Entrepreneurship Supported by Private Equity Capital

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Crony capitalism, lack of capital and leveraged capital are terminologies we would often hear in conversations a few years back. Over time, the scenario has significantly changed in the country. The change was initially ushered in by venture capital funds providing capital to start ups. Today, long-term private equity firms and buyout firms are promoting and supporting the growth of entrepreneurship in India. This remarkable shift is also supported by public markets and the market regulators.

As our public markets have matured, private capital has also evolved. Private capital, though a single terminology, takes on various forms for investing as well as for exits. There are mainly three forms of the investment - venture capital, minority private capital and buyout capital. Private capital is more long term/ permanent than public capital, however this is also not perpetual. Therefore, private capital requires exit at an appropriate time from their investment. Over time private capital has explored different forms of exits such as minority sell down, block sale in the public markets if the investee company is a listed company, strategic sale in cases of control transactions and private equity to private equity sale. We have also witnessed other modes of exits like a controlling stake being sold in the public market, sale from one fund to another fund within the same group and exit through SPAC process.

More recently, we see the new trend of private equity exiting through public market. This new concept has been successfully tried by private equity investors, where they exit by way of an Initial Public offering (IPO) of the company.

Buyout firms had long believed that strategic investors pay more value than public market. The rationale behind this is that strategic investor can combine their businesses and derive synergies. In addition, since they would control the entire cashflow of the business, they have an additional incentive to acquire the business. As a result, there is a general perception that a strategic investor will pay premium valuation. Contrary to this belief, the new alternative of public markets has started offering much better valuation. This is because there is higher confidence in the adequacy of governance framework of a company which is owned by professional investors. With comfort around professional management, higher corporate governance, absence of related party transactions etc. the public markets are also paying full value.

This new trend of making private public is very significant as it gives a boost to entrepreneurship. Let me explain the concept. If there is an entrepreneur who sets up a business or has an idea, a venture capital can fund the idea/ business. Once the business is established, the venture capital investor will exit by selling their stake to a private equity investor - the private capital will either buy the entire stake solely or a group of private equity investors could together invest. Once the business grows further, the private equity investor will want to exit. Eventually, they will sell either to a strategic investor or through public market. Sale to a strategic investor curtails the involvement of original entrepreneur. However, if the private capital gets an exit through the public markets, then the entrepreneur can continue to run and control the business so long as he or she has the confidence of the Board.

I would say that this is a big change that will bring in a new age business model with professional capital, professional management and professional entrepreneur. The good part is that the regulator is also playing the role of a key enabler. The recent consultative paper of SEBI proposing to change the present provision of promoter to the concept of controlling shareholder is a move that would make it easier for entrepreneurs and private investors to access public markets. Identification of promoter, promoter group and relatives of the promoter; and minimum promoter's contribution/ shareholding/ lock-up requirements have been a challenge for the new age companies and businesses. The concept of controlling shareholder and the proposed change in the current lock-in requirements will resolve some of these issues. Further, with the role of independent directors getting strengthened, the interests of larger public shareholders will be protected from a governance perspective.

To my mind, all ducks are in a row for a combination of Laxmi and Saraswati in the form of capital and capability to give us a lot more Unicorns!