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Imported business models break down beyond first 20m people

BY [MUGDHA VARIYAR](#) & [MADHAV CHANCHANI](#), ET BUREAU | UPDATED: MAR 30, 2018, 11.41 AM IST

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Canada's second-largest pension fund and institutional investor, La Caisse de dépôt et placement du Québec (CDPQ), has made an initial investment of \$20 million in the first growth fund of **Nandan Nilekani's Fundamentum**, its first in a **venture capital** fund in India. The **Infosys** cofounder established the \$100-million fund last year with Helion Ventures cofounder **Sanjeev Aggarwal** with a particular focus on helping companies scale up, a philosophy CDPQ is in sync with.

"There are too many small businesses that get built to be sold. The objective here is to build businesses that last," said **Michael Sabia**, **Chief Executive of CDPQ**, which will also look to make larger direct follow-on investments in portfolio companies of Fundamentum.


In India, CDPQ and Fundamentum will seek to back startups addressing problems specific or unique to the country, focusing on sectors such as financial services, logistics and healthcare. Globally, CDPQ was managing CAD 298.5 billion (\$238.2 billion) in net assets as on December 31. So far, it has invested about \$4.5 billion in India.

The CDPQ-Fundamentum deal is the second such partnership in the country after University of California's endowment (UC Investments) partnered with Ratan Tata's RNT Capital to invest in technology companies in India.

Fundamentum is one of the few firms focusing on mid-stage financing of \$10-15 million, a gap in the venture capital market in India. One-third of its corpus will come from Nilekani and Aggarwal. The fund hopes to make its debut investment in the next few months.

Sabia, Nilekani and Aggarwal spoke with Mugdha Variyar and Madhav Chanchani about their investment strategy, the next big opportunities in the Indian startup space, data protection and the growing need for regulation in the technology industry. **Edited excerpts:**

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How did the partnership with CDPQ develop?

Nilekani: Sanjeev and I came to Fundmanetum from two different points. He had done the Helion journey for a decade and I am more of a newcomer to investments and have been doing it only for the last 3-4 years. We realised that while there were a lot of startups, there were not a lot of large companies emerging from them. Sanjeev had set up Daksh (a business process outsourcing firm that IBM acquired in 2004) and I was a part of the founding team at Infosys. We have seen how companies start from a small base and build. Our goal is to work with companies that have reached a certain product market-fit and are ready for takeoff. These companies now have to deal with issues like how to build capacity, technology, leadership development, marketing...

Sabia: There is a pretty strong affinity of interest here. We intend to establish a significant presence in India in a variety of areas. One of the areas where we wanted to get more involved in, because it is so important to the evolution of the **Indian economy**, is the combination of technology and entrepreneurship. One of the things that set Fundamentum apart in our minds is that it is about building bigger businesses. It is not about just funding relatively early-stage businesses but finding winning ones and then helping them scale. In the world today, it is about scale. As they say, 'go big or go home.' There are too many small businesses that get built to be sold. The

objective here is to build businesses that last.

What made it click for you?

Nilekani: We began (Fundamentum) as a fund for entrepreneurs. Apart from the money Sanjeev and I have put in, we have got a lot of entrepreneurs who can help the small guys become big. What we found attractive about CDPQ is their worldview of building large business. The way we see this partnership is we get access to their global network and knowledge. And they become a part of this scale up.

But is one of the reasons for the partnership that companies needed a lot more capital than you thought?

Nilekani: With \$100 million, we may make 8-10 investments of \$10-15 million each. But it is also important that these companies, if they become successful, will need more capital. And, therefore, having partners with capital will help our companies do better.

Sabia: In a way, what the fund is doing is curating a group of winning companies for us and we want to be able to step up with significant additional capital spend to support their growth.

CDPQ By Numbers

- TOTAL ASSETS UNDER MANAGEMENT: **\$238 billion**
- INDIA EXPOSURE: **\$4.5 billion**, including private and public markets

CDPQ's India Investments

- **Bought 20% of Edelweiss** Asset Reconstruction Co. for an undisclosed amount; committed to invest \$750 million in stressed assets over 4 years
- **Backed Tata Power-ICICI** Venture joint venture that is buying power projects
- **Through real estate** subsidiary Ivanhoe Cambridge, has committed \$631 million to India, which it plans to double
- **Also owns stakes** in Kotak Mahindra Bank and TVS Logistics
- **Big investor in** the renewables space. Has invested in solar-based independent power producer Azure Power and is in talks to pick up stake in CLP India for \$400-450 m

Big companies in India have models similar to those in the US. Will you focus on businesses that are focussed on India-

specific problems?

Sabia: Yes. Our interest here is in supporting India-based companies. Because that is how we want to build businesses in India. We are investing in financial services, logistics, renewable energy, a whole variety of different things... We work better as an investor if we work as almost a local investor that has access to global capital.

How do you see the Indian startup ecosystem developing? There is a view that the India market is becoming a proxy war between US and Chinese companies.

Nilekani: There are large horizontal markets where the large global players will compete on size, scale and lots and lots of capital. That is not where we are going to be investing. There are many markets in many sectors, many verticals, which solve India's unique problems. Doing that will create companies where big horizontal players, no matter how much capital they have, will not be able to enter.

Can you give some examples of this?

Aggarwal: Think of a company like RailYatri, which is an investment Nandan and I have made. It is solving a problem for the next India, which is the middle-class traveller who cannot afford to travel by air and needs to travel by train or bus. That's catering to emerging internet consumers, which requires a very different type of architecture that probably will be hard for a MakeMyTrip to replicate.

Alongside CDPQ, we can become a lifecycle partner for portfolio companies. In India, there is the missing middle. There is a very strong early-stage ecosystem and there is a very strong late-stage ecosystem populated by the Chinese, Naspers, and so on. And there is this missing middle where there is a big need for capital and mentorship. Our partnership will address that.

Nilekani: I think curation becomes very important because the companies are not yet fully there, they do need capital. They reached a point of scale, but how do you find them and how do you make sure that you are backing the right ones? That is where there is the Fundamentum curation model. The selection itself is a rigorous process and we invest in one out of 100 companies that we validate. Since we are sitting with them in the trenches helping them grow, we know very quickly that they are genuine guys and we understand their ethics, corporate governance and approach to scale, their willingness to defer gratification. All of those are important for us.

The discovery process will be simplified because of the involvement we will have in these companies. For these companies, becoming a part of the Fundamentum approach means they are getting access to really solid people who have rolled up their sleeves and built companies; these are not spreadsheet types, these are guys who know how to do business.

You had said you will be staying away from investments in fintech, edtech and India Stack-focused companies due to conflict of interest with your personal involvement? Will that cut out a chunk of opportunity?

Nilekani: I am staying away from where I am directly involved with policy.

Aggarwal: The biggest opportunity in India is retail, because retail is at \$600 billion... 30% of our GDP is in one sector. Parts of fintech we will not do. Fintech will not be more than \$100 million odd. Edtech is just starting. Globally, it is unproven play, hard to monetise.

Nilekani: There is retail, there is travel, there is logistics, and so on.

You (Nilekani) have said India will be data rich before it becomes economically rich. In the context of what is happening with Facebook and Cambridge Analytica and GDPR in Europe, do you see some regulations being framed? What will be the impact on Indian business models?

Nilekani: When I say India will be data rich before becoming economically rich, I mean that when technology took off in the West, per capita income was \$40,000. Therefore, data was valuable to businesses to sell better to you, target ads more effectively. Those businesses use people's data. In some sense, it is a 'when it is free, you are the product' kind of situation. And we are now seeing the consequences of that.

I think there will be regulations coming there. Fortunately in India, there is already a push to have regulations. The Srikrishna Committee (on data protection and privacy) has put out a draft, taken feedback and will come out with a data protection law in the next few months to govern these activities. The other point is, if your per capita income is \$1,500-\$2,000 but your digital footprint of individuals and businesses is like in the Western world—someone using a smartphone has the same permissions as someone in the US, or someone doing business with digital payments—the business models that will emerge are those that will allow individuals and businesses to use data for improving their lives.

But shouldn't there be stricter laws? Because companies like Google and Facebook don't make as much revenue per user (in India) as they can make in the US?

Nilekani: Those models break down beyond the first 20 million people. The digital advertising revenues of these companies in the US is hundreds of billions of dollars. The total digital advertising revenue in India is less than \$2 billion. That growth will happen if purchasing power goes up and more people can see ads. That will take a long time. That model will break down beyond a point, which is what is happening now.

How do we service hundreds of millions of people? These models will not be imported models. Indian firms will be able to think differently and build high high-volume, low-cost frugal transactional models that are small-value and delivered all over the country.

Is the tendency to exploit data higher in India?

Nilekani: Data will always be valuable. But hopefully in India, data will be with the individual. The individual will use it for his benefit as opposed to being captured by platforms that take away the value.

A few companies approached the Supreme Court recently with a petition that they need Aadhaar to offer their services. What happens if the Supreme Court rules against Aadhaar?

Nilekani: That will play out in the next few weeks. I don't want to comment on that.

What is CDPQ's India exposure?

Sabia: It is about \$4.5 billion. For the foreseeable future, India will be the fastest-growing emerging economy. We are looking to ramp up our exposure here. India has issues, like every other country, but it is an interesting place.

What sectors do you want to look at in India?

Sabia: It is important for us to get a deeper understanding of tech in India. We have done a lot of work in financial services, logistics and renewable energy. The whole broad area of consumer is a big opportunity. The second one that is of considerable interest to us is healthcare... The whole consumer side of the economy is where we would like to be significantly invested.

(To Nilekani) After Fundamentum was announced, you went back to Infosys. How much time have you been able to spend with startups?

Nilekani: I don't do any more startup investments. All my investments in this space are through Fundamentum. This is not a time game but a judgement time. I spend time required on selection. Once we make investments, I will spend time with each one.

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