Name of the Scholar: Diwakar Dadoo

Name of the Supervisor: Dr. Pankaj Kumar Gupta

Name of the Institution: Centre for Management Studies, Jamia Millia Islamia, New Delhi-110025

Topic of the Research: Potential and Problems of Private Equity Market in India

ABSTRACT

Keywords: Private Equity, Venture Capital, Buyout, Asset Class, Limited Partners, General Partner, Investment

Indian economy is heading towards the top position in terms of GDP growth rate and promoting venture capital and private equity is absolutely essential to foster the growth agenda. Comparison of the performance of private equity and public equity is a challenging task because investment in PE of dynamism of entry and exits overtime. Variety of valuation methods like Long and Nickels Index Comparison Method (ICM) introduced in 1994 followed by public market equivalent or profitability index are also gaining the attention of researchers. The rise and fall of Indian stock markets have a cause and effect relationship with the PE activity in the country. Liberalization with respect to FDI into India, and the enormous potential for mergers and acquisitions activity involving Indian companies has accentuated the need to examine the growth of the PE market in an Indian context. We also see a change in the government policy in handling the venture capital funds. Various studies on the trends and performance of private equity markets have conducted on yearly basis by well-known consultants like Ernst and Young, Bain and Co. etc. However, a comprehensive study on the potential and problems of Indian Private Equity markets is an imperative. The study, therefore, endeavours to analyse the perception of the private equity funds on the trends and future movements of the PE market. It also attempts to address the problems of the PE firms and a suggestive framework.

PE as an asset class serves funding requirements of a large number of businesses that are conceived, nurtured and developed by Entrepreneurs across the world in a myriad of sectors. The study describes the present practices and procedures followed for Private Equity transactions. On the one hand, the study examines the issues involved and challenges faced in Investment of Capital, Return of Capital and Return on Capital, in this asset class. On the other hand, the study reflects on the dynamism of Private Equity markets and the potential that the asset class commands the world over, with particular reference to India. It is important to evaluate its use as an alternative to other means of corporate finance viz. Bank debt and Public Offerings through IPO. Also it explores its relative effectiveness given the regulatory framework prevalent for protecting the interests of the PE investors. The study also explore the various valuation methodologies adopted for pricing the

transaction both, at the Entry stage i.e. at the time of making the investment and at the Exit stage i.e. at the time of liquidating the investment and the relative effectiveness of each of the methodologies. Accordingly, the broad objectives formulated for the study are-

(a) To examine the present scenario of Private Equity Markets in India vis-à-vis developed markets.

(b) To examine the current practices and strategies in use for making Private Equity Investments.

(c) To identify the major problems of Private Equity investments in India.

For the purpose of the study, both primary and secondary data are used. The primary data has been collected personally from the respondents. The range of sample size of different categories of LPs, GPs, Investment Bankers and Entrepreneurs has varied from 200 - 300. For collecting the primary data, a survey through close-ended questionnaires has been conducted of different funds, investment bankers and corporate. The questionnaire deals mainly with various aspects of investment, which affect the overall success of the private, equity transaction as an alternative corporate funding mechanism. Besides this, in-depth semi-structured personal interviews of different investors and executives have also been carried out. The information so collected has been analysed using standard statistical methods of dispersion and association.

The penetration that emerging markets have of private equity is a small portion of what it is in the developed markets while economic growth rates are significantly higher in some emerging economies like India. Healthy macroeconomic conditions continue to maintain India's position as a preferred destination by investors. Inspite, of the regulated environment, India continues to be a favoured destination for foreign investment. It offers interesting and lucrative investment opportunities both in the traditional asset light service sectors, light manufacturing, banking, information technology, media and entertainment and, in the asset heavy sectors such as infrastructure, pharmaceuticals, telecom and which are likely to further attract substantial amounts of investment. It is however expected that the government shall continue to liberalize the economy further and make doing business in India a pleasure, to boost foreign investment as the Indian emerging economy grows at a fast pace. Foreign investors may have overestimated the speed at which structural reforms could be implemented in India but these are not much behind.

New sub-sectors like diagnostics in healthcare and SAAS (Software as a Service) in ITES are examples of emerging opportunities in the economy. Similarly sub sectors in most other verticals or sectors when explored show various business opportunities both for the entrepreneurs and consequently investors.

India's PE and VC industry is also faced with certain peculiar challenges like high inflation, over valuation etc. Lack of Exits is also being seen as the biggest hurdle for PE Firms in India

On the regulatory front, the issues are largely on account of (a) *Protection of Minority Interests & Rights,* (b) *Capital Gain* . Post-deal collaboration between GPs and promoters is a crucial area for improvement as perceived by survey respondents. .Recognising this importance, Fund managers are emphasising on building a clear plan for creating value as a critical element of a making the investment successful. PE Firms are recognizing that they need to build their brand with promoters, functioning to win their confidence as a prelude to making the investment successful. Given the stakes involved developing that deeper collaboration through greater confidence and understanding between the PE investors and entrepreneurs, is a must.

It is clearly evident from the study that there will be greater alignment of interests between GPs and the company management in the day-to-day workings of the portfolio companies. However, it should not be construed that promoters will become more amenable to interference in operations of the enterprise.

Most respondents estimated that profit growth will be the key engine of future returns, and share price-to-earnings multiple expansion may or may not be the case. Similarly, other conventional methods of investment returns may not work. Quality returns are expected to go to promoters and PE investors who are able to best drive value creation in the portfolio company.

While PEs will evaluate every opportunity and ensure that they sell high-quality portfolio companies by making them go public, buyouts, secondary and strategic routes are also gaining favour for Exits.

PE funds that can track appropriate investment targets and assist in growth of the company after deal closure and contribute effectively to adding or improving value in the companies that they invest in ought to be able to produce the conventional PE returns benchmarks. There is also consensus that the speed and intensity of the industry’s future growth could increase even more if valuations in India become tighter and exits continue to build on the impetus recently established.

PE firms must show their proficiency in helping management of start-ups and in formulating and executing on mutually agreed strategies and operational plans. However, value creation should not be mistaken for driving operational improvements. PE would first need to create an alluring portfolio to attract potential acquirers and clear the build up from the rocket years.