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Private equity in Modi's India

Singapore Management University

PRIVATE EQUITY IN MODI'S INDIA

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There are plenty of opportunities for PE investors in India but make sure you do your homework

In October 2014, the Singapore government-owned investment firm, Temasek Holdings, struck a deal to buy a stake in Indian restaurant chain operator, Devyani International. Temasek will commit 5 billion rupees (about US$82 million): 1 billion rupees to buy an existing stake in Devyani from ICICI bank, and invest another 4 billion rupees directly into the company, which is the largest franchisee of Kentucky Fried Chicken (KFC) and Pizza Hut in India.

According to consultancy and professional services firm, Grant Thornton, private equity (PE) investments in India for the first nine months of 2014 was US$8.4 billion, up from US$7.4 billion for the same time period in 2013. Much of that is the result of the current macroeconomic environment.

"At a macro level, India is well poised," explains **J. Niranjan,** Chief Executive Officer of *Tata Capital Pte Ltd (Singapore)*. "Inflation is slowing down, and it helps that China is slowing down so it doesn't heat up the commodities, particularly oil. That's because the fiscal deficit situation in India is dependent on oil and commodity prices.

"Even more so than the 2006-2008 phase, the macroeconomic conditions may be more conducive for Indian growth going forward. Once the deficit comes under control and inflation – along with interest rates – comes down, we expect corporate growth to kick in. When that happens, corporate investments go up, and that's where our business comes in."

A different mindset is needed for success in emerging markets

"Our business" in Niranjan's case would be PE investing: Tata Capital has about a billion dollars under management in five funds, with a fifth of that amount coming from India and the rest being international money. Niranjan points out the importance of PE to India: about 50 percent of Foreign Direct Investments into India are PE investments.

Investment in India is expected to pick up significantly thanks to Prime Minister Narendra Modi's pro-business reputation and policy moves. The Bombay SENSEX stock index has repeatedly broken all-time highs since Modi's Bharatiya Janata Party (BJP) swept into power in May, which is as much a reflection of and as it is cause of the upbeat business sentiment. However, PE professionals issue a word of caution: investing in India is not easy.

“If you want to go into the PE industry in emerging markets, you need a different mindset,” advises **AST Rajan**, Managing Director of *Aquarius Investment Advisors Pte. Ltd. “*Within the emerging markets, if you want to do so in India and China, you need another sub-mindset because no rules apply.”

Rajan gave the example of Chomamandalam DBS Finance, the Development Bank of Singapore’s (DBS) unsuccessful venture with India’s Murugappa Group.

“The company gave out nearly US$250 million in consumer loans, of which 80 percent of them went belly up. DBS filed more than 1,800 cases to recover the money; they were unsuccessful. Eventually, they sold their stake (37.48 percent) back to Murugappa.”

DBS has since learnt from that experience, and is running a profitable operation in India (see here). Rajan uses it to highlight an important lesson: “Don’t invest in what you don’t understand, and don’t invest in places where you cannot cope.”

Know your business

Amit Manocha is a positive example of that advice. The Managing Director of Everstone Capital brought fast food giants Burger King to India, and his company has a majority stake in the Indonesian franchise for Domino’s Pizza. It would be fair to say that he understands the Indian restaurant business.

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“An Indian eats out 1.3 times a week when we started investing six years ago; today the number is closer to three,” says Manocha. “As consumers have more money to spend, as they get more exposed to the international brands, they want to go out and shop, and eating and shopping go hand in hand.

“Seven years ago, Domino’s Pizza had 82 stores in India; today it’s 794. Once you’re used to ordering food at a certain price point, you seldom come down unless something goes horribly wrong in your economics.”

Rajan was also involved in the Indian food business. In 2000, his company invested about US$1 million in MTR Foods and helped funded its expansion into becoming one of India’s largest processed food makers. He exited – profitably – in 2007 when Norwegian food giants Orkla Foods bought MTR for US$80 million.

Among the many industries that Rajan has invested in, he singles out the healthcare business as one with immense potential.

“You go into any hospital, and there isn’t even any space to stand. And if you look at the cashier, there is a big queue to pay. Despite that, no hospital has made money in India. The issue is: India is a cash-based economy. If you want to pay with your credit card, the cashier will say, “I’ll charge you two percent more.” So people draw cash from the ATM and pay with cash. Therefore, controlling the bottom line becomes very difficult at hospitals.”

He adds, “Also, hospitals in India are not corporatised. People go to the hospital because of the doctor, and as a result most of the revenue goes to the doctor irrespective of the bottom line. On top of that, medicine is not dispensed within the hospital but patients are made to go to an external pharmacy that has an arrangement with the doctor who runs the hospital. If we can sort out these issues, hospitals will be profitable.”

All this business optimism stems from the economic reforms installed by the new government. While things are looking up, Manocha cautions that there remains plenty to be done.

“As the ease of setting up a new company or doing business is concerned, there are a few things to be done, such as getting a license to do business, and simplifying the entire taxation regime and Goods and Services Tax (GST). We are still not there but we are getting there. Some fundamental changes need to happen more quickly, and GST is one of them.

“Every state in India has a tax law, and beyond the cost there is time lost as well in dealing with this. For a new business to set up shop, they have to make sure their intellectual property rights are protected. They also need to train people, so there is plenty to do. The government is focusing on the right issues, and I am confident that in two to three years, we’ll have a conducive environment in which to do business.”

J. Niranjan, AST Rajan, and Amit Manocha were panel speakers at “Inside PE: Modi’s India, A new dawn for private equity?” organised by The Asia Private Equity Club@SMU on October 30, 2014.