Venture capitalists push deep into seed deals

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MUMBAI: Venture capital (VC) investors are expected to make a more aggressive push into seed deals in 2015, increasingly moving into the market occupied by players such as Blume Ventures, Kae Capital and India Quotient. The increased push by large VCs in the space could squeeze out or change the models of seed-stage investors in this space.

The move by large VCs comes at a time when Series A, or first-round VC funding, deals continue to be slow, with many of the seed-funded portfolio companies finding it hard to raise their next rounds.

In 2014, VCs closed more than 60 seed deals, which consist of cheques of up to Rs 5-6 crore, as they look to lock in early on the potential of the new generation of young Indian entrepreneurs.

And several of these VC firms are firmly edging out seed funds in deal making. Delhi-based online recruitment player TalentPad chose VC firm Helion over a Mumbai-based seed fund when it raised its first round in October last year. "Institutional VCs invest at this stage with an objective of putting more capital in the follow-up rounds, which unfortunately a seed fund cannot as they are restricted by their cheque size," said Mayank Jain, co-founder and CEO of TalentPad.

Venture capital firms like Sequoia Capital, SAIF Partners and Helion Ventures were some of the most active firms in the space, but 2015 will also see others like IDG Ventures India step up such deals. "We will probably do around 14-15 seed deals this year based on the deal flow we are seeing right now," said Sudhir Sethi, chairman and MD at IDG Ventures, which closed five seed deals last year. The firm is investing from its second fund in India, which mopped up $250 million late last year.

This aggressive move into seed deals has increased concerns for seed funds as they look to help their portfolio companies raise new rounds. "How do third-party seed deals actually get funded at Series A, that to me is the biggest worry. Series A has not evolved over the last five years as everything else has," said Karthik Reddy, co-founder of Blume Ventures pointing to the influx of capital and new investors at growth stage rounds like Series B, C and D.

Data from research platform VCCEdge showed that the number of angel and seed deals has consistently increased from 117 in 2011 to 283 in 2014. At the same time, Series A deals have come down from 119 in 2011 to 74 in 2014.

Seed stage funds like Kae Capital and Blume Ventures started out in 2011-12 to fill the gap before Series A rounds, which were over Rs 10-15 crore. Seed rounds are typically done to develop the product and find a market fit while Series A rounds are to start building the business. Market watchers feel that for the VC firms, who manage funds of over $200-300 million, it's a low-risk strategy to deploy $8-10 million in seed deals.

Seed funds are also ready for a competitive environment as they look to defend their turf. "There will be some funds who will be serious about it, and for others, it will be just flavour of the season," said Sasha Mirchandani of Kae Capital, an angel investor in companies like InMobi and Myntra.

What is leading the push is that "the quality of the first-time entrepreneur is now world class", according to Sequoia Capital MD Mohit Bhatnagar as they now "have the engineering and company building skills to go with the ambition". The VC firm, which raised a $530 million fund in 2014, expects to do a lot more seed deals, going forward, even as it closed more than 10-15 such transactions during the year, according to market sources. The push into seed deals also comes as the size and valuation at Series A has changed, making it more attractive for VCs to invest early. While Series A transactions were sized at $2.5-3 million earlier, now they have increased to $5 million.

This is driving VCs to buy into startups more early in their life cycle. Zoomo, a mobile marketplace for used cars, was started in June by its three co-founders, incorporated in August and closed a Rs 6 crore round by October from SAIF Partners.