

# Private Equity and Venture Capital – Preamble

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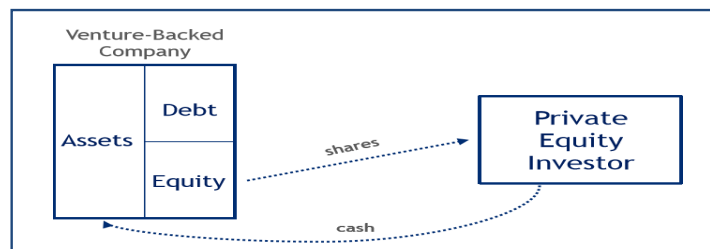
### Abstract

Private equity investment can offer very strong returns in comparison to any stock market returns or public market investment opportunity. Private equity invests in companies which are not listed in the recognized stock exchange. Every business comes across six stages of the life cycle which include; Development, Start-up, early-stage growth, expansion, maturity, and decline/crisis stage. PE firms invest in the initial three stages. In today's fast-moving world with technological changes very great business plan may hit by various events and successes of companies. Private equity not only invests in companies, but they also provide management support and assist in the overall success of companies. The present study discussed on Birth of US Private equity, Indian Private Equity major players, steps in venture capital funding.

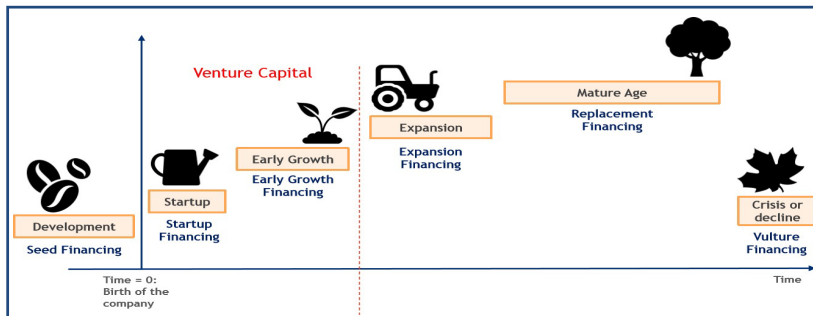
**Keywords:** Venture capital, Private Equity.

### Introduction to Private Equity and Venture Capital:

Private equity or PE denotes investment in the equity of any organization which is not listed on the recognized Stock Exchange. Every business comes across six stages of the life cycle which include; Initial development stage, Start-up stage, Early Stage Growth, Expansion, Maturity, and Decline /Crisis stage. Normally Private Equity investors invest in any company in the initial three stages, this investment called "Venture Capital". The issuing company is known as "Venture-backed company".



Sources: Private Equity and Venture Capital, Coursera.org  
MOOC Course



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Private equity not only becomes an owner or shareholder, but they contribute to the management of the company. Private equity contributes to business management on a large scale if the company is small and investors will be earning profit only through Capital gain through the sale of shares during the exit.

### The Relevance of Private Equity

Venture-backed companies invite Private equity investment not only for raising finances to companies but also for other benefits. These benefits include;

- Certificate benefit: before investing Private equity investors, it completely screens the company performance which confirms the very high quality of accounts and certifies a sign of greater health of the company. This high quality can be used as a promotion for the branding of the company.
- Knowledge benefit: many PE investors with broad experience and knowledge assist in company management decisions as an advisor or a mentor.
- Network benefit: Private equity investor gives the VBC a high level of a network interms of the supply chain, vendors, suppliers of raw materials, customers, service providers or any other supporting entity which multiplying their contacts.
- Financial benefit: the ultimate purpose of the company to get cash, PE investor gives cash in return of equity shares. The funding or cash may improve the cost of capital to VBC.

### Birth of US Private Equity

In the year 1946, 2 venture capital firms: ARDC – American Research and Development Corporation and J H Whitney & Company, planted the US private equity industry. Before World War II, Venture capital investments also earlier known as “Development capital” were primarily the sphere of wealthy individuals and families. The first leveraged buyout was made by J.P. Morgan in 1901 by acquiring Carnegie Steel Company. Georges Doriot considered as” father of venture capitalism” initiated the modern era of private equity, with capital raised from institutional investors, to encourage private sector investments in the business run by soldiers who were returning from World War II. ARDC invested \$70,000 investment in Digital Equipment Corporation (DEC) which created history by ROI of 101% after DEC valued over \$355 million during IPO. Venrock Associates formerly known as Fairchild Semiconductor was the first venture-backed startup founded in 1959.

### Indian Private equity

First India’s private equity initial fund started in the year 1990s by the private equity pioneers. They enjoyed relative prosperity during the initial state due to the challenges of convincing both

perspective limited partners and entrepreneurs. During 2000- 2005, the Indian private equity landscape, dramatically changed as it began to take its place on the world stage. Due to liberalization, increased GDP, lower inflation, newer market opportunities new venture capital investment started opening up. In 2001 Jim O'Neill- Goldman Sachs identified India is a promising BRIC country that eventually overtakes the developed nations and becomes a leader in a global economy. Private equity investment can offer very strong returns in comparison to any stock market returns or public market investment opportunity.

They typically raise a significant amount of debt to purchase the assets and minimizes initial equity investment.

### Major players in the Indian Venture Capital Market

- ICICI Venture fund management: subsidiary of ICICI bank, located in the commercial capital of India, Mumbai raised almost 3 billion dollars in the last decade.
- Kotak Private Equity Group: the company makes major investments in health care and infrastructure in India. Started in 1997, one of the most esteemed PE firms in India raised more than 2.8 billion dollars.
- Chryscapital: started in the year 1999, invested more than 50 projects, and raised more than 2 billion dollars in PE fund. The head office located in New Delhi.
- Sequoia Capital: world-class PE firm, invested more than 2 billion in Indian energy, consumer goods, and financial services in the last decade.
- Blackstone Group: started in 2006, invested more than 2 billion in diversified infrastructure and the real estate sector.
- India Value Fund: formerly known as GW capital, established in the year 1999 Mumbai, raised 1.4 billion dollars and the whopping sum is divided among four funds.
- Baring Private Equity Partners: The oldest Private Equity firm started the journey back in 1988. The company raised 1.1 billion and invested 53 different investments across a different domain.
- Ascent Capital: known for entrepreneur funding helped 40+ start-ups to achieve their dreams. Currently managing 600 million dollars divided into three funds.
- Everstone Capital: established in 2006, the firm primarily focuses on clothing and Engineering firms. They are currently managing around 425 million dollars of funds.

### Process of Private Equity and Venture Capital

Every private equity follows 4 major steps which include; Fundraising, investing, Managing & Monitoring, and finally exiting.

#### Step 1: Fundraising

- **Creation of business idea:** PE firm prepares investment plan, check the prospects of the investment unofficially in the PE market. PE prepares "Information Memorandum, which includes; choice of vehicle, target sector/area/life cycle stage of investment, size, funding size, corporate governance rules, the track record of promoters, leverage usage, and costs.
- **Selling Job:** PE markets and convince investors to contribute to PE fund through a formal agreement. Investors can be HNI, Insurance companies, or a bank/financial institutes.
- **Debtraising:** debtraising so selling job, but PE firm in debtraising approach a bank to contribute their share into the fund.
- **Closing:** depending upon the reputation and purpose of funds, the deal can be closed in two ways; "Successful closing" – a collection of money for investment, and "Pure Closing" where deal closed and unable to collect money.

Step 2:

**Investing:** technical and advisory committee follow 2 processes in the investing stage

**Decision Making:**

- **Origination:** identifying the companies for investment may be Spontaneous – when all companies know your PE and offer you to invest or Proactive – where PE firm searches for companies.
- **Screening:** among the listed for investment, technical committee screen out few companies in alignment with fundamentals and prospectus.
- **Due diligence and valuation:** valuation and assessment of companies of each screened firms. Due diligence takes a longer time.
- **Rating and negotiation:** The committee and managers rate every company according to risk and return profile. Negotiation steps include a discussion with the entrepreneurs regarding the requirement of money and the number of shares to be issued against the equity.
- **The decision to invest:** after approval of board members and general partners, the manager decides to invest.

**Dealmaking**

- **Targeting:** Firstly, the decision on Direct – investment directly by PE firm or indirect investment – through the creation of a special purpose vehicle. Direct control gives a strong commitment among investors, whereas indirect investment involves debt with limited control. Secondly, the percentage of shares the PE firm has to buy and their role with that amount of equity.
- **Liability Profile:** opting for Syndication strategy – to convince other PE investors to invest in that company together or Debt issuance – to raise debt either by issuing bonds by SPV or obtaining loans from the banks/financial institutions.
- **Engagement:** setting up rules and regulations to govern the Venture-backed company. It includes the category of capital, paying policy, and governance rules.

**Step 3: Managing and Monitoring:**

- Actions to generate Value: depends on the life cycle of an investment firm and nature of PE firm some action plans will be taken, which include; board services, recruiting management, performance review, and mentoring and relationship management.
- Actions to protect the value created: it covers duties, rights of investors, entrepreneurs, and shareholders, which includes: lock up, permitted transfer, staging techniques, stock option, tag-along rights, right of first refusal, and exit ratchet.

**Step 4: Exiting**

- PE firms want to exit or come out of an investment is the last stage in Venture capital.
- PE firms can follow the different alternative ways of exiting the investment.
- **Trade sale:** selling it to another entrepreneur or corporation
- **Buyback:** sell to existing shareholders or entrepreneurs.
- **Initial public offer:** offering shares to the public for the first time, where the Venture-backed securities should be very attractive.
- **Write off:** canceling the shares/stake in the firm in case of default by the company.

## Conclusion

The world is moving rapidly, our tastes and needs are changing dramatically, where a change in technology changes our everyday habits and our activities and events are affected on a worldwide basis. With the changes in today's fast-moving environment, if you have a great and professional business plan, businesses can be hit by various factors in other places in the world that can reduce the value of the company and the success of the company. Private equity funds are looking for ever-changing ideas to invest and PE's have the attitude and willingness to invest in corporate change. Private equity likes entrepreneurs with a great track record, with a successful expansion/growth stories, compliance /due diligence management and proven management teams. The companies need to distill to change in their business model to overcome crises and providing new products/ services to their client.

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