The role of private equity as a driver of economic growth

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Private equity is not just funding businesses the country needs, but is establishing a unique eastern model that stresses on controlled growth that aids the growing economy and is the right fit for it

Private equity has been linked inextricably to the India story for more than a decade. It has been in lockstep with the country as it has negotiated a series of historic events that have shaped it as well as the global economy – from the meltdown of 2008 to the more recent landmark reforms and political changes.

Today, India is a global power, one of the fastest growing and coupled with the world economy, attracting massive investment because of its GDP expansion as well as favourable demographics. It is this great value woven into the economic fabric that enabled it to weather such storms as the subprime crisis. India wasn't immune to the threat but the inherent strength of its economy, governance and regulatory oversight pulled it through and made it the country to watch for investors, especially private equity.

The Licence Raj and the early years of reform seem like a different age, even though they were just a couple of decades ago, and today it's private equity that is driving most of build out. Be it infrastructure or enabling the rise of new-age business, it is driving growth and investment.

This is a paradigm shift. Private equity was once a niche space focused on attracting foreign investment; now it is part and parcel of the investment landscape and is particularly important to infrastructure, industry and the digital economy.

The road ahead

As we forge ahead, private equity is best placed to leverage the opportunities before us. The greatest advantage – and magnet – is India's growing entrepreneurial strength. This, in conjunction with ongoing big-ticket reforms, is exciting.

Demonetisation, for instance, has had a collateral but long-lasting impact through digital transactions, particularly in 'middle India' - tier 2 and 3 cities. The private equity sector has played a stellar role through its funding of financial service businesses including fintech startups. This trend will continue to grow and impact, especially, larger national missions such as financial inclusion – most importantly in rural India.

Let's consider also the Goods and Services Tax (GST). It means more transparency and compliance, as well as a common market for goods and services across India. From the private equity point of view, it means more deal-making opportunities. With the number of GST registrations crossing 10 million, what we are witnessing is the growing spread of the organised market. This also aids inflation management and stability in tax rates – which in turn fuels consumption and industry.

Accordingly, the World Bank's 'ease of doing business' report saw India's rank improve for the second straight year, jumping 23 places to the 77th position. Not surprisingly, India's contribution to world growth increased from 7.6% in 2000-2008 to 14.5% in 2018 and it became the 10th largest recipient of foreign direct investment in 2017, according to the 'United Nations Conference on Trade and Development Report 2018'. It is now among the top three destinations for greenfield capital investment.

The eastern model

As is evident, the country has come a long way from the time when government systems could be manipulated – we've gone from promoter-led models to highly-governed institutionalised platforms that are ideal for building businesses the right way. Again, private equity has led the way.

And in doing so, it has created a uniquely eastern model. In the West, it's about using financial engineering and leverage to buy out businesses and generate returns. This is not suitable for a country like India where high cost of leverage and valuation multiples of businesses make it a very risky proposition. The model that's works is a controlled growth model - investing capital into businesses to deliver value and growth. This generates jobs, velocity of capital, more productivity – and, most critically, overall economic growth.

According to EY India data, in the past five years, control deals grew at an annual average rate of 50% to $9.9 billion in 2018. Overall private equity investments grew at an annual average pace of 25% to $35.8 billion. Note the emphasis on control deals – more evidence of the eastern model mentioned above. This is important in the context of the turbulence we are seeing in corporate India due to unsustainable levels of debt.

So, what next?

Assuming a 7% growth rate, the Indian economy should be $4.5 trillion by 2025 with private equity investments

likely to exceed $65 billion – accounting for ~1.50% of the GDP.

This year is expected to be a good one. Investments are likely to set a new record; keep an eye on green infrastructure, real estate, consumer, financial services and healthcare. Exits, too, will rise on the back of increased capital market interest as well as corporate restructuring and M&A. As average size of funds raised grows, the industry is likely to pursue larger transactions and an increased role given increased preference for control deals.

It's evident now that, spurred by these opportunities and regulatory evolution, the Indian private equity space has changed. It is now an important driver of the economy.

There is room for private equity to account for a greater proportion of the GDP, bringing in efficiency, stability, transparency and better returns. India remains a deeply compelling story.