



SMEs to drive PE deals in India, says report

But lack of successful exits may make it harder for India-focused funds to raise resources than funds dedicated to China and Brazil

TE NARASIMHAN
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India continues to be a small- to medium-sized deal market, with SMEs continuing to be the backbone of most PE investment portfolios in India, according to a recent report by Protiviti Consultants and the *Asian Venture Capital Journal*.

The report, *India Investment Opportunity: An Insight*, based on a survey of PE fund executives, said that 48 per cent of respondents felt SMEs presented a better value opportunity than other categories of companies, while 40 per cent said it would depend on the sector, and only 12 per cent cited large enterprises.

In terms of investment size, India will continue to be a small- to medium-sized deal market, the report said. When asked what they thought would be the most common size of investments in SMEs, given the current economic scenario, 48 per cent said \$5-10 million; 36 per cent said \$10-15 million; 8 per cent said greater than \$15 million; and another 8 per cent said \$2.5-5 million.

Most survey respondents (61 per cent) felt that India still holds a better promise as a long-term investment destination than China or Brazil. However, 62 per cent pointed out that the lack of successful exits and valuation mismatches would make it harder for General Partners (GPs) today to raise India-dedicated funds than funds dedicated to China or Brazil.

Survey respondents listed four other factors that would make it more difficult today – than in the past – for India-dedicated funds to raise resources: the large number of India-focused GPs that are looking to raise funds; the tightening global liquidity scenario; volatile macro-economic factors (high inflation and a large fiscal deficit) in India; and corporate governance issues.

When asked what would be the most significant challenge facing India-focused GPs in the next 12-18 months, survey respondents cited the difficulty in exiting existing investments; the difficulty in finding quality investment opportunities; the uncertain regulatory and reform scenario; and eco-

nomic uncertainty.

Fifty-seven per cent of the respondents held that recent corporate accounting scams have had a medium-to-high impact on their investment destination decisions. Managing profitable exits and building top-quality professional managers and stricter investment parameters of Limited Partners (LPs)/investment committees were the key challenges respondents felt Indian PE/VCs could face in the near future.

Further, 64 per cent of the respondents felt that PE/VC investment in India would slow down over the next 12 months.

Respondents listed pharmaceuticals / healthcare, FMCG, education, energy, banking and finance, hospitality, infrastructure, IT, retail, auto ancillary, real estate and telecom (in that order) as the most promising for investment over the next 12-18 months.

While the “bear runs” in the stock markets have created attractive investment opportunities in listed entities (PIPE – private investment in public equity deals) and recent

changes to the takeover code may lead some PEs to look more favorably at PIPEs, 75 per cent of survey respondents were in favour of investing in unlisted entities. Only 25 per cent were in favour of investing in listed entities.

The preferred exit choices of respondents for current investments in the next 24-36 months were strategic sales (40 per cent) and secondary sales (36 per cent) – understandable, given that recent volatility in stock markets have caused dormancy in the IPO market and also given that promoter buybacks in India have been historically unsuccessful.

Corporate governance has historically taken a back seat in SMEs, the report observed. However, with the recent spate of accounting irregularities, there is renewed focus among investors on corporate governance and stronger financial controls, it said.

Survey respondents felt that the first in line for a change after their investment would be positions in the finance function, followed by internal audit, external audit and MIS.