



Expert Says

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Future of Private Equity in India

To become a private equity industry characterised by good governance, healthy returns and true partnerships, the Indian PE industry has to travel through a torturous path littered with questionable deals, negative returns and failed partnerships.

Today's India offers a compelling proposition to PE practitioners due to its youthful demographics, large domestic market, presence of financial and capital market mechanisms, huge demand for infrastructure, a large and growing repository of intellectual capital, track record of independence of judiciary and healthy rate of economic growth.

However, equally daunting are the challenges of finding opportunities due to general deficit of governance, abundance of pliable management, uneven playing field, inaction by regulating agencies and frequent changes in rules of the game.

Indian PE market is different from that of Europe or America in many ways. The western model of PE is built on the premise of cheap debt, abundance of institutional equity and value creation opportunity arising out of difference of opinion between shareholders and managers.

India is driven by a different set of paradigms, leaving a target market of unlisted companies short of funds. Investing in unlisted companies is challenging as they do not have a record of corporate governance, has higher risk and require longer holding periods from investors.

Currently, the PE industry has intense rivalry, leading to upping of valuations, and a capital market driven more by foreign capital inflows and outflows rather than the performance of the industry or the company.

Also there is a scarcity of investment management talent capable of adding value to the investee—a recipe for poor returns in near term. However, logic of investing in growth

locations and scale will let India remain in the forefront of PE investing. As the pace of investment increases, some trends will become more apparent, this includes greater need to add value to investee companies. This will reduce competition for deals as those incapable of adding value will be weeded out.

The holding period for PE investments is also likely to increase, putting pressure on firms with short term deliverance target to seek alternate pastures. There will also be greater importance of governance and sustainability of business reducing risk for PE investors.

Today's India offers a compelling proposition to PE practitioners

The growing presence of domestic GPs and VC funds with local knowledge will lead to better pricing of local risk in entry valuation increasing probability of healthy returns.

More PE funds acquiring portfolio investments from peers will rise sharply, creating a more robust market for secondaries, which will energise the exit scenario. We will see a fairly unique Indian model for the PE industry emerge, unlike the West where PE is practiced through control deals. This is due to the traditional mindset of Indian promoters who are not keen to cede control.

There are also few professionally managed companies that PEs can acquire control and also huge difficulties in taking a company private from the listed space, while current regulations also do not allow FVCA and VCF-registered PE funds to acquire secondary listed shares.

PE funds will have to become partners in strategic, operational and human capital matters for the owners of Indian companies. This will mean PE managers should have operating experience in India.