoter will have to dilute only a small percentage of his stakeholding and can retain better management control.

"Affluent investors are replacing venture capitalists in start-up financing space. The segment is witnessing huge interest from individual investors and are giving tough competition to small private funds as well," said Ved Prakash Arya, managing director, Milestone Capital Advisors. According to Mr Arya, the deal space between Rs 1 crore and Rs 40 crore is crowded with high-net-worth individuals who act like VCs.

Most of the times, rich investors are goaded by wealth managers and private bankers (who help

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Angel Investor	Companies Funded
Ashish Gupta	Daksh, Naukri.com, Tavant Technologies
Kanwal Rekhi	Hotmail, Kaboodle, Apptivity, CyberMedia and others
Kumar Malavalli	Alpine Tech, Clover Leaf Comm, Intersan
NS Raghavan	Cades Digitech, Careers India, Stump Vision & others
Sanjeev Agarwal	Mindworks, Gridstone, makemytrip.com
C Sivasankaran	Amby Valley, S-Tel

Source: Indian Web Start-Ups, Economic Times

on other investments) to invest in a private company. The sole investment criteria for investment — invariably all the time — is pocketing better returns on their investments. Risk-taking wealth managers also advise clients to invest into seemingly promising start-ups to add a high-return kicker (seeking an alpha component) to the client's investment portfolio. Rich investors choose to invest directly (rather than investing into a project through PE fund) to skip fund management fees payable to a PE fund manager.

While the period of investment — decided in consultation with the investor — may range between 2 and 4 years, the expected rate of return

could be anywhere between 25% and 30% on capital invested.

"Most of the time, the investors do not know the risk profile of his investment. They do not really understand the need for long-term cycles to generate returns on capital investment. The investor — wholly trusting his wealth manager's advice — remains fixated on the high-return criteria," said Arun Natarajan, managing director, Venture Intelligence, a private equity research firm.

According to experts, such 'lesser angels' are pure fair-weather investors who only invest when markets are good and they are making gains on other investments. The problem starts when things start going downhill. Most of the time, the individual investor will refuse to honour drawdowns (fund instalments) due to the start-up. Institutional money is more stable and disciplined when it comes to capital infusion, say experts.

"Even though the start-up promoter may get better valuations from a small individual investor, he'll have to go in for a downturn (a state where current valuations are lower than previous valuations) when he approaches for a second round of funding from bigger institutional investors. At this time, he'll have to part with a larger share of his company to get capital," said Padmaja Ruparel, president, India Angel Network, a large group of established angel investors and venture capitalists.

By teaming up with a network of established angel investors or institutions, the start-up benefits by way of strong top management, business expertise, easy bank finance and muscle to close bigger business deals, say start-up funding experts.

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