Business Standard

Indian PE comes of age

Renuka Ramnath **December 24, 2015** Last Updated at 00:02 IST

In the past 15 years, private equity (PE) has evolved from being a financial solution for start-up enterprises to being a more ubiquitous term in the dictionary of Indian entrepreneurs, financial markets, regulators and the newspapers. So, what has changed? (**PARADIGM SHIFTS**)

- Fifteen years ago, India was a small venture capital market that saw ideas and early-stage companies getting funded with small amounts of capital. In those days, I recall evangelising and educating about this product called PE to entrepreneurs and institutions alike. Today, Indian PE covers the entire product suite from venture to growth equity and buy-out. Along the way, there has been a transformation in the mindset of the stakeholders.
- Annual PE investment in India has gone up to $18 billion from less than a billion dollars in 2000. PE now accounts for around half of the foreign direct investment coming into India
- About 40 billion-dollar companies in India have been created with the backing of PEs
- There is evidence to show PE-backed companies have demonstrated faster growth, generated more employment and are generally better governed

All this has brought PE to the limelight - to the headlines from the supplement pages, to a full-time business from a part-time activity, attracting serious amounts of capital and talent, akin to any other large sector. Along the way, there have been several paradigm shifts.

I am pleased that PE has emerged as a full spectrum solution provider to entrepreneurs, in building businesses to scale, enhancing productivity of invested capital and unlocking the value of companies facing near-term difficulties.

Let me cite a few examples from my own experience on the role played by PEs beyond providing capital.

- PEs have stepped in to resolve shareholder disputes (we backed the founder promoters of Milltec to buy out the remaining shareholders)
- Backed companies in game-changer acquisitions, which in some cases triggered consolidation in sectors (PVR's buyout of Cinemax made it number one player in the country with leadership in key cities)

- Enabled carve-out of businesses from larger groups, empowering management teams to take bold steps (the management team of VA Tech backed by PE, bought out the India business from the parent. Subsequently, it was also able to buy out the Austrian parent company as well)
- Provided last-mile capital to engineer turnarounds in high-quality assets (took control of Vikram Hospital and resolved the financial stress to unlock the full potential of the hospital)

  One of the setbacks for the PE sector has been the lack of exits and the high entry valuations. In this scenario, fund managers also have not been biting the bullet and in making exits at below cost or at par, after holding on for five to seven years. There are probably two key reasons for the lacklustre performance for some funds. One is collapse of the financial sector in 2008. Two, collapse of the infrastructure sector and, for a good part, the real estate sector as well in India in the intervening years.

  Having said that, the future is going to be vastly different from the past. There is a huge exit mindset at the time of making the investment by PE managers. PE to PE exits will be a major source of exits, reducing the dependence on the public markets. In the past decade, the market has separated the wheat from the chaff and fund managers are exercising great financial discipline. Combined with the maturity of fund managers and optimism around the economy, I expect India will continue to be a preferred emerging market destination for limited partners.

  Much of the credit for evolution of the PE sector goes to entrepreneurs, who have changed their lens and embraced private equity as a true long-term partner in their journey.

  This has paved the way for better communication and more compelling partnerships between the PE and the entrepreneur, and has improved the overall outcome for PE-invested companies.

The author is founder of investment advisory firm Multiples

PARADIGM SHIFTS

ENTREPRENEUR MINDSET	
2000s: Not comfortable with investors taking a substantial stake in their companies. Many of them were not PE-ready and several of them were suspicious about getting on board a PE investor	**2015:** Open to PE funds playing a larger role in providing solutions beyond only capital such as solving shareholder disputes, enabling M&A, buying out businesses, etc.
LIMITED PARTNERS (investors in PE funds)	
2000s: Largely Development Financial Institutions (DFIs) and some domestic institutions	**2015:** Perennial sources of capital (global pension funds, sovereign wealth funds), fund of funds, Indian HNIs and family offices
PE FUND MANAGERS (also known as general partners or GPs)	
2000s: PE funds were a part of large financial institutions like UTI, ICICI, etc. GPs were first time fund managers, with limited experience. Exits from PE investments in India were lacklustre	**2015:** Experienced fund managers have seen full life-cycle of raising, managing and returning capital to LPs. Many of them have set-up Independent PE platforms. Valuation discipline and exits have become key focus areas for successful fund managers
TYPE OF INVESTMENTS AND EXITS	
2000s: Largely venture/early stage minority investments. Exit routes were largely thought of as IPOs	**2015:** Wide array of products straddling through the capital structure, including venture, growth equity, mezzanine equity & controlling buy-outs. Exits through selling to other PE funds and strategics has become the norm
REGULATION	
2000s: Several restrictions on investment in sectors, FDI approval was time-consuming, taxation waterfall was unclear and there was one regulation for both PE and VC funds	**2015:** SEBI's VC Fund guidelines (1996) to its AIF Regulations (2012) has been a giant leap. More liberal FDI policy, allowing an automatic route of investments in wide range of sectors. Clarity on taxation with tax pass-through
ECOSYSTEM	
2000s: Non-existent	**2015:** A vibrant ecosystem of investment banks, experienced due-diligence professionals across commercial, legal, forensic & financial aspects. Sector practitioners actively working with PE funds on investment and post-investment value creation