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Investing in biofuels to create a sustainable and competitive industry

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Over the last two years, global venture capital firms have invested over $700 million into the biofuels sector. However, India needs to catch up.

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Billionaire investor and financier George Soros wrote a book called The Alchemy of Finance, widely regarded as one of the best books ever written on financial markets and investing. Today, a new breed of investors worldwide is betting big on the finance of alchemy. Riding high on the wave of innovation is a group that has been collectively christened "cleantech" that includes advances in materials science and chemistry of energy production, energy efficiency and environment management. Recent entry into this brigade is biofuels. Over the last two years, global venture capital (VC) firms have invested over $3.7 billion into this fast-growing sector, out of which over $700 million has gone into the biofuels sector. In India, however, biofuels companies are largely funded via the commercial banks through project finance route, in the form of debt capital.

The biofuels industry, along with the broader cleantech sector, is at an embryonic stage in India. Globally, the model for funding biofuels companies has been through the private equity and venture capital route. Such firms contribute not just equity capital and financial capital to the venture, but also intellectual capital in the form of knowledge, expertise, know-how's and best practices. VC firms are able to supply social capital and human capital, leveraging their network to develop the business and also establish relationships with large companies, thereby recruiting key advisors and senior management.

Moreover, it makes sense to fund biofuels companies through the VC route given the risk inherent in the venture. While banks tend to focus on protecting its principal, VCs with their greater risk appetite do not shy away from implementing innovative ideas and strategies. Given their equity stake, VC investors are partners in the growth of the business, and unlike bankers, will not take away the proverbial umbrella when the rain starts to pour. Clearly, the deployment of private capital is imperative for the development, competitiveness and sustainability of the biofuels industry.

Biofuels and the larger cleantech sector stand where the telecom industry did in 1998. There is a need to attract innovators and entrepreneurs to the sector along with equity investors. Global nonprofit organization The Indus Entrepreneurs (TiE) has joined hands with leading venture capital firms and innovators to form localized special interest groups in cities all over India. Moreover, IIT Bombay in its Eureka! 2008 business plan competition has kept a special focus on cleantech and biofuels. Such initiatives nurture innovation, enable information flow and create a knowledge base.

India has limited competency in inventing clean technologies, but our country holds tremendous potential for deploying technologies in biofuels and other cleantech areas. The size of our economy and geography warrant very large investments in energy and waste management. There is a lot of money to be made for entrepreneurs and innovators, who can identify the appropriate technology and adapt it according to India's needs.

However, we need to get our priorities right. While the US has invested hundreds of millions of dollars in developing alternative fuels in response to the global oil crisis, we have been straining under the burden of subsidies and price controls, which distort market prices and stifle innovation. The government has an important role to play in facilitating policies. The recent proposal to have dual pricing for diesel consumption in the industrial and automotive sectors somewhat rationalizes a bizarre fuel pricing policy. The recent policy mandating 20 percent ethanol-blended petrol by 2017 is a significant step forward, and it's now up to the entrepreneurs to meet the demand.