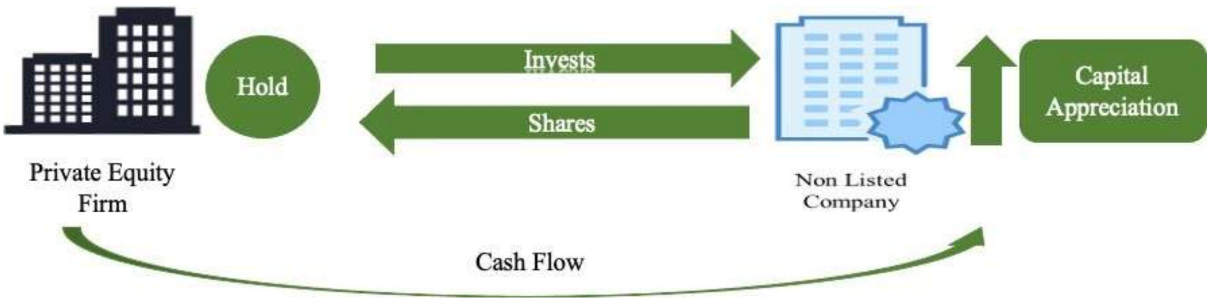
Private Equity and Venture Capital

The first aspect of PE is as a source of financing. Companies need money to operate and they can raise money through various methods that include loans, the stock market or internal accruals. One of the methods through which a company can raise money is Private Equity.

The second aspect of PE is as an investment. From a financial institution standpoint, a private equity investment is defined as an investment made in the shares of a non-listed company.

Venture Capital is also a term that is commonly used along with Private Equity. VC is a case of PE when an equity investment is made in the very early stages of a company's life cycle.



In a private equity or a venture capital deal, the investor purchases shares of the company that she invests in. The primary benefit for the investor is the shares that she goes on to hold. The primary remuneration for an investor in a private equity investment is capital appreciation. It means that the investor expects that the value of the shares that she has purchased would increase as the company does well due to the cash inflow that it has received from the investor.

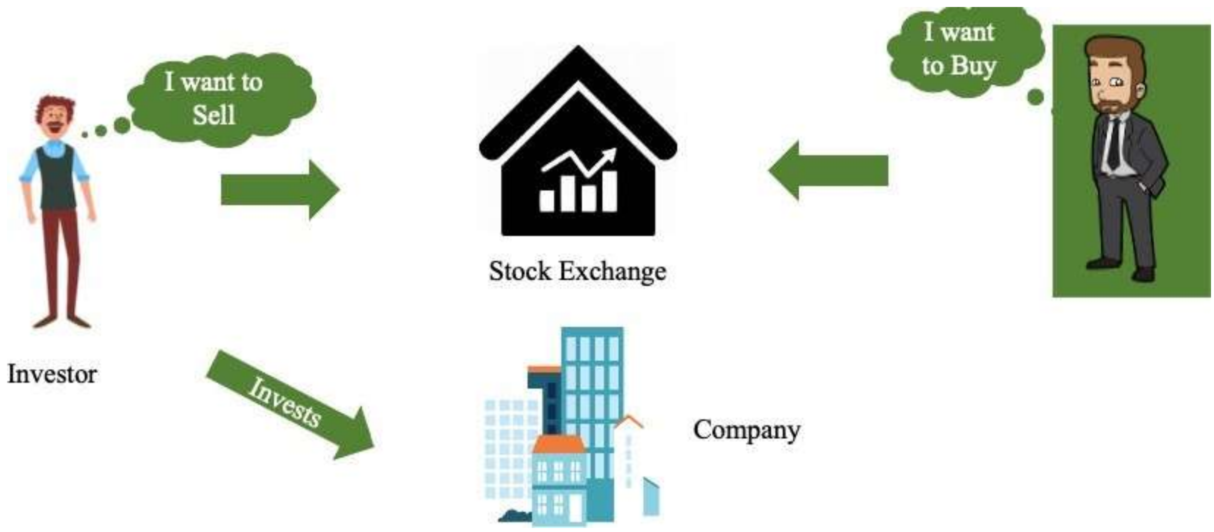
Important Characteristics of Private Equity and Venture Capital Investments

1. Pricing

In public markets; the share price of the company is driven by market forces. If an investor wants to invest in the equity of a company that is listed on the stock exchange, she can easily find out its price as it would be available on the exchange. As private equity investment is mostly done in the shares of companies that are not listed on the stock exchange, the share price of the company would then be fixed as a process of negotiation between the investor and the management of the company.

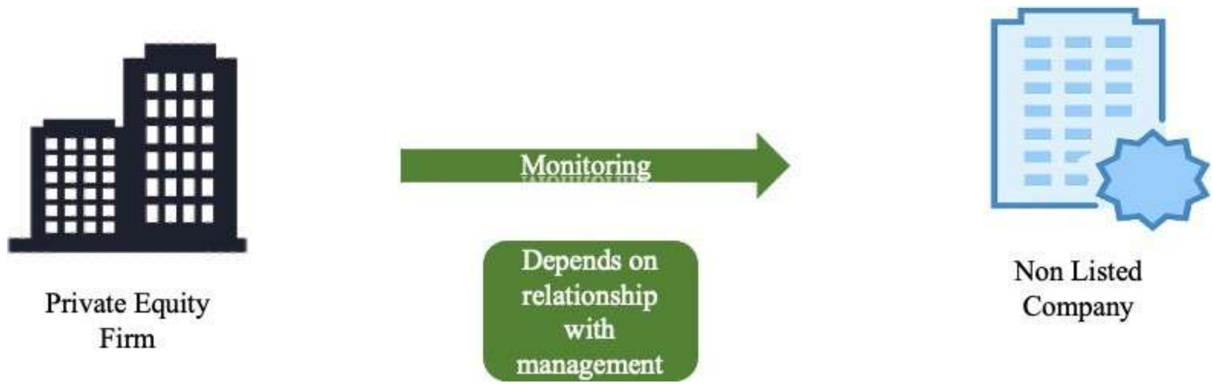
2. Liquidity

Whenever an investor invests in shares of a company listed on the stock exchange, she finds it very easy to sell those shares. Whenever she wants to sell them, she can always find a buyer, through the stock exchange itself. This is generally not the case with a private equity investment. As a PE investment is done in companies that are not listed on the stock exchange, in case an investor wants to sell the shares of such a company, in many cases, it can be very difficult to find a buyer. Also, it is important to keep in mind that not only is finding a buyer difficult but negotiating the price with the buyer can also be a task.



3. Monitoring

In case of companies listed on the stock exchange, there are tremendous disclosure requirements that they have to comply with, which help investors monitor and track their progress. In case of private companies, monitoring their progress can also be quite difficult and in many cases, it is dependent on the relationship shared by the management of the company and the investors. In more recent times, Governments have come up with many rules and regulations related to reporting standards of private companies. However, those can never be as stringent as publicly listed companies.

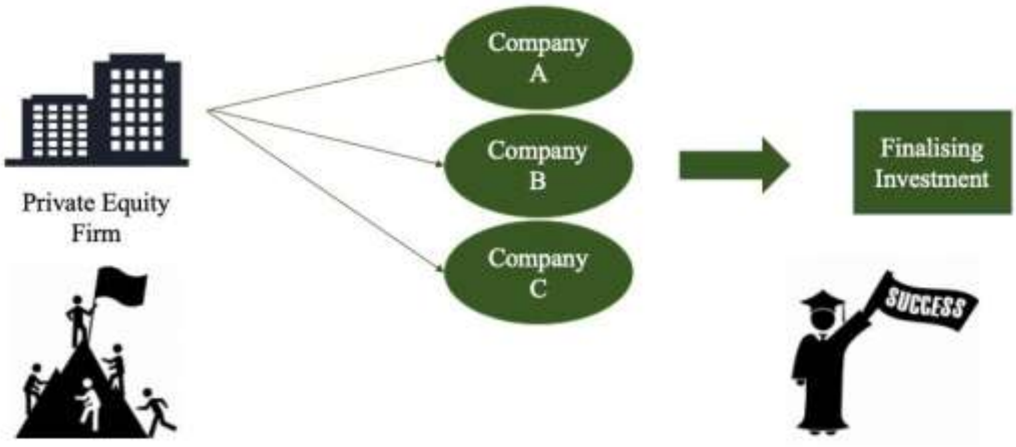


Benefits of Private Equity

There are four primary benefits that a company gets:

1. Stamp of Quality

Before investing in a company, the Private Equity investor, be it a fund or an individual, it goes over a long drawn process of shortlisting companies, engaging with them and then finalising a company for investment. The fact that a company has not only survived such a competitive process but also emerged successful in it – shows the sheer quality of the company. Hence, a private equity investment acts as a stamp of quality for the company.



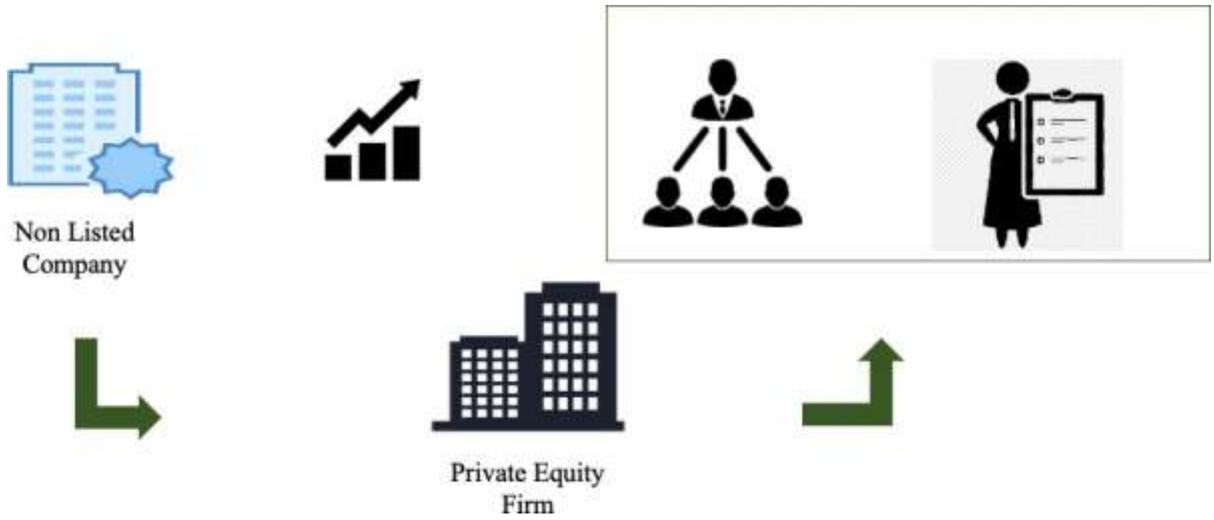
2. Network-Driven Benefits

Due to the high value of transactions and varied industry segments that Private Equity firms and investors work & deal with, they are tremendously well connected in the broad business ecosystem. Therefore, when they invest in a company, the company access to this ecosystem that can prove pivotal for its future growth.

3. Advisory Benefits

There are two ways that a private equity investor also acts as an advisor to the company that she invests in.

a. When a company grows, it is faced with many non-core but extremely important issues. These important non-core issues include organization building, increasing regulatory compliance that comes as a result of growth among others. As the PE investor has been through the same cycle with many companies in her portfolio; she is an able advisor to a new company that she has invested in and is going through the cycle.



b. Certain private equity funds and investors only look to invest in specific sectors. When a company raises funds from a sector specific investor, the advisory function of the PE investor shifts from a non-core aspect to a core aspect. The PE investor is an able advisor on core business and product developments.

4. The Financial Benefit

From a financial standpoint, the company benefits from two aspects:

The PE investor infuses cash in the company that helps it grow. In case the company has debt, an equity infusion helps in two aspects:

- It helps the company to reduce its debt to equity ratio.
- A reduced debt to equity ratio puts more confidence in banks and financial institutions to lend as well. Therefore, in case the company wants to raise debt going ahead, it is in a better position.

Type of Private Equity Investments

The type of private equity investment depends upon the stage that the company is in.

1. Ideation Stage

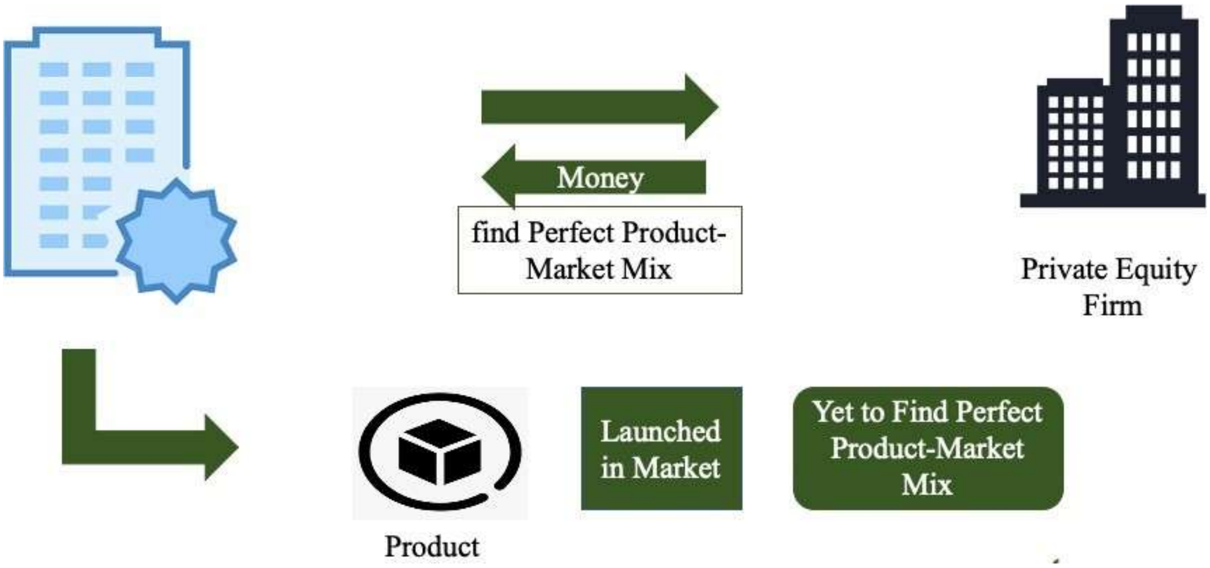
This is the first stage at which an entrepreneur can look to raise money. When an investment is made in an idea, the product of the company is still in development stage and has not launched. It has to be a really high potential idea to garner investment in this stage. In practice, an idea needs to have two qualifications in order to get investments in this stage:

- The idea should be creating intellectual property using technology
- At the same time, the idea needs to have a wide target market.

The funds that are raised in this stage are used to develop the product.

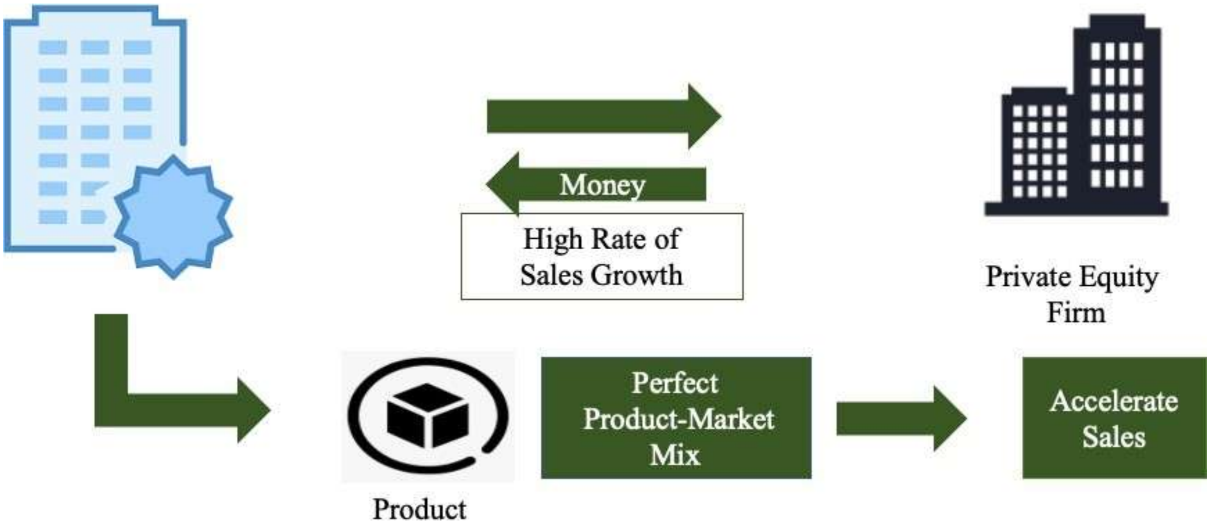
2. First Stage of Commercialization

This is the second stage in which a company can look to raise money from private equity investors. In this case, the company has already launched its product in the market. In this case, the product is getting traction but the company is yet to discover the perfect product-market fit for its product. This money is broadly used to discover this product market fit.

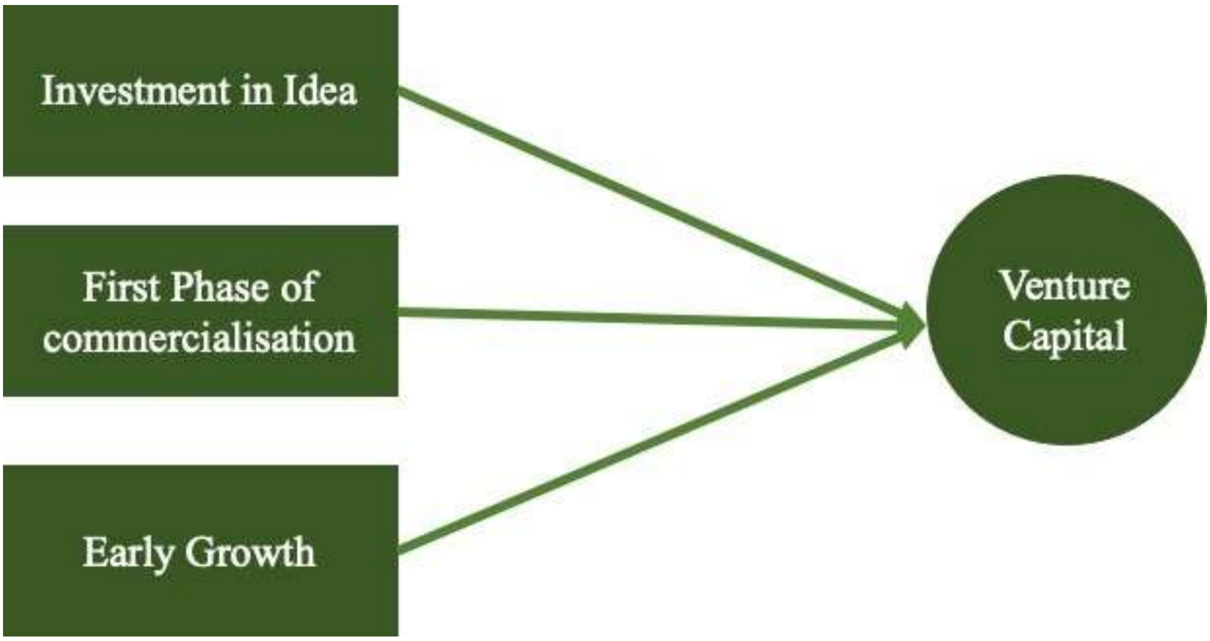


3. Early Growth Stage

This is the third stage in which a company can look to raise money from private equity investors. In this case, the company has discovered the correct product-market fit for its offerings and now wants to accelerate usage and sales. The money raised in this phase is used for getting a high rate of sales growth.

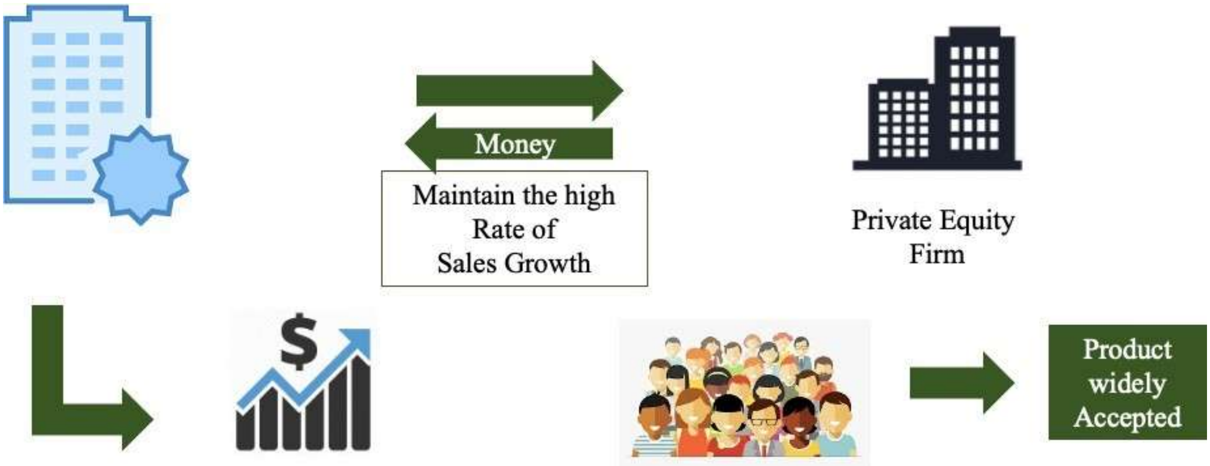


Venture Capital investments primarily belong to the first three stages of the company life cycle.



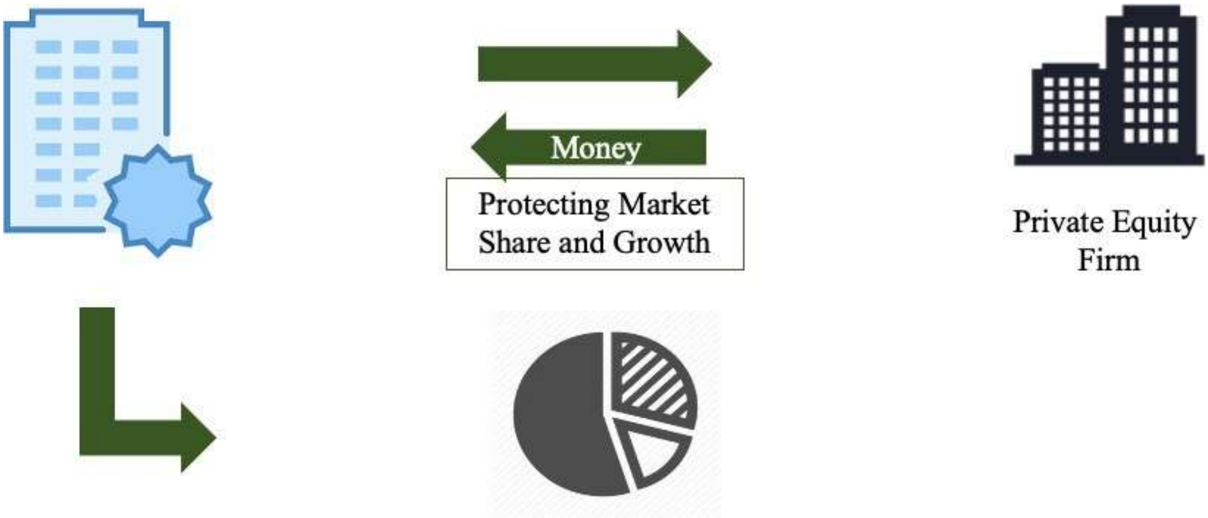
4. Growth Stage

This is the fourth stage in which a company can look to raise funds from private equity investors. In this case, the company's sales are already growing at a very high rate and its product has been widely accepted in the market. The raised funds are used to maintain the growth rate that the company has achieved.



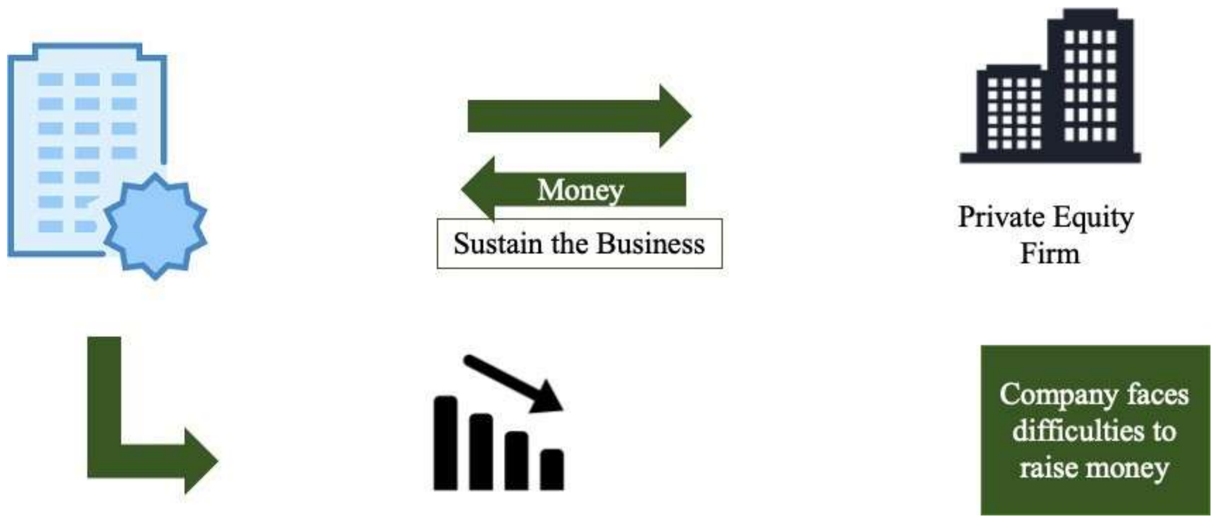
5. Investing Stability

This is the fifth stage in which a company can look to raise funds from private equity investors. In this case, the company's offerings have already achieved a significant market share in its line of business. Protecting its market share, while growing at the same time are the primary reasons for the company to raise money.



6. Investing in Crisis

This is the last stage in which a company can look to raise funds from private equity investors. In this case, the company's has seen a decline in growth and needs money to sustain its business. This is not an encouraging scenario and generally it is quite difficult for a company to raise investment at this stage.


Money
Sustain the Business
Private Equity Firm
Company faces difficulties to raise money