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Young Turks: India an attractive market says CDPQ CEO

In the special addition of 'Young Turks', we are speaking about the opportunities for investment in the Indian startup space with three investors who see India as a "bright spot in a world of grey".

On the face of it 2017, it appeared to be a good year for funding compared to the last three years. As of December 2017, Indian startups raised a total of a little over USD 10.14 billion versus USD 4.5 billion in 2016. But it was the consumer internet Unicorns that cornered a lion's share of the inflows and it was Japanese conglomerate Softbank helmed by Masayoshi Son who played kingmaker.

According to a Grant Thornton report private equity investments also hit an all-time high of USD 21 billion in 2017. So, what does the picture look like going forward?

In an interview, Nandan Nilekani and Sanjeev Aggarwal, the founding partners of the USD 100 million growth stage fund Fundamentum Partnership and Michael Sabia, the President & CEO of one of Canada's largest pension funds CDPQ which has invested USD 20 million in Fundamentum spoke about their outlook on Indian startups space.

Below is the verbatim transcript of the interview.

Q: Why did you decide on Fundamentum as your first investment in the VC space in India?

Sabia: This is part of our largest commitment that we are making to invest in India. One of the most attractive countries in the world we think to invest in today and I say that because India presents almost unique combination of tremendous entrepreneurial skills and great technological skill as you see in the digitisation that is going on in the Indian economy today. So, the partnership that we are establishing today with Fundamentum is a lot of about giving us access to that combination of entrepreneurship and technology where we think that there are very big opportunities for India and very big opportunities for ourselves.

The other thing I would say, one of the things that really struck us about the approach that Fundamentum has, the fund is in the business of building businesses, of building businesses to last and that is a very central part of how we think about investing as we go around the world investing. It is about building things, it is about building durable enterprises and that is at the core objectives of the Fundamentum.

Q: You spoke specifically about your interest in technology and wanting to bet and back Indian entrepreneurs. Specifically, within the technology space if we look at the Indian startup ecosystem what looks attractive to you, what looks exciting to you today?

Sabia: I think an area that interests us a great deal and again Fundamentum is very much focused on is the development of technologies particularly internet based online technologies that can benefit India itself, that can benefit the emerging middle class of Indians. As Sanjeev often says can benefit the next India that there are huge opportunities there in areas for instance online applications in retail, online applications in travel and other things all of those areas are of considerable interest to us.

Q: We still haven't seen Fundamentum make its first investment yet. When can we expect that? You have obviously gone through the process of identifying potential companies that you could partner with, you could invest in what looks good at this point?

Nilekani: We are yet to make our first announcement that is correct and we hope to do that soon. We have gone through may be over the 100 companies in the last few months. We have a very exacting process of selection. We diagnose the companies, we spend a lot of time with the founders. We look for people who have the market, the momentum, the maturity to deal with what we need. So, it is a process, but I am confident now we have in the next few months you will see couple of investments from us.

What is exciting to us is that once we make the investment, we hope to bring our collective expertise on technology, on HR, on leadership development, on marketing, on strategy, on distribution, on sales, on quality, all these old fashioned things that are required to build a business. We are going to bring that expertise to our selected companies to help them scale up rapidly.

Q: The last when we spoke when you did set-up Fundamentum and you had spoken about how you are looking at the possibility of investing on an average of USD 15 million is in the start-up that you would like to back, is that the average ticket size that you are still working with?

Nilekani: It could be anywhere from USD 8 to 15 million kind of thing. We are looking at maybe maximum two or three companies in a year because it is not about quantity, it is about quality and it is about selecting these 10-15 companies in the fund and then working with the them and helping them to scale up. We also expect that as they scale up, we expect that if they have more capital requirements then we would perhaps go back to CDPQ because we are seeing this as a whole lifecycle approach to these companies. So, what we are starting announced today with Michael Sabia and CDPQ is really the first step of what we think is a longer term relationship.

Sabia: I think this point that Nandan Nilekani has made is really important because you mentioned before a USD 20 million contribution on our part which is true. But that is really just a beginning of a much broader relationship. One of the things that we are looking for here and that interest us is that as these companies grow they will require additional capital and therefore it is not just the Fundamentum platform itself which is the starting point, but as companies, if I can put it this way graduate in size, as they grow that will create opportunities for us to continue to accompany them as a financial partner as we invest more and more in the growth of those businesses.

Q: This is only the beginning of this relationship that you have with the Fundamentum and if required you could look at investing significantly more than the 20 million that you have committed to today but would that also mean that you could look at other VCs in India or would this be restricted to your relationship with Fundamentum?

Sabia: A First point I will make is as an element of our investment philosophy, we cannot invest in a lot of funds. We manage 90 percent of our assets ourselves with our own investment teams. So when we select a fund to work with, it is on a very surgical process in our minds.

We have decided to work with Fundamentum for a couple of reasons both - number one, the quality and a great capabilities of the two people I am sitting besides, who speak for themselves, those qualities speak for themselves in India and the second point is just an extremely good, extremely strong meeting of minds on what is this about because this is not about just funding start ups because in fact that is not the goal, the goal is to take businesses that are operating and that we all think have the potential to become substantial, large businesses in their own right and to fund the growth and development of both businesses and to provide them with the kind of operating a business skills, you need to turn the small business into a great big business.

So if the case that similarity of mind-set and similarity of objective that had let us to want to do this as to whether or not, we would engage with other funds, I don't think Fundamentum is a venture capital fund in my mind but I think we would probably be quite hesitant to do so given that we don't tend to invest in funds a lot. So this relationship we are establishing with Nandan and Sanjeev is a unique relationship.

Q: I want to pick up on the point that Nandan made that you have looked at over a companies or so, since you decided to set up fundamentum, you haven't made your first investment just yet and you hope to be able to do that over the next few months, what if I may ask has held you back, you have seen a lot of companies with potential but you and I have spoken of an issue that has concerned you and that is the ability of Indian start-ups to scale up as well as to replicate their business model, has that been a constraint on your decision to invest so far?

Aggarwal: A couple of responses there. One since we want to build a very concentrated portfolio, we want to make sure that we do the right curation around entrepreneurs who want to build large businesses in large markets. So unlike the early stage funding business which tends to be about optionality and making several optional bets, we are in this with the company for long haul and therefore the assessment process is lot more detailed than a start-up because we are committing our capital and time.

Two, I have certainly seen personally cleansing of the ecosystem from what it was two-three years back to now. Now I think the focus on customer, unit economics, building a culture and do it for long haul versus building companies for valuation and exits, I think that transition is certainly underway and the entrepreneurs who are coming into the fray are lot more committed. So I don't think we are opportunity constraint. It is just that we want to be very selective in whom we work with. Both in terms of chemistry and people who want a help in building an institution.

Q: If I may ask you, any area in specific of the companies and the entrepreneurs that you have examined, the valued so far, any specific areas that you believe are the ones that you would like to back that looked most promising, most exciting to you at this point in time?

Nilekani: Let me first say where it is that we are not going to invest " we are not going to invest in large horizontal markets where it is all about people outplaying on capital. That is not where we want to invest. We don't want to invest in places where the unit economics is not working out well and we are not going to invest in areas where customer acquisition is very expensive.

So we are looking for more vertical markets, India focussed which have organic customer acquisition by virality as opposed to by spending money and for companies that are either reached unit economics or about to reach unit economics and we are looking at areas today in travel, in vertical retail and couple of other sectors like that.

Q: Let me ask you, outside of the investment that you have done in Fundamentum, about the India story. You are excited about the opportunity in the renewable space, you are looking at the stressed assets opportunity in India as well. Can you give me a sense of what is the current level of investment in India and where we could see that headed?

Sabia: Up to today, we have invested about USD 4.5 billion in India. In our mind that is a relatively small amount for an economy of the size and the growth potential of India. So that we are clearly working on increasing that number step by step. What we are announcing today is one small step in that direction and hopefully it will become an even bigger step going forward.

In terms of areas that are of interest to us, as you mentioned, we have done a lot and we will continue to do more in financial services, we are very interested in logistics where we think there are big opportunities in India given both the emergence of ecommerce and second all the important changes that will flow from the Goods and Services Tax (GST). We are very interested, we have done some, and we would like to do much more investing in renewables, renewable energy. India's energy requirements are obvious to everyone and the fact that they will have to be increasingly climate conscious, seems to us to be strong and underlying trend that we would like to be part of.

In addition to that, we are also very interested in the consumer product space. That is an area where we think there could be some very interesting opportunities coming forward. Similarly, in healthcare, that is another area of considerable interest to us. So what we are trying to do is to do more some of the things that we have already done with some of the really good partners that we have had the pleasure of working with here, to go deeper in those relationships and also to spread a little bit with respect to say consumer and healthcare to broaden the base of the investment activities that we have. However, we would like to see over the coming years a significant step up in the overall level of investment here.

Q: What could it be, in the next five years USD 4.5 billion could be what?

Sabia: USD 4.5 billion will be determined by the quality of the opportunities and the quality of the partners who we find here and can continue to work with here. However, I think that USD 4.5 billion is a relatively small percentage of our total asset base. So, I think you could expect to see some pretty substantial increases in that number over the next five to seven years, but I am not going to give you a target because we are pretty disciplined about " it is about the quality of the partner and it is about the quality of the transaction, and the capital follows both of those two things.

Q: If I could ask you about some specific investments that you have already done, for instance you have got about a little over 1 percent stake in Kotak Mahindra Bank and there is a requirement, a regulatory requirement there for Uday Kotak to bring down his stake by December 2018. Would that be an opportunity where you would look at upping your stake in Kotak Mahindra Bank or for instance in the asset reconstruction business of Edelweiss where again you have picked up a stake. So would those be areas where you would look to significantly up your presence and stakes?

Sabia: The short answer to your question is yes to both of those. In the case of Kotak Mahindra Bank, our thinking is not driven by whether or not or what the regulatory issues are that Uday Kotak is working on as we speak. Our interest in that is we think that that is a great bank and it has a great future.

Similarly Edelweiss, we have a very good partnership with Rashesh Shah. We think that business Edelweiss is very interestingly positioned across a set of very specific financial services that are very important as India works through this important asset reconstruction challenge that it is facing. So, would we be open and interested in increasing our presence in both of those businesses? Absolutely.

Q: On the renewable side it was in 2016 that you had spoken of a commitment of USD 150 million. How much have you invested already in the renewable space so far and where do you see that headed?

Sabia: Our principle investment in renewables is in a company and interestingly Sanjeev is also an investor and we are partners in that business as well. Solar power company that I am sure you know of called as Azure, that is our principle area of investment in renewables, but the renewable space is, so that is a pillar of what we are doing and it is a pillar of what we will continue to do. That is a very important part of the portfolio for us here.

That being said, the renewable space in India is so large with respect to both solar and wind in particular, and we would like to very significantly increase our exposure to both of those alternative sources of energy over the next three to five years, there is a very significant growth opportunity there. As you know, the cost functions of those technologies have changed so much that they have become so competitive against traditional power generation that as I said, it just opens up big opportunities.

I think in North America we are the biggest investor in renewable energy among the pension funds. So, it is an area that we know a lot about and we are very confident in the expertise of our people and therefore we want to apply that expertise here and to build substantial businesses in the renewable space in India.

Q: Speaking of growth opportunities in India, what about real estate because your realty arm has inked a partnership with Piramal. What is the outlook as far as the Indian real estate sector is concerned and the prospects of further investments within this sector?

Sabia: We certainly have an interest and our real estate subsidiary has done an interesting partnership with Piramal. Ajay Piramal is a great partner of ours and we are looking to extend and deepen that relationship with him, not just in real estate, but potentially in other areas as well. So we will continue to look for very targeted opportunities in real estate and probably with an emphasis on different forms of real estate financing with probably some emphasis on the housing sector.

Q: You talked about exploring other opportunities with Ajay Piramal outside of real estate. What could those opportunities be?

Sabia: I think I am going to have to ask you to stay tuned. When we have got things nailed down, we will be more than happy to announce them.