New Trends and Developments in The Private Equity Industry in India
written by Prashant Kataria | November 9, 2021

While inbound investments into India were hit hard due to the pandemic in the early days, one can confidently say that there has been an upswing in private equity trends and deals in recent times. Although India's GDP contraction of more than 10% occurred initially, leading to the highest-ever annual fiscal deficit at 9.5% for the fiscal year 2021, the latest forecasts by the IMF predict a strong rebound with growth returning to the long-term trend of 7% – 8% from 2022 to 2025.
[1] With investor sentiments bolstered by mass vaccination drives, the overall release in pent-up demand across sectors and realistic valuations in many cases, private equity funds have felt encouraged to rekindle their investments in Indian companies once again. Some of the sectors seeing a resurgence of interest are FMCG, consumer-tech (ed-tech, med-tech, fintech), e-commerce and IT/ITES, amongst others.
Exits made by private equity investors till 2020 were primarily through sales in acquisitions or exits via secondary sales in later investment rounds; a fair number of exits now appear to be happening through IPOs. This trend has been fuelled by a bull run and high market valuations available to companies owing to the inflow of a large quantum of institutional and retail investments; as such, private equity investors seem to be laughing their way to the bank with large exit multiples.
Evolving Trends in the Industry - Private Equity Trends
Although there had been a decline in the overall volume of investments, the consumer tech sector has experienced significant growth due to an acceleration of digital usage owing to the times; this growth spurt has fostered an increase of investments – especially in the sectors of ed-tech, fintech, verticalized e-commerce and food – with companies such as Byju, Zomato, Flipkart and FirstCry witnessing healthy fiscal progress.
Within the IT/ITES sector, heightened demand for software as a service (SaaS) and digital readiness drove multiple large ticket deals like Mphasis, 3i Infotech, Zenoti, Postman, and Majesco. However, the banking, financial services, and insurance (BFSI) experienced a decrease of 60% in investment value due to a rise in non-performing assets.[2]
The healthcare industry, normally treated as a step-child, is understandably one of the sectors that investors pivoted towards most rapidly once the reality of COVID-19 settled in. Traditionally, India's healthcare

infrastructure has not had adequate funding or resources, but the pandemic naturally affected this as well; a massive spike in demand for medical services over the last 15 months has led to a 1.6x increase in investment in the field of medicine and healthcare.

Demonstrably, API (active pharmaceutical ingredient), CDMO (contract development and manufacturing organizations), and formulation segments have witnessed a huge upsurge in the same and have garnered the lion's share of 80% of total healthcare investment, with Piramal Healthcare, JB Chemicals, and SeQuent Scientific being the most significant players in the market.[3]

The advent and rapid growth of direct-to-consumer (D2C) players, the acceptance of remote working solutions, consumer prioritization of safety and convenience and an increased focus on healthier living by individuals has resulted in investors making sound and structured decisions while investing in such companies.

Multiple government initiatives to bolster the economy like 'Make in India', which endeavours to boost the domestic manufacturing sector, *'Aatmanirbhar Bharat'* which aims to make the country and its citizens independent and self-reliant,

the Start-up India Scheme which reduces the burden of regulatory compliances on start-ups and provides tax breaks resulting in ease of doing business, allowing foreign direct investment (FDI) of up to 100% under the automatic route for port and harbour construction and maintenance projects along with a 10-year tax holiday to enterprises that develop, maintain and operate ports, inland waterways and inland ports and the overall dethroning of China as the leader of global supply chains are also factors that have strengthened the private equity investment ecosystem in India.

The Indian government also recently introduced the Public Private Partnership (PPP) model for the privatization of airports which should provide multiple opportunities to private players in the market to not only bid for operations and maintenance of such airports on a PPP basis but also in the provision of ancillary services. The framework of investment in a total of 12 airports in India is expected to be around INR 130 billion.[4]

The past year has also attracted the attention of private equity investors to environmental, social, and governance (ESG) issues – which is usually driven by LP mandates. Private equity firms are increasingly regarding ESG factors as prominent value drivers that will generate excellent financial returns as consumer attitudes continue to shift towards a concern for social issues and climate consciousness.

Going forward, from an investment perspective, high traction is expected in IT/ITES, consumer tech, and healthcare sectors, with BFSI set for recovery as well. Investors also expect interest to exponentially increase in digitally accelerated opportunities such as digital health (65% of investors), fintech (57% of investors), and ed-tech (52% of investors), e-commerce and online marketplace (43% of investors), digital information services (36% of investors) and online entertainment (35% of investors).[5]

New Legal Developments Affecting the Private Equity Industry

Via the FDI Policy Circular of 2020, all prior amendments to the FDI Policy, since its release in 2017, have been consolidated, thereby easing the interpretation of the framework from a foreign investor's perspective. Further, FDI has been permitted in the defence sector and the insurance sector up to 74% under the automatic route from the previous limits of 49%,

which should give impetus to home-grown R&D in the defence sector and ought to boost the insurance and insure-tech sectors.
The reduction in sectoral caps across various sectors seems to indicate the strong belief of the government in the maturity of the Indian markets when it comes to seeking foreign investments.
Moreover, structural and procedural reforms for telecom service providers have been recently implemented with FDI under the automatic route up to 100% (from earlier 49%), which should give stimulus to the beleaguered telecom services sector through increased investment flow.
The introduction of the Pre-Packaged Insolvency Resolution Process for micro, small and medium-scale enterprise (which was hit hard by the pandemic) via an amendment to the Insolvency and Bankruptcy Code is a proactive, market-led and time-bound regime that requires a company to have a plan in place for rescuing itself from bankruptcy. This step should instil faith in the investor community as a whole against the possibility of losing their invested capital due to downturns in the investee company.
Furthermore, the consolidation of 29 different labour-law statutes (formerly considered a quagmire by many) into four labour codes has streamlined and detangled the labour laws for the benefit of not just the employers but employees as well. This should boost confidence amongst MNCs wishing to set up shop/grow their existing businesses in India –which ought to further invite investments into such entities.
An amendment to the Indian Arbitration Act has resulted in parties being allowed to seek an unconditional stay on the enforcement of an arbitration award when a court discovers that the underlying agreement or the making of the award was stimulated by fraud or corruption. This amendment should assure foreign investors as to the strength of the Indian dispute resolution mechanism.
Another major development was concerning the intensified scrutiny on foreign investments coming from countries sharing land borders with India via Press Note 3 of 2020 – such investments now require government approval. Furthermore, any existing transfers or future investments from these countries have also been made subject to government approval (though past investments were not in contention).
This has resulted in a fair number of investments coming under the governmental lens – with more than 100 applications for government approval pending. This has resulted in companies, especially the ones with existing Chinese investments – Byju’s, Ola, Doubtnut, Flipkart, Niyo, Khatabook, Pinelabs, Swiggy, etc. – to re-strategise any planned future capital raises from such parties and instead, encourages them to seek investors domestically or from other jurisdictions.
The Yellow Brick Road Ahead
Investors are increasingly putting their funds into companies that are not only just disruptive but also possess a wide array of characteristics like better returns, creative business structures, robust promoters, and infrastructure, amongst a few. Around 90% of private equity funds have agreed that their portfolios persevered in the face of the pandemic. India-focused dry powder appears to be at a resilient USD 8 billion and over 90% of closed funds are at target or oversubscribed.[6] 2021-2022 is positioned to be an active year for private equity activity as record-high dry powder coupled with the anticipated pent-up demand is projected to help drive

acquisitions.[7]

While there may have been a paradigm shift in the way private equity funds consider investments and place their bets, fundamental factors like strong balance sheets, steady cash flows, lower debt levels, and dependable management teams along with the requirement of their investee companies to have an open mindset, ability to adapt quickly to changing scenarios, focus on crisis management, and developing multiple contingency plans are still significant points of reassurance for the private equity market.

If one were to crystal ball-gaze, all the ingredients for a further upturn in private equity investments in Indian companies seem to be available and overall growth in this sector appears to be on the anvil for the following years.

- [1]India Private Equity trends Report 2021, IVCA and Bain & Company, https://www.bain.com/insights/india-private-equity-report-2021
- [2] *Ibid*.
- [3] *Ibid*. private equity trends
- [4] Presentation of details of 5th Tranche announced by Union Finance & Corporate Affairs Minister Smt. Nirmala Sitharaman under Aatmanirbhar Bharat Abhiyaan to support Indian economy in fight against COVID-19, May 17, 2020, https://static.pib.gov.in/WriteReadData/userfiles/Aatma%20Nirbhar%20Bharat%20%20Presentation%20Part%205%2017-5-2020.pdf
- [5] *Ibid*.
- [6] *Ibid*.
- [7] Looking Ahead: Private Equity Trends for 2021, KPMG, https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2021/01/looking-ahead-private-equity-trends-for-2021.pdf.

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