



## CHALLENGES FACED BY PRIVATE EQUITY INVESTORS IN TAMILNADU: AN ANALYSIS

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**ABSTRACT** Private Equity Investments have been a part of India's emerging story about a decade which has seen a multitude of events that have shaped the investment climate in India. The country's growing global stature, a far more open economy coupled with positive indications of reforms and perception of value residing within the fabric of the economy, encouraged investments into the country. Between 2001 and 2017, Private Equity funds invested more than \$175 billion in India and establishing Private Equity as a stable source of equity capital across several business cycles. The investments have been made across regions of the country. The investors involved have been facing the pros and cons on their path of earnings. The present study has been made as an attempt to analyse the challenges faced by the investors involved in making the private equity investments in Tamilnadu.

**KEYWORDS :** Private Equity Investments, Private Equity Funds, Economy and Challenges.

### INTRODUCTION

Globalization has become the norm across the world where over the past few decades; financial investors in developed countries have increasingly diversified their portfolios with a view to broadening their exposure to different sectors and regions within an ever-changing global financial structure, while still seeking higher returns on invested capital. It's no secret that the world is changing faster than ever before. The forces of globalization, technological advancement and demographics are powering dramatic changes to the ways of living, business, communication, travel and trade. Amidst this rapid change, global governments are struggling to respond and adapt. In relation to the aforesaid facts and in contradiction to the public equity market, an innovative and alternative asset class refers to medium to long-term capital investment platform in the primary equity of private companies named Private Equity investment came as an avenue for investment seekers.

The international Private Equity landscape has developed significantly in recent years. Until the recent credit squeeze, deal sizes were ever increasing, the market was highly competitive, high premiums were being paid, and many trade buyers have often lost out to Private Equity houses. Private Equity companies got interested in the Indian Market during the mid-1990s, when the unfolding of the process of liberalization and globalization generated a lot of global interest in the Indian economy. The Indian Private Equity market is attractive for many reasons. Firstly, because of its entrepreneurial status, secondly, the associated ease and benefits of an English speaking culture, thirdly, an investment base that truly understands the multiple opportunities for Private Equity, and finally a developing infrastructure with strong underlying economic growth.

India has been the fastest-growing Private Equity market in Asia along with China and Japan. India's fundamentals will continue to attract eager Private Equity investors and the pace and strength of the industry's future growth would be accelerated if valuations in India become more attractive and exits continue to build on the momentum as on progress. Indian promoters are gradually coming to recognize Private Equity as a patient source of active capital that can help building their businesses.

### REVIEW OF LITERATURE

**Brad Young (2014)** stated that there are many challenges for the institutional private equity investor – of course with those challenges come real opportunities for well-informed, well-positioned investors. With each of the challenges proper knowledge, accompanied by proper execution will allow for strong portfolio performance, indeed for the outperformance that all investors are seeking from the asset class.

**Mark Humphery-Jenner (2012)** examined the challenges why large PE funds earn lower returns. He argued that large PE-funds are suited to making large investments and small PE-funds are suited to nurturing start-ups. Thus, the suboptimal investment in small companies is one driver of the size effect in private equity. A theoretical model and

empirical results from a sample of 1222 funds in the United States support this prediction. The largest 25% of PE funds earn IRRs of 5.17% when they invest in the largest 25% of companies but only -2.98% when they invest in the smallest 25%. This suggests that investment size is a driver of the size effect in private equity.

**Sahil Sandhu and Namrata Sandhu (2012)** stated that there exist six significant challenges facing the Indian private equity industry: deteriorating economic climate, ethical/regulatory concerns, poor performance, competition, illiquidity and lack of professional expertise. In the wake of these challenges there is a need to proceed with caution. The study further concluded that The extreme lack of credit in the Indian industry viz-a-viz the foreign industries may be on account of the many challenges faced by the Indian private equity industry. Therefore, the challenges facing this industry must be meaningfully combated before this industry can take the desired shape.

### STATEMENT OF THE PROBLEM

The Indian economy has been a planned economy and thus becoming a safe and attractive destination for foreign investment. Ever since Indian economy underwent series of reforms in 1991, there have been progressive steps in banking, finance, industry, investment climate, income, employment, etc. India has enjoyed an average growth rate of 7-8 per cent per annum in GDP growth in the recent years and investments from FII's, increased FDI in several sectors, surging Foreign Exchange reserves, deregulation of interest rates, etc., have all been witnessed in recent years.

After 2008, more Greenfield investments emerged, macroeconomics and government policy delays worked against infrastructure companies and returns dropped steeply. Moreover, with higher inflation, while revenue grew for all sectors, profits did not grow at the same pace. By 2013, the 25 largest Private equity firms in India had at least one infrastructure investment in their portfolio, and altogether, this type of asset represented 43% of the \$77 billion Private equity firms invested in India between 2007 and 2013. Beyond specific sectors, this excessive optimism also led to about 75% of new investments being made at valuations higher than the median for the previous 15 years.

Having an affirmative growth in the sub-continent, the Private Equity Market has been scattered all over the country. The Chennai region (Tamilnadu) has shown the considerable development in the past few years competing with National Capital region (NCR), Mumbai, Delhi, Bangalore and Hyderabad regions. Though, the region stands back to other major regions of the country, the growth of the market has been phenomenal where the number of deals involved is sustaining year by year. As the quantity of investments raises, the problem pertaining to the process also raises steadily, which may be systematic or non-systematic. Hence, with the basis of aforesaid facts the researcher intended to identify the answer for the following research question;

1. What are the problems faced by Private Equity Investors in

making investment in Tamilnadu?

**RESEARCH OBJECTIVES**

Based on the aforesaid problem, the following research objective has been formulated;

1. To identify the problems faced by investors in making Private Equity Investment in Tamilnadu.

**HYPOTHESIS**

Based on the above objectives, the present study attempts to test the following hypothesis;

**H<sub>01</sub>:** The problems of Private Equity Investment have no difference among the investors based on their demographic classification.

**RESEARCH DESIGN**

**SOURCES OF DATA**

The study is based on primary data and the required data for the study will be collected and compiled from the private equity investors using the mailed questionnaire method. In addition, the other required data will be collected from various websites, journals and magazines.

**SAMPLING DESIGN**

The census method is being adopted to pick the 313 samples, who are Private Equity investors of Tamilnadu.

**FRAMEWORK OF ANALYSIS**

The collected data will be used for analysis with the help of econometric and statistical tools. The statistical tools to be applied are;

1. Simple Percentage Analysis
2. Friedman's Rank Test
3. Analysis of Variance

**SCOPE OF THE STUDY**

The present study is an analytical research on the challenges by private equity investors in Tamilnadu. It aims to spotlight the major problems that an investor would face during the tenure of his/her investment.

**LIMITATIONS OF THE STUDY**

The study has the following limitations;

1. The study has been made in consideration with the locality of Tamilnadu and the results and suggestions may not be applicable to other parts of the country.
2. The data collected will depict the attitude of respondents which may be self-biased.

**ANALYSIS AND DISCUSSION**

**TABLE – 1: DEMOGRAPHIC CLASSIFICATION OF RESPONDENTS**

S. No	Particulars	No of respondents	Percent age (%)	
1	Gender	Male	301	96
		Female	12	04
		Transgender	-	-
2	Age	Less than 25 years	12	04
		Between 25 and 35 years	20	06
		Between 35 and 50 years	184	59
		More than 50 years	97	31
3	Area of Residence	Non-Urban	26	08
		Urban	287	92
4	Educational Qualification	School Level	07	02
		Under Graduate	215	69
		Post Graduate	59	19
		Professional	32	10
5	Association in Private Equity	Whole time	245	78
		Part time	68	22

6	Years of Association	Less than 01 year	29	09
		Between 01 and 03 years	110	35
		Between 03 years and 05 years	25	08
		More than 5 years	149	48
7	Source of Awareness	Mass media	103	33
		Persons dealing with	122	39
		Approach from the needy	71	23
		Others	17	05
8	Initial investment	Less than 10 lakhs	105	33
		Between 10 and 20 lakhs	154	49
		Between 20 and 30 lakhs	43	14
		More than 30 lakhs	11	04
9	Annual investment	Less than 10 lakhs	61	19
		Between 10 and 20 lakhs	12	04
		Between 20 and 30 lakhs	108	35
		More than 30 lakhs	132	42
10	Reinvestment	Less than 25 per cent of earnings	39	12
		Between 25 and 50 per cent	54	17
		Between 50 and 75 per cent	178	57
		More than 75 per cent	42	14

Source: Primary data

The above table represents the demographic classification of Private Equity Investors of Tamilnadu, who have been taken as samples for the study. The numbers of various heads and their classification along with the cumulative percentage have been presented in the table. It is clear from the above table that majority of the respondents are male (301), the age of between 35 and 50 years (184) are the leading group of respondents involved in PE investments, the respondents belongs to urban residence (287) are the majority than non-urban residences, most respondents are under graduate (215), respondents at the highest are whole time investors (245), respondents at their best are involved in more than 5 years in the field (149), most respondents get awareness through persons dealing with (122), almost half of the respondents had started their investment worth between 10 and 20 lakhs (154), majority of the respondents having their annual investment worth more than 30 lakhs (132) and most respondents have the habit of reinvesting between 50 and 75 per cent out of their earnings (178) respectively.

**Table – 2: PROBLEMS FACED BY PRIVATE EQUITY INVESTORS: FRIEDMAN'S RANK TEST**

Source: Primary data

Problems of Private Equity Investors	Mean score	Rank
Irregular dividend	5.84	11
High risk	6.58	1
Information unavailability	6.48	3
Scarcity of capital appreciation	6.54	2
Less safety	6.02	9
Lack of liquidity	5.98	10
Hedging problems	5.45	13
Queries and its responses	4.90	18
Severe competition from strategic buyers	4.43	19
Increasing regulatory barriers	5.29	15
Tight profit margins due to the economic conditions	6.32	4
Understanding the increasing number of investment strategies and working out to find the best	5.27	16

High valuations	6.31	5
Digitizing the operations to stick to the reporting requirements, etc	5.32	14
Transparency	5.76	12
Management shifts	4.22	20
Improvement in corporate governance and reporting practices	5.12	17
Fewer companies in the market	6.18	7
Risks from non quoted companies	6.11	8
Funding risk	6.20	6

The problems faced by investors while making private equity investment in Tamilnadu is being presented in the table 2. The problems are being ranked according to the mean scores. Higher the mean score better will be the rank. The total of twenty variables have been analysed amongst which the problem named high risk is being ranked first followed by scarcity of capital appreciation at second, information unavailability at third, tight profit margins due to the economic conditions and high valuations at fourth and fifth ranks respectively. The problems named queries and its responses, severe competition from strategic buyers and management shifts occupied last three spots based on mean scores respectively.

### ANOVA OF PROBLEMS OF PE INVESTORS AND THE DEMOGRAPHIC CLASSIFICATION

$H_{01}$ : The problems of Private Equity Investment have no difference among the investors based on their demographic classification.

**TABLE – 3: PROBLEMS OF PRIVATE EQUITY INVESTORS AND THE DEMOGRAPHIC CLASSIFICATION - ANOVA**

S. No	Dependent Variable	Independent Variable	F	Sig. value	Hypothesis
1	Problems of PEI	Gender	139.25	.847	Accepted
2	Problems of PEI	Age	128.25	.025*	Rejected
3	Problems of PEI	Area of Residence	158.32	.011*	Rejected
4	Problems of PEI	Educational Qualification	124.21	.041*	Rejected
5	Problems of PEI	Association in Private Equity	155.30	.629	Accepted
6	Problems of PEI	Years of Association	188.36	.048*	Rejected
7	Problems of PEI	Source of Awareness	198.32	.021*	Rejected
8	Problems of PEI	Initial investment	88.32	.088	Accepted
9	Problems of PEI	Annual investment	101.36	.582	Accepted
10	Problems of PEI	Reinvestment	98.22	.368	Accepted

**Source:** Primary data

The above table depicts the analysis of variance between problems of private equity investors and their demographic classification. It is clear from the table that the demographics namely age, area of residence, educational qualification, years of association and source of awareness have their significance less than 5 per cent and hence it is inferred that the null hypothesis is rejected for those. For the rest of demographics whose significance is higher than 5 per cent, the null hypothesis is accepted.

### Suggestion and Conclusion

Contemporarily, Private Equity have become a crucial source of finance for corporate and has earned the status of an important asset class. With an expanding domestic market and additional opportunities brought by globalization, the impact of private equity on Indian business is likely to increase in the coming years. However, the rapid growth and globalization of the PE industry has raised demands for increased regulation and disclosure within the sector due to concerns regarding anti-competitive behavior, excessive tax benefits and stock manipulation. With growth in the European markets almost becoming stagnant and other countries in the globe in equally tight economic conditions, India and parts of Asia and Africa are believed to be experiencing the next phase of the growth. The study so reviews the problems of investors of private equity in Tamilnadu, where policy and regulatory support would sustain the same level of or attract even higher investments in the coming decade. Information availability and transparency through effective governance can further strengthen the market structure.

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