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PRIVATE EQUITY – INDIA Vs GLOBAL

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Abstract
Private Equity (PE) is an internationally renowned alternative asset class. It has become an indispensable tool not only for financing but also helpful in streamlining the operations and proactively changing the contours of Portfolio Company thereby enriching value leading to successful exit. Our country is becoming increasingly integrated with the global economy. Global economic conditions have a bearing on the PE functioning in India. The present article makes a comparative analysis between India and global PE in terms of parameters such as: the conditions through which the PE passed through the previous year 2014, fund raising, investments, average deal size, returns, exits, challenges faced by the stakeholders of PE industry and the future outlook of the industry both in India and across the globe.

Key Words: ***General Partners (Gps), Limited Partners (Lps), Value Creation*.**

OVERVIEW OF PRIVATE EQUITY

Private equity is an alternative asset class where funds are created by General Partners (GPs) and manage them on behalf of investors known as Limited Partners (LPs). LPs may be institutional investors such as foundations, endowments, sovereign wealth funds and pension funds. GPs are private equity firms who manage the funds on behalf of LPs for management fees.

NEED AND IMPORTANCE OF STUDY

Indian entrepreneurs and public policy makers have noticed the benefit private equity can bring to them. The former identified the expertise, guidance and value creation proposition it has and the latter understood its pivotal role in fueling India's growth aspirations. The growth prospects of India are attracting private equity inflows from foreign countries as well. The global economic conditions have influenced the Indian PE industry in a significant manner. But the impact of global positive climate was much pronounced than the adverse impact. The rise of Indian PE industry to the favourable tunes of global economy is much rampant than the fall. When the BRICS started facing slower growth rates, India is an exception to it. Thanks to our regulatory framework, a two pronged tool which sometimes acts as a detriment to the development and other times insulates against the contagion. The present study attempts to compare the global and Indian PE scenario and analyze the extent of alignment between them.

GLOBAL ECONOMIC CONDITIONS

1. The global economy experienced slow but stable growth in 2014, as evidenced by a 2.4% increase in global GDP.
2. In 2014, private equity is flooded with abundant capital worldwide. The number of value of buyout exits climbed to an industry record in 2014. Strong distributions of capital flowed back to LPs, helping to make 2014 another solid year for raising new funds.
3. New ways of building relationships between GPs and LPs have developed.

INDIAN ECONOMIC CONDITIONS

1. It was a year of rising optimism, expectations and aspirations for India, especially in light of its formation of new government.
2. The Indian stock market gave phenomenal returns of more than 30% over the year, compared with less than 10% in 2013.
3. Backed by the stronger macroeconomic landscape, PE activity continued to play a pivotal role in the country's capital needs, accounting for 53% of foreign direct investment inflows.

FUND-RAISING GLOBALLY

LPs were eager to increase their allocations to PE, but they remained highly selective in the commitments they were prepared to make and the firms with which they were willing to invest. Worldwide, 1001 PE funds procured $499 billion in new capital commitments in 2014. Capital raised for buyout funds dropped 11%, but growth funds and ventured funds all registered impressive gains. Fund-raising increased for Europe-focused PE funds and in Asia pacific region in 2014.

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FACTORS WERE FAVOURABLE FOR FUND-RAISING GLOBALLY

LPs had lots of room and plenty of capital to invest in new PE funds. They had seen a bounty of cash flow their way over the past four years as distributions from GPs exiting mature investments were huge. This is one important pillar supporting PE fund-raising, and it has been gaining strength in all major regions of the world.

Another crucial support holding up fund-raising over the past two years has been the strong returns generated by the bullish public equity markets. Rising stock prices have inflated the unrealized value of institutional investors' overall portfolio holdings, requiring them to boost their new commitments to PE funds simply to maintain their target allocation for the asset category. Competition intensified as GPs eagerness to raise new funds for surpassed LPs' ability to commit. The persistent imbalance between GP supply and LP demand continues to make fund-raising challenging. The average amount of time GPs needed to raise a new fund still hovers at nearly 17 months.

FUND-RAISING IN INDIA

While the fund-raising was swelling globally, the India fund-raising remain challenged by the regulatory environment, macroeconomic uncertainties such as currency and inflation, and longer gestation period for investments. In 2015, PE firms plan to increase their focus on fund-raising, and they cite track record, team expertise and exit success as the most important factors in this regard. However, the majority still expect more fruitful fund-raising in 2015 than in past years.

INVESTMENTS

Global conditions and Deal-making

1. PE funds' were hunger to buy in an environment of intense competition and also imposed self- restraint not to overpay. Second, the continued rise of the public equity markets had lifted the floor on valuations that prospective PE buyers face, increasing acquisition multiples to levels that price many deals out of reach.
2. Vast sums of undeployed capital in the hands of a record number of PE firms had been the biggest factor propelling deal-making forward in 2014.
3. Buyout firms announced 1,955 transactions in 2014, an increase by a massive 179% over previous year with a total deal value of $252 billion (Table 1).

Table 1: Global PE deal value and volume

Global	2013	2014	% change
Deal value ($ billions)	231	252	9% increase
Deal volume (Count)	700	1955	179% increase

Source: Bain Global PE reports

INDIAN SCENARIO

PE investments in India saw a robust increase in 2014 over the previous year. Deal value, including real estate, infrastructure and venture capital deals, increased by 28% to $15.2 billion (Table 2). Overall deal volume grew by 14%, over previous year to 795 with early-and-growth stage deals accounting for 80% of total deals in 2014. GPs in India expect a further increase in deal activity, propelled by macroeconomic conditions, positive investor sentiment and an improved exit environment.

Challenge for Deal-Making

GPs remain concerned about a mismatch in valuation expectations and the tough competitive environment for good-quality deals.

India needs to continue to improve the ease of doing business in the country, a large part of which involves a regulatory environment that is more conducive to business growth to attract investment. In terms of attracting foreign investments, India continues to face competition from other emerging economies with prospects for strong growth, including South Africa and Nigeria.

Table 2: India PE deal value and volume

India	2013	2014	% change
Deal value ($ billions)	11.8	15.2	28% increase
Deal volume (Count)	696	795	14% increase

Source: Bain India PE reports

AVERAGE DEAL SIZE

Globally

Self-imposed and externally applied restraints reined in PE deal making. Coming out of the global financial crisis, PE funds had avoided joining forces with one another in the big club deals that were so popular in 2006 and 2007; as a result the equity check size for any deal has been limited to what a single fund can write (fund mandates typically cap a fund from investing more than 15% of the fund size in a single portfolio company) along with co-investors. Squeezing PE deal size from the debt side, regulators are trying to limit the amount of leverage on deals. In the US, for example, regulators have issued guidance to banks not to finance takeovers where debt exceeds six times EDITDA.

Taken together, the caps on the amounts of equity and debt that can be marshaled to conduct a transaction keep a fairly tight lid on deal size. Limitations like those take potential deals off the table – not just public-to-private conversions but also large sponsor-to-sponsor deals and carveouts. The Buyout market today is composed almost exclusively of deals valued at less than $5 billion.

India

In 2014, the average size of PE deals, excluding real estate and venture capital deals, increased from $41 million to $53 million. The majority of GPs surveyed expect that average deal sizes continue to rise over the next two or three years.

RETURNS

Factors responsible for generating returns globally

The factors comprising market beta such as an exhilarating mix of GDP growth, near-zero interest rates and covenant-lite loans, and rising mark-to-market valuations helped power PE's rebound. GPs also had a starring role in the recovery through smart financial and operating restructuring of assets that fortified them against the economic storm and positioned them to benefit from the recovery. Together, the combination of market beta and the returns from active value creation programs engineered PE's resurgence. PE returns are up both in the short-run and over the longer term.

Returns: Buyout funds climbed 23%; growth-equity funds were up 25%; and venture capital fund came in 30% above the previous year. Across the major geographic regions, buyout and growth-equity funds gained 24% in both the US and in the developed economies of Europe over 2014 through midyear; emerging market focused funds posted a modest 5% uptick.

INDIAN SCENARIO

Funds in India feel very positive about their potential to generate returns, and more than 60% expect the median Internal Rate of Return (IRR) to exceed 20% in the next three to five years.

Exits globally

Exits through all channels increased significantly in 2014, with sales to strategic buyers and IPOs dominating. By value, total exits to strategic acquirers topped $303 billion – a 91% jump. Globally, buyout-backed IPOs numbered 210, an increase of 20% over 2013, and their value jumped 48% to $86 billion. The total number of exits were 1250 and value being $456 in 2014 (Table 3)

Sales to PE buyers were up by 15% and by value they increased a solid 18% over the previous year.

Table 3: Global PE exits value and volume

Total Exits			
Global	**2013**	**2014**	**% change**
By value (US $ Billions)	274	456	67 % increase
By volume (Count)	1090	1250	15% increase

Source: Bain Global PE reports

India

As per the Bain India Private Equity Report 2015, the number of reported exits in India grew 14% to 187 in 2014 compared to 164 in 2013 (Table 4). The value of exited investments dropped by 22% to $5.3 billion compared with $6.8 billion in 2013. In 2014, the strong performance of capital markets drove up public market sales. Funds expect a further increase in the significance of IPOs, strategic sales and secondary sales. In contrast, they expect promoter buybacks to decline.

India is going through significant exit overhang, and the pressure to exit is expected to rise. Funds continue to face challenges with pre-2008-vintage unexited deals; yet, the situation is improving compared with the past two to three years.

Table 4: India PE exits value and volume

Total Exits			
India	**2013**	**2014**	**% change**
By value (US $ billions)	6.8	5.3	22% decrease
By volume (Count)	164	187	14% increase

Source: Bain India PE reports

CHALLENGES – GLOBAL

Super abundance of capital led to intense competition for deals thereby resulting in high purchase prices. GPs need to differentiate themselves; create and embark upon value-creation programs. It had led to the opening up of new realm of relationships between LPs and GPs.

CHALLENGES - INDIA

As per the results of Bain-IVCA Private Equity Survey 2015, it has been observed that over the past two years volatile political, macroeconomic factors, regulatory changes and difficulty in fund raising had been the challenges for GPs. In the next two years they expect mismatch in valuation expectations and tough competitive environment to be the potential shaking forces of the industry. Due to increased valuations, there is likelihood that the average investment horizon to increase. Around 40% of GPs expect that the investment horizon period of 3-5 years will probably increase in the next 2 years.

Similar to the challenges faced by GPs globally, PE funds in India also need to have a value creation plan for most portfolio companies. But the drawback is about 80% of funds have a value creation for most portfolio companies; fewer than 50% are able to implement those plans and deliver results.

Another challenge faced by GPs is with regard to their shareholding pattern. In 2014, in more than 65% of deals, GPs were holding less than 25% stake in their portfolio company. In the next two years this trend is going to continue or increase further. Given the minority stakes of GPs in portfolio companies, the room to perform to their maximum and exhibit their expertise gets restricted.

CONCLUSION

It has been observed that India is well integrated with the global economy. The PE industry of India will sink and shine to the tunes of the global economic conditions. The challenges of GPs such as minority stakes are common both in India and rest of the world. However, the only country in BRICS which did not experience slower growth in 2013 is India. As the world economies started accelerating their growth rates, India's GDP growth rate pick up is much rampant than other nations of the world. This is reflected when in absolute terms, funds focused solely on India amounted to twice in 2014 compared to that of the previous year.

Majority of GPs expect that in the coming 2-3 years macroeconomic conditions and the potential IPO market will be the main driving forces behind exits. There is still untapped potential of PE in India. India boasts strong GDP growth, a vibrant entrepreneurship ecosystem and a positive future outlook, making it one of the most attractive of the emerging economies for PE investment in future.

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