

SMEs have become the new magnets of PE/VC funds

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A NIMPRESSIVE line up of private equity and venture capital funds are looking for funding opportunities in the SME space. Several dedicated SME-focussed PE/VC funds have come up in recent years on sensing a funding gap of nearly \$10 billion in the sector.

By Crisil estimates, there is scope for banks to increase their lending to small and medium enterprises by ₹50,000 crore. On an average, banks funded just around 60% of the incremental working capital requirement of SMEs between 2006-07 and 2008-09. This shortfall offers a significant business opportunity for PE/VC funds.

Investments by PE/VC funds have been consistently picking up in the SME sector. If 2009 witnessed 69 deals worth \$765.24 m, the figure shot up to 81 deals worth \$1401.786m in 2010 and 74 deals worth \$1,384.05m in 2011, according to VCCEdge estimates.

Research firm VCCEdge analysed funding patterns of companies in the revenue range of ₹10-100 crore.

The year 2012 has seen some big PE/VC investments in SMEs. In February, Jaipur-based Star Agri Warehousing & Collateral

Management, which provides post-harvest handling, transportation, warehousing and collateral management, got \$30.29 million from IDFC Private Equity Fund III. Last month AMP Capital's Asian Giants Infrastructure Fund invested \$29 million in Hyderabad-based Shalivahana Green Energy Limited that focuses on renewable energy generation using biomass as the primary fuel. Other notable investments in 2012 include Tiger Global investing \$20 million in Bangalore-based Myntra Designs, an online marketplace for on-demand consumer products. Norwest Venture Partners invested \$15 million in Bangalore-based Manthan Software Services that provides retail business intelligence, advanced analytics and optimisation solutions.

"The biggest draw in a small and mid market company", according to Harikrishnan S, managing director, Avigo Capital Partners, "is that it comes at reasonable valuations as compared to large companies, where valuations can skyrocket. As an investor one gets good valuations as you enter the game early. Also, an early stage company with the right fundamentals would have a relatively better growth prospect."

A small company can grow at

about 30% whereas a large company would grow at a maximum of 20%, says Harikrishnan. Avigo Capital Partners was one of the first PE funds to have started operating in the SME space back in 2003 and it currently manages over \$365 million. "Within the SME space we are bullish about manufacturing and engineering, and generally make investments in the range of \$8 million. More than the capital, it is building a company from the scratch that makes all the difference," he says.

A PE investor can make a significant difference to the growth of an enterprise. Meru Cabs, for example, got a PE infusion of ₹50 crore in 2006 from India Value Fund at a time when it practically had no turnover. Siddhartha Pahwa, chief executive officer, Meru Cabs, spells out, "Our association with the PE investor has been a great bet. Without PE infusion, it would have been impossible to get experienced consultants on board and build a profitable business." Pahwa added that this PE partnership has been critical to expanding the business and today the turnover of the radio taxi provider stands at more than ₹200 crore.

Even niche service providers are entering the funding space, by helping SMEs source investors

and doubling up as their image consultants. Pooja Kumar, who worked as a banker for SMEs for almost a decade, has set up a platform, SME JoinUp, to help enterprises looking for funding, visibility and markets. SME JoinUp has on its panel more than 200 VC/PE funds, angel networks, angel investors, banks and NBFCs. "We help SMEs connect with the right source of finance. We do this through various models, either directly or through consultants or investment bankers," says Kumar.

In 2011, the biggest chunk of investment basket for SMEs has been consumer discretionary with \$390.14 million, followed by financials clocking in \$364.66 million. Amit Chander, partner at Baring Private Equity Partners, points out, "Consumer-driven sectors such as healthcare and pharma, IT, banking and financial services and consumer discretionary have emerged as the new red hot sectors for investment as they're growing despite the slump."

Regardless of the sector-focus, the simple fact is that no long-term PE/VC player in the Indian market can overlook the SME space. As Gopal Srinivasan, chairman and managing director of TVS Capital Funds, sums up, "SMEs are the future pipeline of big companies in India that no investor can afford to ignore."