Private Equity Investment Trend in India - Pre and Post Global Financial Crisis

Dr. Smita Shukla
Associate Professor, Alkesh Dinesh Mody Institute for Financial & Management Studies, University of Mumbai
Dr. Anjali Gokhru
Assistant Professor, K. S. School of Business Management, Gujarat University, Ahmedabad

Abstract

Global financial crisis has created negative impact on growth rate of developed as well as developing economies like USA, UK, Germany, France, China, India, Brazil, Russia etc. Negative impact of the global financial crisis continues to be felt till date. Recent Dubai financial crisis is a case to point. Recent growth exhibited by some major global economies also indicates that global economic recovery is in process, though it is still in very nascent stages. Global financial crisis has also negatively impacted private equity investments worldwide. This paper attempts to understand the changing trend of private equity investment in India, pre and post global crisis and also delves into the negative impact of global financial crisis on private equity investments in India.

Key Words: Private Equity, Investment, Deal, Global financial crisis, Trend

Introduction

The sub prime crisis initiated in US on account of greed to use financial arbitrage for monetary gains by investment bankers and financial institutions and lack of regulation in space of credit derivatives has resulted in crisis of global proportion that has affected the world badly in the last one and a half years. Impact of same has been felt by many countries worldwide. As per IMF (International Monetary Fund) report on "World economic Outlook", carrying world GDP projections for the years 2009 and 2010 for various economies across the globe, the projected global growth figure for 2009 stood at dismal 0.5% (lowest value since World War II). For many of the developing economies this projection was negative: USA -1.6%; Germany -2.5%; UK -2.8%; Japan -2.6%; Russia -0.7% etc. The details of IMF Projections are as follows:

Table 1: Year on Year Growth Rate and Projections of World Economies for the Year 2009 and 2010 (In %)

World/Country	2008	2009	2010
World Output	3.4	0.5	3
United States	1.1	-1.6	1.6
Germany	1.3	-2.5	0.1
France	0.8	-1.9	0.7
Japan	-0.3	-2.6	0.6
United Kingdom	0.7	-2.8	0.2
Russia	6.2	-0.7	1.3
Brazil	5.8	1.8	3.5
India	7.3	5.1	6.5
China	9.0	6.7	8.0

Source: IMF, World Economic Outlook Report - January 2009

The projected scenario seems to be undergoing a change now. During last few months Global economy is exhibiting signs of recovery. As per a report of Thomson Reuters, the preliminary US (United States) government data revealed that the US economy expanded in the third quarter of 2009, first three month period of growth since the second quarter of 2008. Similarly most of the European economies like Germany, France, and Italy etc are exhibiting marginal increase in the growth trends in the third quarter of 2009. However issues that are still a matter of worry for the global economy are that the US unemployment rate in October 2009 also reached for the first time double digit reading in last twenty six years. Similarly rapidly rising asset prices (Gold, Oil etc) are again stoking fear of rise in global inflation figures that may again negatively affect the rising positive growth sentiments. Biggest recent negative news for global economy has been the financial crisis in Dubai. The latest crisis has again shaken the global growth sentiments.

Impact of global crisis has also been felt by Indian economy. India in particular has been affected on account of its integration with the global economy. The direct flow of funds it has been receiving from rest of the world in its equity, money, debt markets (FII investments) have moved down in the recent time period. Similarly, India also has been affected on account of adverse performance of export sector (Gems and jewellery, Textile, Leather Products, export of IT and ITES services etc). Lower domestic consumption of automotives, other durable consumer goods, and real estate products further has resulted in lowering the GDP growth rate till recent past. Immediate impact of global meltdown has been felt by the stock market in India. Sensex which had touched high of almost 22,000 level in the first month of 2008 slumped down to the level of almost 8000 by the end of the year 2008. Though the market indices (Sensex) has recovered strongly in the year 2009, it is still unstable and growth in the index has not been consistent. This has resulted in fall in valuation of most of the listed companies and thus has negatively affected many big and small investor groups and financial entities including that of mutual Funds, merchant banking firms, broking houses, retail investors and even the private equity companies in India.

Understanding the Term Private Equity

Private Equity stands for investment in the primary equity of a company, the equity that is not freely tradable on a public stock market. Such an investment is outcome of negotiations between the company and the fund. Such an investment is primarily in the unlisted companies. The companies directly receive the money coming in on account of private equity investment. A private Equity fund can provide support to the target companies at various stages of its growth. Venture capital investment is a subset of private equity investment.

The growth of private equity funds and the investment in India during the last few years thus has been extremely significant. The growth data of private equity and venture capital investments in India over the last few years is as follows:

Table 2: Total Number and Value of PE and Venture Capital Deals in India-

Year	Number of Deals	Value of Investment ($ billion)
2000	280	1.160
2001	110	0.937
2002	78	0.591
2003	56	0.470
2004	71	1.650
2005	146	2.20
2006	302	7.47
2007	387	14.23
2008	399	10.97
2009	232	3.82

Source: Evalueserve, IVCA, Venture Intelligence India

Literature Review

Relevance and possible growth of private equity in India for the first time was possibly recognized by George Varughese. George Varughese in his essay "New Trends in Private Equity Funding" (published in 1998 in the book 'Global Trends in Finance') stated that India had expertise to develop home-grown Private Equity companies. He felt that availability of capital and savings in economy were encouraging enough to result in creation of domestic private equity companies. He stated that over a period of time private equity companies will establish themselves strongly in the Indian market and funding by private equity companies will emerge as an attractive source of funding companies passing through various stages of growth. In his essay he also concluded that the development of private equity market in India was possible only if SEBI (Securities and Exchange Board of India) accepted that as regulator it had no role in pricing or execution of private equity deals.

In a study conducted by Prof. Amit Babuna of ISB (Indian School of Business) in association with Venture Intelligence India and ICICI Ventures, (paper titled "Private Equity Impact Study", year 2007) for the first time in India, compared private equity backed companies against the companies not funded by private equity companies. He in his study concluded following:

- Private equity backed companies grew at significantly higher rate in comparison to the non private equity backed companies as well as market indices like Nifty.
- Wages at private equity backed companies grew at significantly higher rate in comparison to their non funded peers.
- 96% of the top executives of the private equity funded companies felt that without the private equity support their companies would have either not existed or their growth rate would have been lower.

The study of George W. Fenn, Nellie Liang and Stephen Prowse has been one of the most comprehensive studies in the area of private equity in USA (United States of America). The authors in their research paper "The Economics of Private Equity Market" (work for Federal Reserve Bank, USA, 1996) conducted an extensive study of history and pattern of growth of Private equity companies in United States since early 1930's till mid of 1990's. The study also lists the factors which should be considered by limited partners before passing funds to general partners of a private equity company. Some factors as listed in the study are: Past track record of private equity fund, Age of private equity company, Transparency of Partnership structure and Partnership Covenants.

Eric Nowak, Alexander Knigge and Daniel Schmidt of University of Frankfurt, Centre for Private equity research, in their paper "Does Market Timing Matter" (2005) have concluded that investment timing has an impact on the performance of venture capital funds, while disinvestment timing has no significant impact on returns. The analysis reveals that in case of later stage management buyouts (MBO) the fund performance is not driven by market timing but is significantly related to the experience of the fund manager. The paper also concludes that for successful investing into more mature portfolio company factors like getting access to better deal flow and managing the investments appropriately affects the success of the investment more in comparison to mere the market timing of the deal.

In a working paper for Deutsche Bank, Thomas Meyer, has stated that, private equity investments have become a substantial source of corporate finance in the European financial system. The paper explores the structural relationship between private equity investments and economic growth. The paper uses econometric analysis for a set of data from 20 European countries spanning from period between 1994 till 2004 to prove his hypothesis that private equity investments are associated with economic growth. The paper specifically focuses on venture capital investments and buyout deals and their impact on economic growth.

Impact of Global Meltdown on Private Equity Investment Trends in India:

Private equity investment trend has been clearly affected by global crisis. From the data mentioned below it can be seen that the value of private equity investment deals in India has changed as follows (starting from the year 2005 till the end of the year 2008):

Table 3: Change in the Value of Private Equity Deals (2005-2008)-

YEAR	2005	2006	2007	2008	2009
Value of deals (In Millions)	2184	7474	14236	10790	3824
Increase/ Decrease in value	534	5290	6762	(3446)	(7344)
Percentage increase/Decrease	32.36	242.21	90.47	(24.2)	(68.06)

Source: Venture Intelligence India

The percentage increase in the value of deals executed was 32% during the year 2005, this figure further went up by 242% during the year 2006. This was on account strong economic fundamentals, astonishing growth registered by various sectors of the economy, and finally on account of rising returns on the Indian stock market resulting in high returns on investment done by private equity companies. The growth as exhibited in the previous year slowed down in the year 2007 on account of rise in the Sensex till 20,000 levels by the end of year 2007. The same made valuation of target companies very expensive thus resulting in slow down in private equity investment trend year on year basis. Still the growth rate of 90% in value of deals executed during the year 2007 was an impressive one. During the years 2008 and 2009 the private equity investment deals in terms of value of deals declined on account of global financial market crash caused by sub-prime crisis in United States of America. The trend mentioned above can also be observed in terms of rise/fall in number of deals year on year basis.

Table 4: Change in Volume (number) of Private Equity Deals (2005-2008)

YEAR	2005	2006	2007	2008	2009
No. of deals	146	302	387	399	232
Change in the number over the previous year	75	156	85	12	(167)
Percentage change	106.63	106.8	28.14	3.1	(41.85)

Source: TSJ Media, Venture Intelligence India

The average value per deal which exhibited rising trend till the end of the year 2007 exhibited a decline in the year 2008 and 2009 on account of the reasons mentioned above. The trend as mentioned above exhibits that starting from the year 2005 till the end of the year 2007, the private equity players grew more and more positive about the Indian market and this resulted in more deals with higher stake involvements. However plunge in the average value per deal size in 2008 indicates negative impact of global meltdown on private equity deals in India and this negative trend became even stronger in the year 2009 with substantial decline in the number of deals. From the below mentioned trend it also emerges that average value per deal also changed with the changing economic sentiments related with Indian economy.

Table 5: Average Value per Deal - Period 2005-2008

YEAR	2005	2006	2007	2008	2009
Average value per deal (USD Million)	14.96	24.74	36.78	27.04	16.48

Source: Venture Intelligence, Private Equity Annual

Roundup Report

Quarter wise investment of private equity fund in India has also varied over the last few years. Generally such variations emerge on account of stock market performance, industry and economic outlook etc. The quarter wise investment details are as follows:

Table 6: Quarter Wise Investment Details (2005-08)

Quarterly Investments during the years 2005, 2006,2007 and 2008									
Sr. No.	Quarter	No. of Deals				Amount			
		2005	2006	2007	2008	2005	2006	2007	2008
1	Jan-Mar	25	73	97	133	374	1218	2700	3890
2	Apr-June	40	67	70	80	410	1858	2536	2790
3	Jul-Sep	35	94	90	125	600	1829	4000	2962
4	Oct-Dec	46	68	130	61	800	2569	5000	1151
	Total	146	302	387	399	2184	7474	14236	10793

Source: TSJ Media, Venture Intelligence India

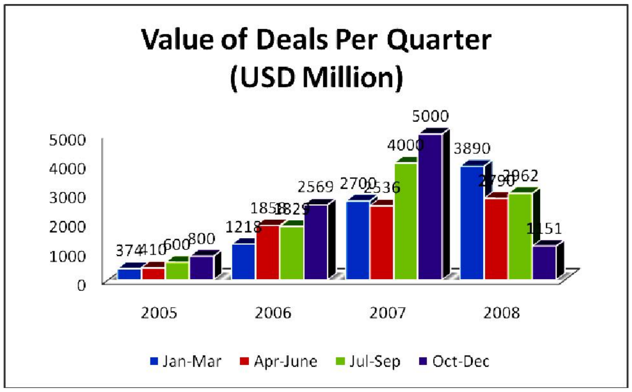

Figure 1, Value of Deals per Quarter (in USD Million) - 2005-200

As we can see from the above table, generally during the quarter October-December (Except for the reference quarter in the year 2008 during which investment seems to be lower on account of poor market performance and global financial problems), the numbers of deals taking place increases as most of the private equity funds towards the end of a positive year try to close as many deals as possible towards the end of the calendar year. This however has not been true for the year 2008 on account of negative impact of global financial crisis emerging strongly by the end of the year 2008.

Again quarter wise investment data, starting from second quarter 2008 till second quarter 2009 exhibits the same trend:

Table 7: Quarter Wise Median Private Equity Investment in India

Quarter	Median Investment (USD million)
Q2, 2008	20
Q3, 2008	10.6
Q4, 2008	9.75
Q1, 2009	9
Q2, 2009	15

Source: Venture Intelligence

Thus the impact of global meltdown on private equity investment trend can thus be clearly seen from the data stated above.

Link between Indian Stock Market and Private Equity Investment Deals and Impact of Global Meltdown on the same

Growth of private equity market in any country is also dependent on the exit environment for the investment into which private equity companies had entered into in the past. This has been a significant reason for the private equity investment growth in case of India as well. As the popular Indian stock market indices like Sensex and Nifty soared during the last few years, the value of new private equity deals and also exit of private equity companies from their investments (at huge internal rate of return) followed the suit. Further from the following data the impact of stock market on the private equity investments can be easily deduced:

Table 8: Sensex and Private Equity Investment Trend in India

Year & Quarter	Sensex Open	Sensex High	Sensex Low	Sensex Close	Private Equity investment in Quarter (Million $)	No. of Deals
2006					**7474**	**302**
Jan-March	9423	11387	9159	11280	1218	73
April-June	11343	12671	8799	10609	1858	67
July-Sep	10617	12485	9875	12454	1829	94
Sep-Dec	12474	14035	12179	13787	2569	68
2007					**14236**	**387**
Jan-March	13828	14724	12316	13072	2700	97

April-June	12812	14683	12426	14651	2536	70
July-Sep	14685	17362	13780	17291	4000	90
Sep-Dec	17357	20498	17145	20287	5000	130
2008					**10793**	**399**
Jan-March	20325	21207	14677	15644	3890	133
April-June	15772	17736	13406	13462	2790	80
July-Sep	13480	15580	12154	12860	2962	125
Sep-Dec	13007	13204	7697	9647	1151	61
2009 (Data on Private Equity is till beginning of June)					**1500**	**87**
Jan-March	9721	10470	8047	9708	612	43
April-June	9746	15600	9547		2587	44

Source: BSE, Venture Intelligence

From the above mentioned table it can be easily seen and deduced that as the benchmark indices of Indian stock market soar, the private equity investment also pick up strength and vice versa. Before the Global crisis private equity investment in India went up as the stock market indices went up, However in the year 2008 the private equity investment in India declined with the crash of Indian stock market indices- Sensex. The investment trend again improved with the improvement exhibited by the stock market index towards mid 2009.

Global Crisis, Stock Market Movement and Exit Deals of Private Equity Firms

The number of Exit deals invariably also always goes up along with the stock market indices. Same trend can also be easily observed in the data of exit deals made in India between the years 2005 till end of the year 2008. The above mentioned trend can further be easily analysed by comparing the number of exit deals and stock market movement in Nifty during the same period.

Table 9: Stock Market and Exit Deals

Year	Nifty	Number of Exit Deals
2005	2360	34
2006	3422	27
2007	6240	64
2008	4932	31

Source: NSE, Venture Intelligence India

(Note: The level of Nifty in the above table is based on the average closing value of middle month of every quarter of each year under consideration.)

Thus, from the above table it can be understood that number of exit deals changes along with the stock market movement. Maximum numbers of exit deals in India were reported in the year 2007, when the Sensex as well as Nifty touched new highest levels. The number of exit deals went down by almost 50% in the year 2008, with crash of Indian stock market indices. The data for the year 2006 is slightly against the trend as the number of exit deals reported in the year 2006 was less than that of the year 2005 and this happened in spite of Nifty levels improving in the year 2006. The most probable reason for this paradox can be that private equity funds could have taken the decision to hold their investments in the year 2006 in expectation of still higher stock market growth thus resulting in much higher return on their investments.

To further show the impact of stock market movements, the exit details of private equity funds in the month of May 2009 can be quoted. In the month of May 2009, as stock markets in India exhibited marked improvements in their indices the number of exit deals through open market sales increased dramatically. Lead sellers in the race were private equity funds like ChrysCapital, Standard Chartered Private Equity

(SCPE), IL&FS Investment Managers (IIML) etc. ChrysCapital in the month of May 2009, exited from 5% of its stake in Shriram Transport Finance for Rs. 300 crores, SCPE sold little more than 2% of its stake in Karur Vysya Bank for Rs. 31.6 crores at a price of Rs. 265 per share. SCPE had entered into the stock in the month of February 2009 only at price of Rs. 198 per share. IIML also sold part of its holding (2.2%) in IBN18 Broadcast for more than Rs. 40 crores. Leverage India Fund also exited from its stake at IBN18 almost around the same time. Besides IBN18, IIML also exited from ABG Shipyard. Further, IDFC Private Equity completely exited from Gujarat State Petronet and 3i sold its stake in Mundra Port. In the second quarter of 2009 total number of exit deals which were made was 21 and out of them 18 were exits via public market sales. The details of some such deals are as follows:

Table 10: Exit Details for the Second Quarter of 2009

Company	PE Investors	Type of Exit	Deal Value (USD Million)
Shriram Transport Finance	ChrysCapital	Public Market Sale	60
Delhi International Airport	IDFC PE	Buyback	30
Lupin	Citi	Public Market Sale	19
HT Media	Citi	Public Market Sale	14
KS Oils	Citi	Public Market Sale	9.2
Firstsource	Sequoia Capital India	Public Market Sale	7
Karur Vysya Bank	StanChart PE	Public Market Sale	6
YES Bank	Russell Asian Infrastructure Fund	Public Market Sale	4
KS Oils	Citi	Public Market Sale	3.7
Gujarat State Petronet	IDFC PE	Public Market Sale	2.5
Titagarh Wagons	2i Capital	Public Market Sale	2.4
Titagarh Wagons	2i Capital	Public Market Sale	2
JBF Industries	IIML	Public Market Sale	1.3
Himadri Chemicals & Industries	Citi	Public Market Sale	1.1
ABG Shipyard	IIML	Public Market Sale	1

Source: Venture Intelligence, TSJ Media

Current Direction of Private Equity Operations in India

Post Global crisis, the private equity funds operating in India are now raising fresh funds from the market for the fresh round of investment they wish to make in the Indian market. This is on account of promise exhibited by the Indian economy even at the peak of Global crisis. Though, the growth rate of GDP (Gross Domestic Product) went down in the year 2008, currently the Indian economy is exhibiting strong signs of revival. The growth rate of GDP reported in the second quarter of 2009 has been 7.9%. Further as per views being expressed by the global financial institutions, it is countries like India, China etc which are going to be key players in the global revival and growth process. Thus, interest of private equity companies in Indian market is very high. As per a report published in 'The Economic Times', some established homegrown funds like AV Birla PE, Reliance PE, Milestone Capital, Samara Capital, Kubera Capital, Tano Capital, Axis PE, ICICI Venture and India REIT are planning to raise USD 8 billion over next 12 to 18 months. One account of global crisis and reduced willingness of global Limited Partners to commit funds, the private equity companies in India are now increasingly searching for domestic Limited Partners. This can be further substantiated by the fact that private equity companies like ICICI Ventures, IL&FS Investment Managers, TATA Capital have in recent time period have raised money from the domestic market. In addition to the above another fact relating to Indian private equity market is that on account of good performance exhibited by private equity funds operating in India in past (success of companies like Warburg Pincus, ICICI Venture, India Value Fund, Citi Venture Capital etc), the interest of global Limited Partners in Indian market is still high. The Global Endowment funds, Pension funds, Fund of Funds are still interested to make investment commitment for funds investing in Indian market. Though at the moment the fund raising for the India may not look very interesting (as Prequin, London based research firm, the collection by India specific funds in the third quarter of 2009 was USD 1.1 billion while the fund raising by India specific funds in third quarter of 2007 was USD 4 billion), the interest of global investors in India is real.

Conclusion

It can finally be concluded that in spite of global meltdown and the Indian stock market crash of 2008 the future of Indian economy in the beginning of the year 2009 is again looking positive and so has been the case of Indian stock market indices. This will thus further boost the private equity investments in India in the years to come. However, only strength and resilience exhibited by any private equity company to pass through this rough phase will ensure its long term survival and gains in India. Taking a short term view of Indian market will not help the private equity companies operating in India. They need to remember that stock market movements are cyclical in nature. Further private equity companies also have to keep in mind that in spite of Global slowdown India still is fastest growing economy after China. Thus private equity market in India still holds a good future for many years to come.

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