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High Risk-High Return Formula Finds New Takers In India

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INDIAN high networth individuals (HNIs) seem to have caught on to a new asset class to invest in— start-ups. Though the risk with start-ups is much higher than other asset classes such as real estate, equity, mutual funds, commodities and sometimes even art funds, HNIs are betting on the opportunity of considerably higher returns associated with start-ups.

Mohit Goyal has been a serial entrepreneur all his life. He was the founder of IIS Infotech, which he sold to Xansa. Since he sold his second venture Scicom Technologies last year, Mr Goyal has been investing in start-ups as a part of the Indian Angel Network (IAN). Around 80 HNIs are part of this network today, up from about six when they started in 2006. In the recent past, the angel community has grown considerably in India. A typical investment by an HNI in a start-up falls in the range of Rs 10-50 lakh and the exit duration is usually between 4-7 years. The returns, on the other hand, can vary from 400% to even zero if the investment goes bad.

Investments in other asset classes, on the other hand, might carry a short-term risk but will never go down to zero. Take for example real estate. Historically, this asset class has never fallen to below 50% of its value. "Equity, futures, mutual funds are practically risk free," says Yogesh Raichandani, associate vice-president at Money Bag, a wealth management company. Equity returns average around 18-20% per annum.

So in spite of the risk, why are HNIs so keen to invest in start-ups?

"It is a very exciting and maturing asset class, which is getting professional by the day. There is huge opportunity here," says Mr Goyal when quizzed about why he decided to invest in start-ups in the first place. A big company might grow at 15-20% a year but a good start-up has the potential to grow at 300-400% a year, he adds. "Start-ups are the seeds in a growing economy."

"As a rule, returns and risk are directly proportional. So if the return on investment expectation in the stock market is 15%, venture funds should return twice that return and other investments would come somewhere in between," says IAN VP Padmaja Ruparel. But higher return is not the only motivation for these HNIs.

A number of HNIs are looking at diversifying their investment portfolios. "HNIs are looking at investments, which are not run of the mill and have low correlation to equity markets. Most have invested heavily in Indian equities and are now willing to diversify their exposure into different asset classes," says Religare Macquarie CEO Vikas Agnihotri. Also, most of these HNIs are first generation entrepreneurs who have gone through the grind and today see start-ups as an opportunity to give back. Mr Goyal feels that investing in mutual funds or equities is a very impersonal act. "In a start-up, you interact and participate. Here, I get a chance to mentor and give strategic guidance as well," he explains. Another HNI Rehan Yar Khan, who is the CEO of Flora2000.com explains that the quantum of money being invested in a start-up by an HNI might be low but the quantum of time spent is much higher than with other investments. "This is an excellent way to utilise the knowledge you have accumulated through your life. He calls it knowledge investing," says Khan. These HNI-turned-mentors also get an opportunity to actually see their investments being used in the right way, sometimes with a little hand-holding. But still there is risk.

The gameplan while investing in start-ups has to be to spread your risk, across 10-15 start-ups and a few different segments—IT, retail, entertainment, content, education—which offer good opportunities. You've got to do enough of them to manage your risk. If you invest in 10 start-ups and even just one of them is a huge success, the exponential returns provided by that one could cover up for the losses from others and you could be looking at an average return of over 30%. "I would like to invest in 10 start-ups a year and with time, spread my risk over many ventures," adds Khan.

"People who are familiar with start-ups have the flair to mitigate risks. They often pick the right kind of start-ups to invest in," says Morpheus Venture Partners partner Nandini Harianniah. The risk though is that there are no external agencies helping you to analyse the risk associated with a particular start-up. "You have to manage your start-up portfolio on your own. There is no historical analysis available. We look at the passion of the entrepreneurs, their idea and take the gamble," says an HNI.

And gambling they are.

RICHIE RICH
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