



In the News

Venture capitalists see a Silicon Valley in the making

By John Boudreau

Mercury News

Sunday, Dec. 03, 2006

NIZAMABAD, India - It wasn't long ago that many venture capitalists didn't have to travel more than 25 miles from their comfortable Sand Hill Road offices, because all the deals they wanted to make were just outside their office windows.

But the economic explosion in India has rewritten the rules for those in search of the next Silicon Valley success story, people such as entrepreneur-turned-venture capitalist Vani Kola. This summer, Kola and her family packed up their Saratoga home and returned to India.

"My journey back to India would be very fulfilling if our firm is able to participate in helping to enable a Google or Intel to be built," she said. "Its impact on a generation, in terms of wealth creation and job creation, is very important to India's future."

Known as the tech back-office for the West, India's economy is growing at a sizzling rate and VCs are now funding and nurturing Indian start-ups at a record pace -- from Internet travel sites to gaming companies to a plan for the country's first chip maker.

But the path to success is as precarious as a journey along potholed Indian roads. Is it possible to outsource Silicon Valley's risk-taking culture, one that embraces failure, to a country and culture that value stability and family? Will Silicon Valley VCs usher in an era of tech innovation, or just lose a lot of money creating an Indian tech bubble?

"It took the valley 30, 35 years to get where we are today," observed Ash Lilani, head of Silicon Valley Bank Global, which has an office in Bangalore and assists VCs looking for overseas investments. "We are trying to replicate that in India in two years."

Kola's efforts to transplant the Silicon Valley start-up culture to her homeland begins in a meeting with village elders, clients of a young company that aims to be an eBay for rural India. In this new global VC market, due diligence on a potential \$10 million deal included a bite from an apple, a sip of bottled water.

"They don't grow apples here. They imported them," Kola said on the bumpy ride out of the village. "It's the reason I ate a piece. It doesn't matter if it has flies or no flies on it. A whole family will be fed for the price of that bottled water. To show your appreciation, sense of character -- you can't refuse it."

For Kola, along with VCs such as Rahul Khanna and Bob Kondamoori, success in creating something new will require an agility to straddle two very different tech cultures.

These global citizens, who are as comfortable cutting deals along Highway 101 as they are seeking new business models amid the horn-blowing, fume-spewing pandemonium called Mumbai and Bangalore traffic, are on a mission to India, one that is as much a personal journey as it is a professional one. They are returning to their homeland with the hope of helping to create a global economic giant, one start-up at a time.

"My parents' generation grew up as a country that was ruled by somebody else," said Khanna, 34, director with Clearstone Venture Advisors who returned home from the valley last year to Mumbai, formerly known as Bombay, to help direct investments for a \$205 million India fund. "This generation feels like it is in control of its own destiny. And it believes that with the right amount of energy and the right amount of passion, it can pretty much do anything."

The numbers give VCs dreams of happy tech returns: an economy growing at 8.5 percent, with no signs of a slowdown, creating a new middle class some 250 million strong. A population of 1.2 billion, more than half of whom are age 25 or younger. An increasing gadget-savvy nation subscribing to mobile phone services at stunning speeds -- about 6 million a month. And an army of laptop-toting engineers, graduating at a rate of tens of thousands a year.

Kondamoori, a 45-year-old seasoned valley entrepreneur and venture capitalist, sees the emergence of a new tech business climate. "I think it's what India has been trying to do since independence, for 60 years," he said of the end of British colonial rule. "And finally it's happening."

India's tech start-up culture, though, is in its infancy. During the first three quarters of 2006, venture capitalists poured \$19.5 billion into U.S. companies, according to Dow Jones VentureOne. China has seen \$1.18 billion in venture funding for 145 deals for the same period.

In India, on the other hand, VCs have made 53 early-stage investments in start-ups worth \$355 million during the first nine months of 2006. That's still nearly twice as much activity in that period than the two previous years combined, according to Venture Intelligence, a Chennai research service focused on private equity and venture capital activity in India.

Evalueserve, a Saratoga-based market research firm, estimates that more than 40 India funds have been raised, or are being created, by U.S. VCs. Silicon Valley Bank, though, figures the number to be closer to 24, with about \$1 billion flowing into start-ups during the next few years. Either way, investors are now sensing India's economic ascension is arriving.

In addition to investment cash, Kola is bringing back to India her experience and skills of creating successful valley software companies -- RightWorks and Certus Software.

Kola, 42, and her family -- two daughters, Tara, 13, and Sandya, 8, husband Srinu Kola, founder and chief executive of the Sunnyvale-based broadband technology company C9 Networks, and 5-year-old Labrador, Crea -- left Saratoga in midsummer. They settled into an airy two-story home outfitted with classical Indian furniture -- a village day bed, dowry chests -- and sitting stools from Pottery Barn in the Whitefield area of Bangalore. Tara has a new Apple laptop in her bedroom (it was the one demand she made about the move), which she uses to conduct 5:30 a.m. Web cam chats with her old school friends in Silicon Valley.

"I never expected to come to India and live here again," said Kola, who spent two decades in the United States. "I thought I was too American to be Indian again. But I find that I can be Indian, too. I never lost the touch with the culture."

Kola and Vinod Dham, the father of Intel's Pentium chip, have aligned with VC firm New Enterprise Associates (NEA) to launch a new fund, NEA IndoUS Ventures, focused on early-stage start-ups in India. Its size has not been publicly announced.

"Entrepreneurship here is a survival skill -- it has been forced in the DNA," she said. "Capital is the last piece of the puzzle."

Risk of a tech bubble

It might be a bumpy ride to an initial public offering, however. Some veteran Indian tech executives caution that too much VC money is flooding a market with few, if any, billion-dollar tech ideas.

Sridhar Mitta -- the former chief technology officer of India's third-largest software company, Wipro, and past president of the Bangalore chapter of the Indus Entrepreneurs, the Silicon Valley networking organization whose mission is to promote entrepreneurs -- welcomes the investments.

But, he cautioned, "There's a bubble in the making. Too much money is bad. You have abnormal valuations."

It will take time for the returnees to become reacquainted with India.

"India has changed," Mitta said. "You can't transplant U.S. ideas in India. All of them are coming with a view of trying to impose the Silicon Valley model in India. My feeling is, it won't work."

With its abundance of brilliant young engineers, India might look a lot like Silicon Valley on the newly built Bangalore and Hyderabad tech campuses. But it isn't. It's a different corporate culture.

After hiring, and firing, several vice presidents -- Bay Area executives who employed the valley's hands-off management style -- Kondamoori ended up with a "control freak" from Texas to work at the telecommunications company he relocated from the United States to Bangalore. The Texan's style included monitoring e-mail, blocking cell phone reception and supervising engineers closely -- team leaders give workers assignments on the bus ride to the office. Three years later, attrition is down and his engineers are happy.

Social implications

And India is a country with heartbreaking poverty: Twenty-five percent of its people live in urban slums or impoverished villages. It has among the highest child-malnutrition rates in the world. In Mumbai, India's financial capital where apartments sell for millions of dollars, beggars crowd cars at stoplights, pressing up against windows and making hand-to-mouth gestures.

Nandan Nilekani, chief executive of Bangalore-based outsourcing giant Infosys Technologies, worries that a slip in the economy's growth a few notches -- 8.5 percent to 5.5 percent -- could trigger social unrest.

"Because we have such a huge number of young people coming of the age when they can work, if you don't create jobs for them, you could have a lot of social consequences," he said.

For all the class resentments and infrastructure problems, though, India's rise and potential is irresistible. In addition to the economic boom, it is a vibrant democracy and a land of many English speakers -- comforting facts for investors.

"When your interests are aligned with theirs, you can't pick a better partner," said Bill Draper, one of the first valley VCs to invest in India during the 1990s.

VCs go to the deal

As his driver nosed a sport-utility vehicle through Bangalore, Kondamoori, who has the enthusiasm of a car salesman, pointed to a three-tower office complex that is under construction and will house offices for venture capitalists. "It will be the Sand Hill Towers," he joked.

The vehicle headed out Hosur Road. It was just after daybreak, shortly before the chewed-up hardtop that leads to Electronics City, the city's famous tech park, overflows with a convoy of buses delivering workers by the tens of thousands to the front gates of giant software campuses.

He was en route to Chennai, the seaport city formerly known as Madras. This year Nokia began manufacturing cell phones there, and Flextronics just completed an electronics gadget factory. Others are following.

The 200-plus-mile drive takes about five hours. It's a ride Kondamoori enjoys: He envisions the day the rural landscape is dotted with factories and cities that have sprouted as Bangalore, the nation's software capital, and Chennai, a hoped-for electronics manufacturing hub, are linked as Los Angeles and San Diego are today. The drive was all business: He thumbed his BlackBerry most of the time, conducting a conference call with New York investment bankers, discussing strategy for his telecommunications business, setting up appointments for later in the day.

"If you are a venture capitalist in India, you have to go to Chennai, you have to go to Bombay, Delhi -- and you have to be in Bangalore and Hyderabad," said Kondamoori, who is heading up a new \$100 million fund, Sandalwood Partners, in India. "When you have so much capital floating around, the work for the venture capitalist becomes much harder. You've got to go where the deals are because the deals aren't searching for you."

Rafiq Dossani, senior research scholar at Stanford University who studies India's tech explosion, believes that VCs such as Kondamoori, Kola and Khanna might be too optimistic about the ability of Indian tech entrepreneurs to create the next generation of global tech giants. Young Indian companies face a host of problems, from finding good office space to the kind of rock-star engineers and marketing gurus needed to propel a start-up to quick global success.

"Pushing a good idea into a product, getting the right advice, getting the right people -- that's still very difficult to do outside of Silicon Valley," he said.

Then there's the challenge of promoting new products to a still relatively weak domestic market that lacks the kind of retail and wholesale channels common in the United States. While India's middle class is rapidly expanding, the per capita income is about \$3,100.

There are also legal and regulatory complications, said attorney Shantanu Surpure, who recently returned to India from Silicon Valley to become a partner with Economic Laws Practice in Mumbai. "The legal environment does not encourage risk capital," he said.

For instance, unlike in the United States, there is no preferred stock, which carries more rights than those conferred by common stock. The judicial system moves slowly, Surpure said, so it can take an extraordinarily long time to resolve a legal disputes.

Labor laws also make it tougher to lay off workers when business sours.

Certainly, Clearstone's Khanna knows the challenges well, including that many of the pitches he gets are copycat ideas, such as yet another travel service Web site, or ones with ill-defined business plans. He often asks would-be entrepreneurs: "What's the `So what'? Help me understand that you have blinding insight that nobody else does."

Too often, they can't answer him.

So the company builders must scan the country for the choice deals in the new India, hopping from city to city on Kingfisher

Airlines or Jet Airways planes -- something of the Southwest Airlines of India.

Rural possibilities

In Kola's case, it meant venturing out to a remote village several hours northwest of Hyderabad.

Though the idea of bringing tech to rural India seemed like an oxymoron, she was impressed with the Hyderabad-based start-up, CoOptions Technologies. The company, which installs a PC with a dial-up modem in villages, has compiled a comprehensive database of the farmers and their credit history, which it then uses to link them to banking and insurance services. It wants to expand to other services, as well, such as providing supplies like seed and fertilizer.

The start-up now works with about 100 cooperatives in the rural areas of the state of Andhra Pradesh, which has a population of 80 million, but hopes to get the millions of dollars needed to spread to the rest of the nation's rural regions, where the majority of the country's population lives.

Kola's questioning of CoOptions founder Subrahmanyam Yadavalli during the long ride to the village seemed more like an interrogation.

She leaned closer to Yadavalli, sitting in the back of the vehicle, and took aim: What about being labeled a monopoly? Has he planned for accusations that CoOptions is making profits at the expense of the poor farmer?

"These things can destroy the business," Kola concluded, "and there will be plenty of people out there to destroy the business."

The entrepreneur looked a bit shell-shocked.

She had not decided whether her firm will fund the start-up, but she was impressed with the operation.

In the village, Kola, the Silicon Valley player, was brainy and modest, comfortably maneuvering the nuanced cultural expectations.

She spoke a mix of English and Telugu, the local language, paid the obligatory visit to a clay Ganesha display and received the bindi mark -- a red dot on the forehead and customary gesture usually made for women that signifies good will.

She was given a tour of the village godown -- or warehouse -- the preschool, the milk center. A crowd of dozens followed her every move.

"She is our girl who has come back," Yadavalli observed from a distance. "She is actually bridging two worlds."