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A study on private equity investment growth and infrastructure in India

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***Abstract*---**We use to investigate the investment criteria of 749 private equity investors, growth equity funds, and leveraged buyout funds. Our results indicate that revenue growth is the most important investment criterion, followed by the value-added of product/service, the management team's track record, and profitability. Regarding differences across investor types, we find that family offices, growth equity funds, and leveraged buyout funds place a higher value on profitability as compared to business angels and venture capital funds. Venture capital funds, in turn, pay more attention to companies' revenue growth, business models, and current investors. With these results, our study contributes to the corporate finance literature by deepening our understanding of how different types of private equity investors make investment decisions.

***Keywords*---**private equity, venture capital, infrastructure, investments.

Introduction

The Indian capital markets are now in the developing stage. Ever since the economy of the nation was liberalized in 1991, different types of investors have tried their hand in the Indian capital markets. Private equity investors are one such class of investors. Back in 1991, the industry was almost non-existent. However, now in 2022, there is a full-fledged private equity sector which invests in all stages right from seed capital to leveraged buyouts. The sector has grown rapidly during these years. However, it still faces a lot of challenges, many of which are uniquely Indian. In this article, we will have a closer look at some of the growth of the private equity industry as well as some of the challenges that it faces.

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The growth of the Indian private equity industry

The Indian private equity industry has grown by leaps and bounds. The total market capitalization of the entire industry stood at a mere $2 billion in the year 2004. Within 15 years, the size of the market has grown over 20 times. The current value of the entire private equity market is estimated to be in the ballpark of $40 billion. This massive growth in the market has been largely driven by the sudden increase in deal size. Private equity investors claim that in the year 2004, a deal valued at $100 million was extremely rare. However, now in 2019, almost 70% of the deals which happen in the private equity space are worth more than $100 million. Capital plays a major and probably the most significant financial factor in any undertaking. The sources of finance can be manifold and in a going concern inflow of Capital is required for both short term and long term purposes. The Sources of Finance may include own assets, Banks and Financial Institutions, Investment Funds, Government Grants and Public at large.

Private equity investment in infrastructure

During 1940s, few Private Equity Funds have been established in the United States of America. Initially it started with the fund provided by rich individuals subsequently it formulated into pool of funds by two or more firms for the purpose of strategic investments to the start up firms, Projects, Buy outs, Project expansion, modernization of Plant etc. However the growth of PE Funds can be attributed to the Globalization of the financial market and increasing risk appetite among the global investors, which gave birth to a new genre of financial intermediaries. During the last decade various Foreign Private Equity Firms have flooded in India looking at the enormous opportunities imbedded in it. Many Banks and private Firms in India have also started floating Private Equity Fund. The upward movement of sectoral reforms and opening of doors for the foreign investors including regulatory reforms have further motivated not only the growth of Foreign PE Funds in India but also mushrooming of Indian PE Funds floated by domestic business groups and Banks. The growth of ventures also required liquidity which the conventional medium and institutions were either lagging behind or reluctant enough to put forth in, which gave a further stimulus to the growth of PE Funds. PE Firms are basically strategic investors engaged in investing in mature, profitable business through leveraged /management buy outs, finance transaction with large portion of Bank debts and assume control of management with less interest in the operation. These Funds can be differentiated from the Venture Capital Firm, which invests in early stage, low profitable Firms and rarely use bank debts.

The term “Private Equity” has not been defined in any statute or any other subset of the same; however various Authorities and sources have made an effort to provide a concrete definition of the term. Various definitions have been adopted in order to understand the meaning and interpretation of the same. Equity capital that is not quoted on a public exchange, Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet.

The European Venture Capital Association* defined it as "Capital Association defines private equity as the provision of equity capital by financial investors – over the medium or long-term – to non-quoted companies with high growth potential. It is also called „patient capital" as it seeks to profit from long term capital gains rather than short term regular reimbursements. Similarly, the International Financial Services, London calls any type of equity investment in an asset in which the equity is not freely tradable on a public stock market as private equity. Private equities are generally less liquid than publicly traded stocks and are thought of as a long term investment". A perusal of the aforementioned definitions, suggest the following features of Private Equity Fund:

- It is a pool of fund
- The equity in which it invests are non-tradable equity
- It is mostly in the nature of strategic investment
- Private Equities are less liquid in nature
- Private Equity investment is ordinarily for long term
- This pool of fund is invested through leveraged/management buy outs for expansion, modernization in matured or already existing entities.

Private Equity in India started developing in mid 80s as Venture Capital Firms. Subsequently it widened its sphere and graduated to Private Equity Firms. The First generation Venture Capital funds, which can be looked at as a subset of private equity funds were launched by Financial Institutions like ICICI and IFCI.

Regulation of private equity fund in India

In India the Private Equity Firms are not regulated per se. However the Indian Venture Capital Fund (herein after referred to as „VC Fund") and the Foreign Venture Capital Fund (FVCI) are regulated by the Securities Exchange Board of India (SEBI) through SEBI (Venture Capital Funds) Regulations, 1996 and SEBI (Foreign Venture Capital Funds) Regulations, 2000 respectively. In addition to above the FVCI are also subject to the sectoral restrictions on the inflow of Foreign Capital Inflows. In the absence of any specific Regulation for the Private Equity Funds, they are regulated by the above two regulations and Private Equity Funds are registered with SEBI. The basic features of the two regulations are enumerated here below.

SEBI (Venture Capital Funds) Regulations, 1996

- The Regulation provides for the registration of the Venture Capital Funds, Investment Conditions and restrictions, general obligations, investigation and inspections.
- VC Funds are prohibited from inviting subscription from public; however it can raise funds by private placement of its units.

* Reserve Bank of India Occasional Papers, Vol. 30, No. 1, Summer 2009, p. 109

- The VC Funds are not allowed to get listed on a recognized stock exchange till the expiry of three years from the date of the issuance of units.
- It is obliged to disclose the investment strategy while obtaining registration.
- No investment in any particular undertaking shall increase more than 25% of the entire corpus of the fund.

SEBI (Foreign Venture Capital Investors) Regulation, 2000

- It enables the Foreign Funds to register with SEBI and avail certain benefits, which are not otherwise available under the FDI route.
- There is no lock in period for selling the shares held by registered FVCI and it is also exempted from the valuation norms, so it can buy and sell shares of unlisted Companies at price mutually determined by the buyers/sellers.
- At least 66.67% of the investible funds shall be invested in unlisted equity shares or equity linked instruments and it cannot invest more than 33.3% of the investible funds in shares of listed Companies or debt instruments.
- The SEBI (Substantial Acquisition of Shares and Takeover) Regulation, 1997 is not applicable to the shares transferred to the Promoters from FVCI, more clearly the Promoters are not subject to comply with the above Regulation while intending for a buy-back of its own shares from FVCI.
- FVCI registered with SEBI are „Qualified Institutional Buyers" within the meaning of SEBI (Disclosure and Investor Protection) Guidelines, 2000

Objective of the study

- To examine the PE investments growing strategy in India during 2021-2022
- To find out the factor influencing PE investment in after covid-19 situation

Research Methodology

Type of Study - Empirical

Type of Data - Secondary

Sources and tools used for data collection

The study is based on the technical analysis, previous data relating to venture intelligence investment report of Q1'2021, Q4'2022, and Q1'2022.. The information so taken is compiled through tabulation and shown in graphs

Issues faced by private equity companies

There are several issues which are being faced by private equity companies in India. Some of them have been listed below. Lack of Well Developed Market: In the United States as well as in Europe, private equity companies are known for making leveraged deals. Hence, they use the debt markets to augment their own equity. However, in India, the debt markets are not so mature. The creation of credit is mostly controlled by the government and a few private banks. These entities are not comfortable investing money in private equity transactions. This is the reason why such transactions are not highly levered in India as they are in other countries.

- Opacity Issues: Also, there is a uniquely Indian problem of the promoters not being ethical. Across the world, private equity firms constantly assume that the founders (promoters) are most invested in their companies. However, in India, private equity firms have to be careful not to overvalue the firm. If the firm is overvalued, there is a high chance that the promoter itself may try to exit the firm. Many high profile Indian businessmen have simply left the country after they were able to obtain more loan for their companies than the company was worth! The moral hazard is always present. However, it is higher in the case of Indian companies.
- Regulatory Changes: The government of India also has a habit of making ad hoc changes to the regulatory environment which ends up changing the feasibility of the entire industry. For example, after private equity funds had invested heavily in the microfinance industry, the government changed some rules. As a result, a lot of the borrowers simply stopped paying back the loans. The end result was that the private equity companies had to mark down a lot of their investments.

The same case has happened with e-commerce companies as well. A lot of foreign investors have already invested billions of dollars in the Indian e-commerce business. However, the government decided to change the rules suddenly. This left the private equity companies in the lurch, and they suffered massive losses. In some cases, the government of India has also introduced back taxes. PE/VC Exits have gotten off to a slow start, with Jan-Feb 2022 recording exits 69% and 59% lower than Jan-Feb 2021 and Nov-Dec 2021 respectively.

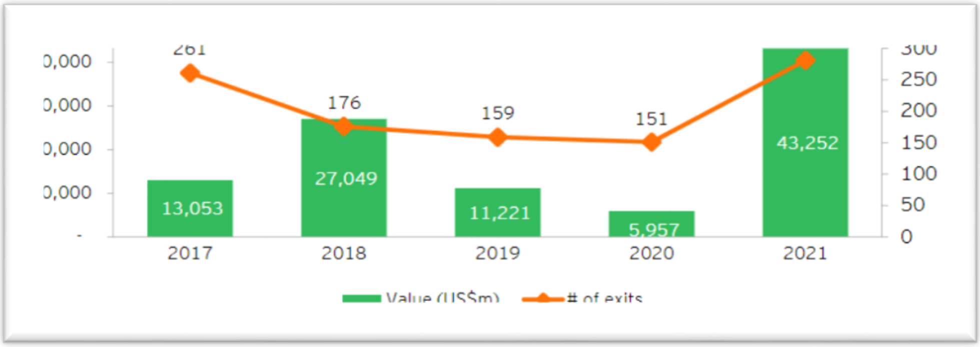
Exits	Value US$ million			Number of deals		
Deal type	2021 (Jan-Feb)	2021 (Nov-Dec)	2022 (Jan-Feb)	2021 (Jan-Feb)	2021 (Nov-Dec)	2022 (Jan-Feb)
Strategic	1,073	43	127	23	17	15
Secondary	1,961	1,537	1,526	11	4	6
IPO	2,517	2,283	8	19	14	1
Open market	1,054	572	19	24	11	2
Buyback	430	-	-	3	-	-
Grand total	7,034	4,435	2,182	80	46	24

Source: EY analysis of VCCEdge data

High liquidity and low funding cost had ensured availability of many buyers, especially for high growth businesses. Further with capital markets having a strong momentum and reaching all-time highs the environment was also suitable for IPOs that enabled many PE/VC funds to take the IPO route for exit at significantly higher valuations than available in the private market. With large corporates acquiring start-ups to augment their e-commerce and technology capabilities, new pools of capital are now available to provide PE/VC investments good exit opportunities. Deals like TATA's acquisition of Bigbasket for US$1.2 billion are indicative of this emerging trend. While PE-backed IPOs were a hit among investors in 2021, the recent sharp correction in some recently listed start-ups in the initial months of 2022 has dampened the sentiment for IPOs from start-ups and other companies to an extent. However, this could potentially increase secondary transactions as many companies that had lined up to list in 2022 mayneed to seek buyers in the secondary market.With better-than-expected Indian economic revival4, successful vaccination drives and abating of the COVID pandemic, we expect 2022 to build on the momentum set in 2021. However, we remain cautiously optimistic given the significant rise in business uncertainty. We look forward to your feedback and hope you have a fruitful and safe 2022.

Investment strategy

One of the biggest reasons for hectic investment activity by PE/VC investors in 2021 was the sharp increase in pure-play PE/VC investments (investments in sectors excluding real estate and infrastructure) that recorded a 79% increase y-o-y (US$66.4 billion in 2021 compared to US$37.1 billion in 2020) and accounted for 87% of total PE/VC investments by value. Headline PE/VC investment value in 2021 was significantly propped up by record PE/VC investments of US$28.5 billion in start-ups6 which accounted for 37% of all PE/VC investments in 2021 and a rebound in buyouts7 that recorded US$22 billion in investments, almost twice the value recorded last year. Growth investments recorded US$19.6 billion across 187 deals, 14% lower than last year (US$22.9 billion). 2020 had recorded large investments in Reliance group entities worth US$17.3 billion. Adjusted for these one-off large investments in 2020, growth investments have grown almost 3.5 times in 2021.Private investment in public equity (PIPE) deals increased by 46% to US$4.5 billion across 77 deals (US$3.1 billion across 62 deals in 2020). Credit investments were at par with 2020 at US$2.6 billion across 85 deals (US$2.6 billion across 74 deals in 2020).Large deals continue to be a defining feature of PE/VC investments with deals of value US$100 million or greater accounting for 75% of all deals by value in 2021. 2021 recorded 182 large deals aggregating to US$59.9billion compared to 93 large deals aggregating to US$38.5 billion in 2020. By sector: From a sector point of view, almost all major sectors recorded an increase in value of investments in 2021. Technology was the top sector with US$16.3 billion invested across 168 deals (6.4 times increase y-o-y), highest ever value of investments in the sector. E-commerce sector was the next largest sector with US$15.9 billion invested across 203 deals (5.5 times increase y-o-y) . Financial services with US$11.7 billion invested across 239 deals (US$5.4 billion across 159 deals in 2020), real estate with US$5.3 billion across 72 deals (US$5.7billion across 43 deals in 2020) and infrastructure with US$5.4 billion across 47 deals (US$4.8 billion across 31deals in 2020) were the other large sectors for PE/VC investments.



Source PV analysis of VCCEdge data

Conclusion

Private equity investment specially in India heavy emphasis on their ability to select promising companies. After covid 19 period start up slow it move on positive stage in India. In spite of the large interest in the decision-making of PE investors, this study is among the investment criteria of these PV investors. While there is an established literature on the characteristics and behavior of specific types of investors, a broader perspective is underdeveloped. The importance attached to the management team does not significantly vary across investors. Second, we find two opposite views with regard to profitability. While the investment criteria of FOs, GEFs, and LBOs are centered on highly profitable companies, BAs and VCs pay less attention to the current profitability of their targets and instead focus on their scalability. Third, our study sheds light, for the first time, on the investment criteria of FOs and finds that, relative to the average of other PE investors, FOs attribute greater importance to current profitability of portfolio companies but less importance to their revenue growth. An explanation is that by undertaking risky decisions, the managers of FOs risk losing family wealth and jeopardize the financial and social wellbeing of future family generations. They are therefore more concerned with the conservation of irreplaceable capital through investments in already profitable companies, rather than bearing the risk – and potentially high returns – of high-growth companies.

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