

Private Equity in India:

TYPES AND ITS EVOLUTION

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Private equity (PE) is an alternative form of investment that involves investing in companies that are not publicly traded on stock exchanges. Private equity investments are typically made by institutional investors, such as pension funds, endowments, and high-net-worth individuals, who seek higher returns than those available through traditional public market investments.

Private Equity in India has grown significantly over the past few decades, driven by the country's strong economic growth and rising entrepreneurial spirit. This article will discuss the different types of private equity in India and how the industry has evolved.

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Types of private equity in India

There are several types of private equity in India, each with its unique characteristics and objectives. The main private equity types in India are:

1. **Growth Capital:** Growth capital is a type of private equity investment that provides funding to companies that are in their early or growth stages. This type of investment is usually made in exchange for equity or convertible debt, and the funds are typically used to finance expansion plans, research,

and development, or working capital needs.

2. **Buyout:** A buyout is a type of private equity investment that involves the purchase of a controlling stake in an established company. Buyouts are typically made by private equity firms that seek to restructure and improve the operations of the company to increase its profitability.
3. **Venture Capital:** Venture capital is a type of private equity investment that provides funding to startups and early-stage companies that have high growth potential. Venture capital investors typically take an equity stake in the company in exchange for funding and provide strategic guidance and operational support to help the company grow.
4. **Mezzanine Finance:** Mezzanine finance is a type of private equity investment that provides capital to companies that are in their expansion stage. Mezzanine financing is typically structured as a hybrid between debt and equity, and the funds are used to finance growth initiatives or acquisitions.

Evolution of private equity in India

India's private equity industry has come a long way since its early days in the 1990s. In the early years, private equity investments in India were primarily made by foreign investors who were attracted by the country's large market and low labour costs. However, as the Indian economy grew and domestic companies became more successful, domestic investors also started to invest in private equity.

Private equity in India took off in the early 2000s, as the country's economic growth accelerated and entrepreneurial activity increased. Private equity investments in India reached a peak in 2007-08, just before the global financial crisis hit. The crisis had a significant impact on the private equity industry in India, as investors became more cautious and funding became harder.

Despite the challenges, the private equity industry in India has continued to grow over the past decade. According to a report by Bain & Company, private equity investments in India totalled \$44 billion between 2015 and 2020, with the average deal size increasing from \$40 million to \$65 million during this period. In the first half of 2022 (January-June), PE/VC investment activity stood at US\$ 34.1 billion across 714 deals, a 28% growth YoY. Among these, startup investments were the highest, standing at US\$ 13.3 billion across 506 deals.[1]

The evolution of the private equity industry in India has also been marked by several trends. For example, there has been a shift towards larger deals, as investors seek to make bigger bets on successful companies. There has also been a greater focus on domestic investments, as domestic investors have become more sophisticated and have started to invest more in private equity.

Key steps in a private equity transaction

Private equity transactions are complex deals that involve several key steps, each of which is critical to the success of the transaction. The key legal steps in a private equity transaction typically include:

1. **Deal Sourcing:** The first step in a private equity transaction is identifying potential investment opportunities. Private equity firms often have dedicated teams that are responsible for sourcing deals by actively seeking out potential targets, attending industry conferences, and building relationships with business owners and other industry participants.
2. **Due Diligence:** Once a potential target has been identified, the private equity firm will typically conduct due diligence to assess the target's

financial, legal, and operational status.[2]

3. Valuation: After conducting due diligence, the private equity firm will determine the valuation of the target company.
4. Letter of Intent: A letter of intent (LOI) is prepared and signed by both parties, outlining the key terms of the transaction.
5. Negotiation and Drafting of Transaction Documents: The parties negotiate and draft the transaction documents, which typically include a Share Purchase Agreement (SPA), Investment Agreement, and Shareholders Agreement.
6. Financing: After the deal structure has been agreed upon, the private equity firm will work with banks and other lenders to secure financing for the transaction. This may involve raising debt financing, negotiating credit facilities, or securing other forms of financing.
7. Closing: The parties sign the transaction documents, and the private equity firm invests in the target company. This typically involves transferring the equity and debt securities to the private equity firm and executing any legal documents required to complete the transaction.
8. Post-Closing Obligations: After the transaction has closed, the private equity firm will work with the target company's management team to implement its growth strategy and to optimize the company's operations, which typically include updating the target company's legal documents, filing regulatory approvals, and ensuring compliance with applicable laws.
9. Exit: The private equity firm typically exits the investment after a few years through means such as an Initial Public Offering (IPO), sale to a strategic buyer, or sale to another private equity firm.

Significant factors encouraging private equity investment in India

Private equity investment in India has been on the rise in recent years. India's fast-growing economy, large consumer market, favourable demographics, and government initiatives aimed at promoting entrepreneurship and economic growth have all contributed to making India an attractive destination for private equity investment. Here are some of the significant factors that encourage private equity investment in India:

Strong economic growth: India has one of the fastest-growing economies in the world. With a projected GDP growth rate of 6.4% in 2023-24, India is expected to be the fastest-growing major economy globally. This strong growth potential offers opportunities for private equity firms to invest in companies that can benefit from this growth.

Large consumer market: With a population of over 1.3 billion people, India has a large and growing consumer market. The middle class in India is expanding rapidly, creating new opportunities for businesses in sectors like healthcare, education, retail, and consumer goods.[3]

Favourable demographic profile: India has a young population, with a median age of 28 years. This demographic profile offers opportunities for private equity firms to invest in sectors like education, healthcare, and consumer goods that cater to the needs of the young and growing population.

Government initiatives: The Indian government has implemented several initiatives aimed at promoting entrepreneurship and economic growth. These include the Startup India program, which provides funding and support to new businesses, and the Make in India campaign, which aims to boost manufacturing in the country. These initiatives have created a conducive environment for private equity investment in India.

Improved regulatory environment: The Indian government has implemented

several measures aimed at improving the country's business environment. These measures include simplifying the tax system, streamlining regulations, and reducing bureaucratic red tape. These steps have made it easier for private equity firms to invest in India.

Conclusion

Private equity has become an important source of funding for Indian companies, and the industry is expected to continue to grow in the coming years. The different types of private equity investments in India, such as growth capital, buyout, venture capital, and mezzanine finance, offer investors a range of options to invest in companies at different stages of growth. Private equity transactions involve several key steps, including deal sourcing, due diligence, valuation, deal structuring, financing, closing, and post-closing activities. Each of these steps is critical to the success of the transaction, and private equity firms must carefully manage each step to ensure a successful outcome.

In conclusion, the strong economic growth, large consumer market, favourable demographic profile, government initiatives, and improved regulatory environment are all significant factors that encourage private equity investment in India. As India continues to grow and develop, the opportunities for private equity investors are likely to increase further in the foreseeable future.

FAQs

What are the risks associated with a private equity investment in India?

The risks associated with a private equity investment in India include economic volatility, regulatory uncertainty, legal and contractual risks, currency risk, market risk, and operational risks.

Who can invest in private equity in India?

Institutional investors, high-net-worth individuals, family offices, and foreign investors can invest in private equity in India. However, private equity investments are typically restricted to sophisticated investors with significant financial resources and experience in investing.

What are the benefits of private equity investment in India?

Private equity investment in India offers benefits such as access to a fast-growing economy, a large consumer market, favourable demographics, and government initiatives promoting entrepreneurship and economic growth. Private equity firms can also provide expertise and resources to help businesses grow and create value.

[1] <https://www.ibef.org/economy/investments>

[2] <https://ksandk.com/corporate/development-of-private-equity-in-india/>

[3] https://www.niti.gov.in/sites/default/files/2022-06/25th_June_Final_Report_27062022.pdf

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