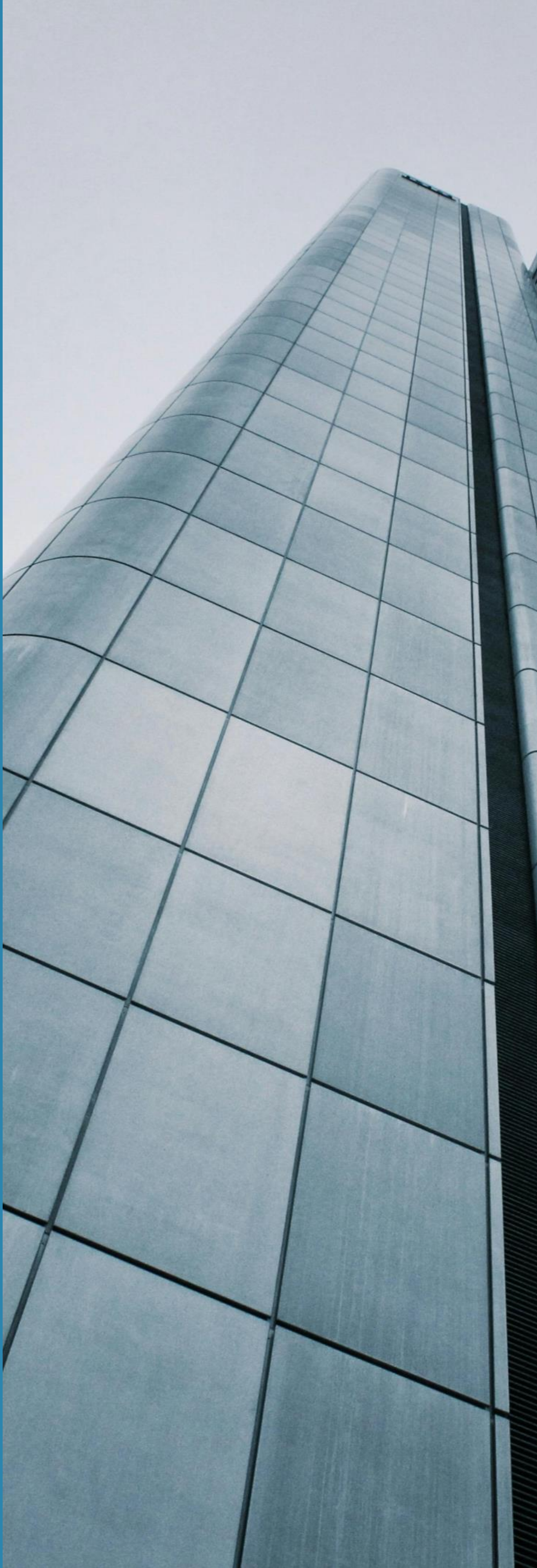

Understanding PEVC and the Nepal Context

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Contents

Understanding Private Equity Investment and its need

Private Equity (PE) is a source of financing: It is an alternative to other sources of liquidity, (such as a bank loan or an initial public offering (IPO)) for the company receiving the financing. PE is an investment made by a financial institution: Private Equity Investor (PEI) in the equity of a non-listed company (i.e., not a public company). The investor gets shares of the equity of the company in return for the inflow of cash.

Q. Why do we need Private Equity were banks not enough?

Private Equity (PE) exists because banks and traditional loans can't meet all the financial needs of businesses, especially in high-risk or complex situations.

1. Banks Lend Money, But PEI Invests & Fixes the Businesses

- Banks → Give loans (must be repaid + interest).
- PE Firms → Buy ownership stakes, bring expertise, and actively improve the company.

Example: If a struggling restaurant chain needs cash, a bank may refuse a loan (too risky). But a PE firm like might buy it, cut costs, rebrand it, and sell it later for profit.

2. PEI Helps Companies Banks Won't Touch

There are some situation where bank wont provide funds:

Situation	Bank's Response	PE's Response
Startup with no Profits	No loan (too risky)	VC invests for equity
Failing Businesses	No loan (high chance of default)	Buys & restructures
Massive buyouts	Won't lend that much	PE pools investor money
Long-term turnaround (5-10 yrs)	Loans due in 3-5 years.	Hold for years

3. PEI Brings More Than Just Money

The Network Benefit: The PEI can give the company a very strong network, in terms of suppliers, customers and banks therefore multiplying its possible contacts.

The Knowledge Benefit: The PEI can transfer the knowledge to the company:

Soft Knowledge: the capability to manage the business.

Hard Knowledge: Specific field knowledge of a business, this applies particularly to high-tech or pharmaceutical industries

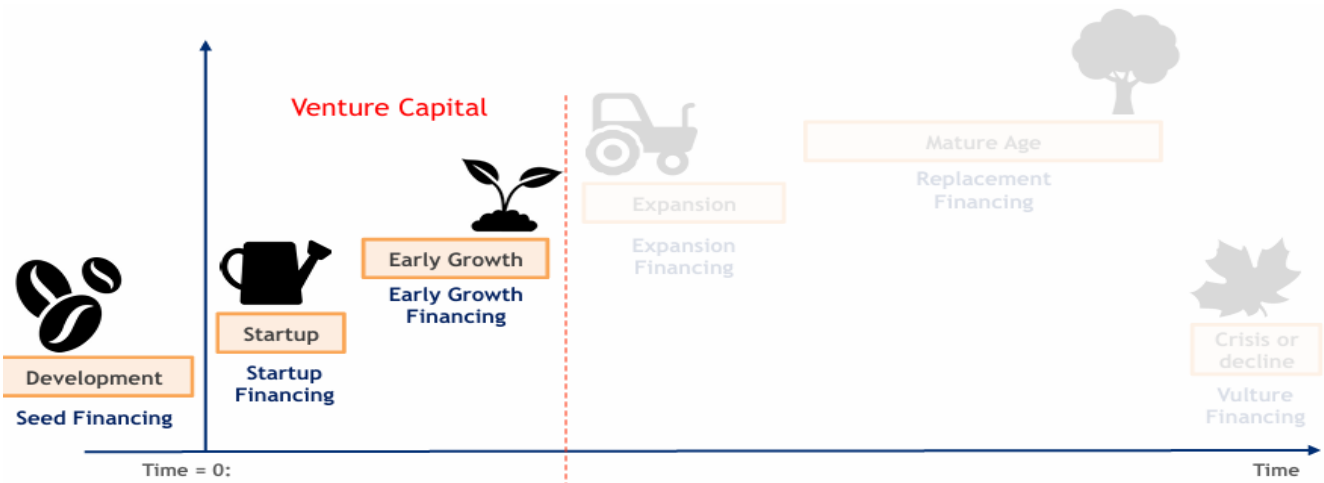
The Certification Benefit: Due to the long screening phase before deciding to invest in a company, if the PEI finally does choose to invest in the venture-backed company, in a way, that confirms the very high quality of the company's accounts. This can give a sign of great health of the company and this high quality can be used as a kind of promotion for the venture-backed company's brand.

Q. What is the difference in Private Equity and Venture Capital?

To understand the difference between PE and Venture Capital lets take a look at different stages of a business and financing terms:

1. Development: The life cycle begins with development. This is when founders create and refine their business idea. The corresponding Private equity investment at this stage is seed financing.
2. Startup: This phase marks the official launch of the business. The PE investment associated with this stage is referred to as startup financing.
3. Early Growth: At this stage, the company enters its initial growth phase, often termed "the financing of the day after" in professional circles. The PE investment here is called early growth financing.
4. Expansion: During this phase, sales experience rapid and sustained growth. The corresponding PE investment is known as expansion financing.
5. Mature Age: This is when sales growth stabilizes. The PE investment at this stage is referred to as replacement financing.
6. Crisis: If the company enters a period of decline, securing PE investment becomes challenging. In such cases, the financing is termed vulture financing.

Venture Capital:



Seed Financing: This type of investment involves funding an idea or a research and development (R&D, MVP/prototype) initiative. It carries two key risks: first, whether the idea can successfully produce a viable output, and second, if it does yield an output, whether that result will have market potential and commercial viability.

Example of seed financing
Airbnb (2009) – Sequoia Capital & Y Combinator.

At the pre-revenue idea validation stage, Airbnb raised a $600,000 seed round in 2009 from Sequoia Capital and Y Combinator (YC), at a post-money valuation of approximately $2.4 million.
Despite the company's early struggles—even resorting to selling cereal to stay afloat—Sequoia recognized the disruptive potential of its peer-to-peer home-sharing model, while YC provided critical mentorship and network access.
The investment paid off enormously: Sequoia's initial $600,000 grew to an estimated $4 billion-plus return (retaining its stake through Airbnb's IPO), and YC's smaller stake achieved a 1,000x+ return.

Airbnb's 2020 IPO valued the company at $47 billion.

Startup financing: This type of funding comes into play once a startup has demonstrated initial traction, such as a working product and early revenue. This stage is about scaling the business model, expanding operations, and refining the product to attract a broader customer base.

Startup Financing Example
Facebook (2005) – Accel Partners.

At the post-launch scaling stage, Facebook raised a $12.7 million Series A round in 2005 led by Accel Partners, valuing the company at approximately $98 million. The platform already had over 5 million users, primarily college students, and was doubling its user base every few months. Accel recognized Facebook's potential to dominate social networking despite MySpace's market leadership at the time, with partner Jim Breyer strongly advocating for the investment. The returns were extraordinary: Accel's initial $12.7 million investment grew to roughly $9 billion (after selling most shares pre-IPO while retaining some for 100x+ returns).

Facebook's 2012 IPO reached a $104 billion valuation.

Early Growth Financing: It designed for startups that have achieved product-market fit and are ready to accelerate their growth. The capital infusion in Series B and C rounds is typically substantial, reflecting both the reduced risk profile and the heightened growth expectations. These funds are primarily allocated toward three key objectives: geographical expansion, product line diversification, and operational scaling.

Early Growth Financing Example

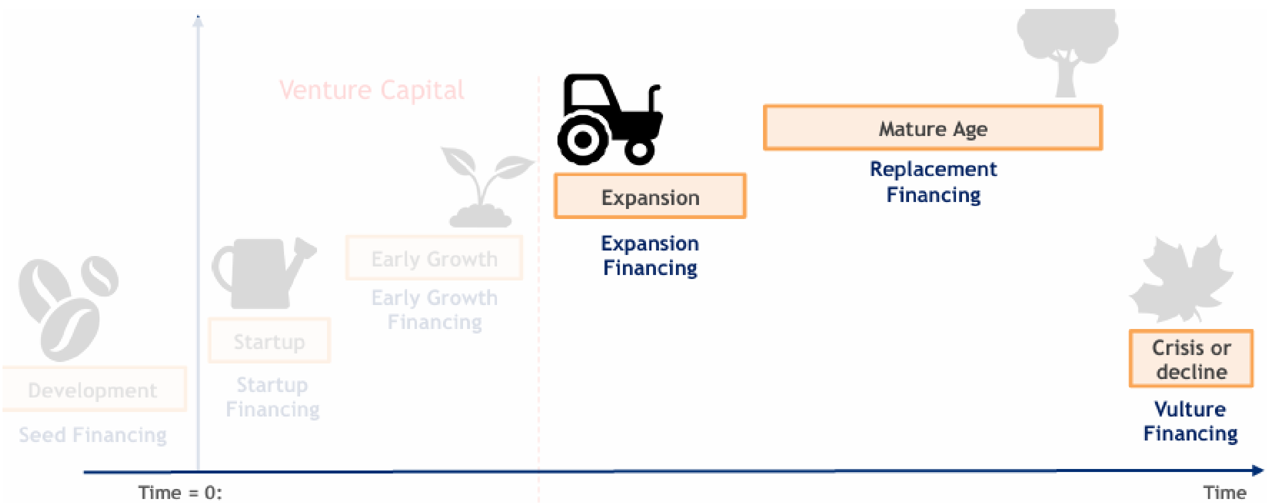
Uber (2011) - Benchmark Capital.

At this stage of proven traction and global expansion, Uber raised an $11 million Series B round in 2011 led by Benchmark Capital, valuing the company at approximately $300 million. Operating in just three cities (San Francisco, New York, and Paris), Uber was already demonstrating strong demand.
Benchmark recognized the company's explosive revenue growth despite regulatory challenges, its first-mover advantage in ride-hailing, and the potential to dominate the market globally, with partner Bill Gurley betting on Uber becoming a transportation monopoly.
The investment yielded extraordinary returns: Benchmark's initial $11 million grew to about $7 billion as they held shares until Uber's 2019 IPO, which valued the company at $82 billion.

Conclusion on Venture Capital:

The investment is often characterized by a high level of risk. Each financing stage reflects a balance between risk and reward, with investors progressively deploying capital as the startup matures. Seed funding validates ideas, Series A scales proven models, and Series B/C drives expansion—ensuring that startups receive the right resources at the right time to maximize their success.

Private Equity:



Expansion Financing: Expansion Financing refers to capital investments made into established, growing companies that require additional funds to scale their operations. This type of financing targets businesses with stable cash flows and proven business models that need capital to enter new markets, develop new products, acquire competitors, or improve operational efficiency. Private equity firms providing expansion capital aim for moderate-risk returns, usually targeting 2x to 4x multiples on invested capital (MOIC).

Expansion Financing Example

Blackstone's Investment in Hilton Hotels (2007)

Blackstone's 2007 leveraged buyout of Hilton Hotels represents a classic example of successful expansion financing through private equity. The $26 billion deal - the largest hotel LBO in history at the time - saw Blackstone invest $5.5 billion in equity while leveraging $20.5 billion in debt. Blackstone identified Hilton as an underperforming asset with significant international growth potential (particularly in Asia), and operational inefficiencies. Their efforts transformed Hilton into a more efficient, growth-oriented business, culminating in a 2013 IPO at a $32 billion valuation. Blackstone ultimately generated approximately 3x returns on their initial investment.

Replacement Financing: Replacement financing takes place in the mature age of a company and the role of the PEI is that of replacing an existing shareholder. This financing type typically targets underperforming public companies, family-owned businesses needing succession solutions, or firms requiring balance sheet optimization. The primary purposes include taking public companies private to avoid short-term market pressures, facilitating ownership transitions (such as founder exits), refinancing expensive debt, or unlocking value through operational restructuring. Replacement capital carries higher risk than expansion financing due to the operational turnaround required.

Replacement Financing Example
Silver Lake's Dell Buyout (2013)
The deal came as Dell struggled with declining PC margins, a failed mobile strategy, and public market undervaluation (trading at just 5x EBITDA). The transaction structure included $13.8 billion in equity from Silver Lake, Michael Dell, and Microsoft, plus $10.6 billion in debt financing, offering a 25% premium over Dell's pre-announcement share price. Post-acquisition, Silver Lake executed a radical transformation: shifting Dell's focus from consumer PCs to enterprise IT solutions. Operational improvements yielded $1.7 billion in annual cost savings through manufacturing streamlining and salesforce optimization, while financial engineering capitalized on favorable debt markets. The strategy proved spectacularly successful - when Dell relisted in 2018, its enterprise value had grown from $24 billion to $70 billion, with Silver Lake realizing a 4x return on its $1.4 billion investment.

Vulture Financing (or distressed investing): Vulture financing takes place in the final stage of a company's life cycle, when it enters its decline phase or, worse, a crisis. This represents high-risk capital deployed to rescue financially troubled or bankrupt companies by acquiring their assets at deep discounts and restructuring them for profitability. Money is used to sustain the financial gap generated from the decline of growth. The financial aid coming from the PEI is used to launch a survival plan. While vulture financing carries very high risk (many distressed companies ultimately fail), successful turnarounds can yield exceptional returns.

Vulture Financing Example
Apollo's Acquisition of Caesars Entertainment (2015)
When Apollo intervened, Caesars Entertainment was drowning under $18 billion of LBO debt from 2008, with EBITDA insufficient to cover interest payments and losing ground to regional competitors. Apollo's strategy unfolded in phases: first accumulating over $2 billion of senior secured debt at 50-60 cents on the dollar, positioning itself as the dominant creditor in Caesars' bankruptcy proceedings. The restructuring slashed debt from $18 billion to $8 billion, converted $5 billion into equity (giving Apollo 72% ownership), and injected $1.8 billion in fresh capital. Apollo operational turnaround proved transformative - Caesars emerged from bankruptcy in 2017, merged with Eldorado Resorts in 2020 to become the largest casino operator, and generated a 3x return on Apollo's $3 billion investment (valuing at over $9 billion).

Conclusion on Private Equity:

Private equity is a powerful engine of corporate transformation, balancing risk and reward while reshaping industries. When executed responsibly, it revitalizes businesses, delivers investor returns, and fuels economic growth—but its aggressive tactics require careful scrutiny to ensure sustainable outcomes.

Structure of PEVC Funds:

While Private Equity and Venture Capital differ in terms of strategy, risk, and the types of companies they target, both operate using a similar fund structure. Let's understand how these funds are built and managed.

1. Fund Lifecycle

A typical PE or VC fund is structured to operate over a period of 8 to 12 years, with 10 years being the industry norm. This period is broadly divided into four interconnected stages:

a. Fundraising: The General Partners (GPs) begin by pitching the fund's investment strategy to potential investors, known as Limited Partners (LPs). LPs can include institutional investors (like pension funds, university endowments, or insurance companies), high-net-worth individuals, and family offices.

For example, The Global Equity Fund in Nepal is backed by institutions such as Himalayan Life Insurance**,** Himalayan Everest Insurance**,** and family-led business groups like Khetan Group and Bhuramal Lunkarandas Conglomerate (BLC).

b. Deployment (Investment Period): This is typically the first 1–5 years of the fund's life. This is the investment period, where GPs begin deploying committed capital into target companies. Investments are made in stages after rigorous due diligence, and often structured in tranches tied to performance or growth milestones. This phase is resource-intensive, involving deal sourcing, negotiations, legal documentation, and strategic alignment with founders or promoters.

c. Management (Holding Period): This period is typically the year 2-8 of funds life. After investing, the focus shifts to actively managing and growing the portfolio companies. The GP's involvement can vary from passive oversight to deep strategic engagement. This can involve sitting on boards, helping with strategy, improving on operations, or preparing companies for exit.

d. Exit (Realization): This period is typically around year 5-10 of funds life. The goal is to eventually exit the investments and return profits to LPs. Common exit routes include IPO, strategic sales, promoter buyback etc.

2. Limited Partners (LPs) vs. General Partners (GPs)

The fund is structured as a Limited Partnership with two main participants:

a. Limited Partners (LPs): These are the investors who provide most of the capital, contributing up to 98-99% of the capital. They have limited liability and are not involved in day-to-day management. Their role is passive, and they expect returns over time through distributions.

b. General Partners (GPs): These are the active fund managers, typically a firm or a consortium of experienced professionals. They are responsible for:

- Fundraising
- Sourcing and evaluating investments
- Managing portfolio companies
- Executing exits

GPs typically contribute a small portion of the fund's capital (e.g., 1–2%) to show alignment with LPs.

3. Revenue Model: Management Fees and Carried Interest

PE and VC firms earn money primarily in two ways: management fees and carried interest.

a. Management Fees: These are annual fees paid by LPs to GPs for managing the fund, usually 1.5% to 2.5% of the total committed capital.
For a $300 million PE fund with a 2% fee, that's $6 million per year in fees.
These fees cover salaries, office expenses, research, legal, and other operating costs.

b. Carried Interest (Carry): This is the performance incentive that allows GPs to participate in the fund's upside. Carried interest is typically 20% of the profits, but only after LPs have:

- Received back their original invested capital, and
- Achieved a minimum rate of return, often called the hurdle rate (commonly 8%)

Once these thresholds are met, the remaining profits are split — 80% to LPs, 20% to GPs.
This structure aligns the interests of GPs with those of LPs and rewards performance over the long term.

Private Equity and Venture Capital in Nepal:

Nepal's Private Equity and Venture Capital sector is relatively new compared to the global landscape. Nepal's private equity and venture capital ecosystem began taking shape around 2012–2014, driven by early fund pioneers supported by international development institutions. Business Oxygen (BO2), often described as Nepal's first private equity fund, was active between 2015 and 2017, backed by the International Finance Corporation (IFC) under its Global SME Ventures program. It invested in over a dozen SMEs and successfully implemented exits in two cases.

A major milestone occurred in March 2019, when the Securities Board of Nepal (SEBON) issued the Specialized Investment Fund Regulation, 2075 B.S. (2019). This landmark regulation created a legal foundation and structure for professionally managed private equity funds in Nepal. As of a report published in 2023 by the Nepal Private Equity Association, there are four PEVC funds licensed under the Specialized Investment Fund 2019 within the Securities Act, and a significant number of fund managers are planning to start operations, with most currently awaiting their SIF licenses.

According to NPEA (Nepal Private Equity Association), from 2012 to 2023, total amount of deals worth approximately US $102 million had been completed, of which US $35 million had been invested in 2023. Primarily the sectors such as renewable energy and information technology leading in the capital deployment.

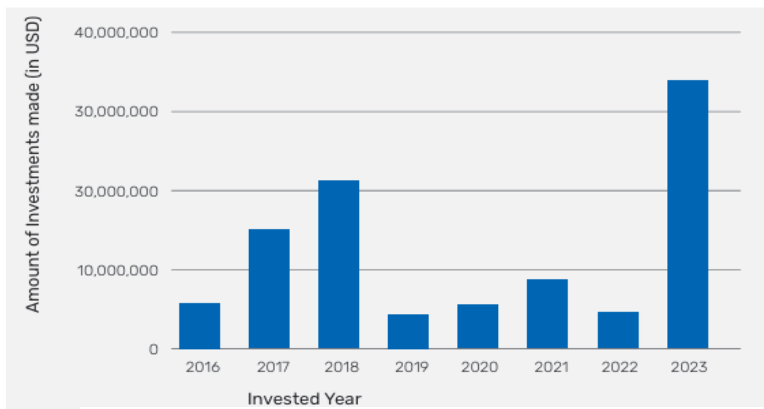
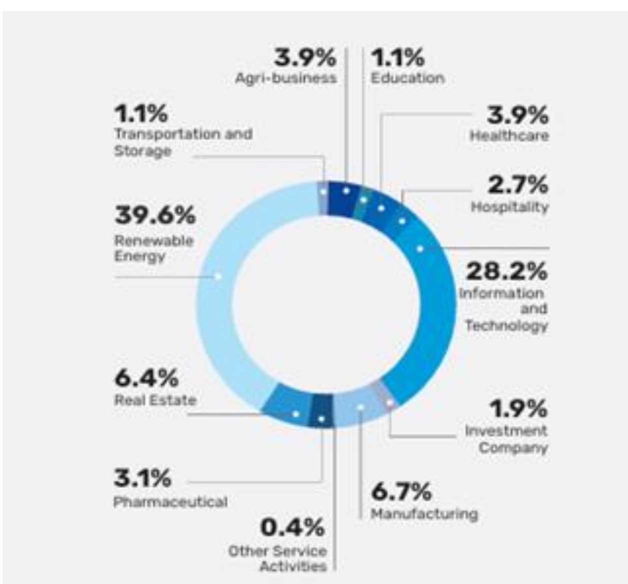
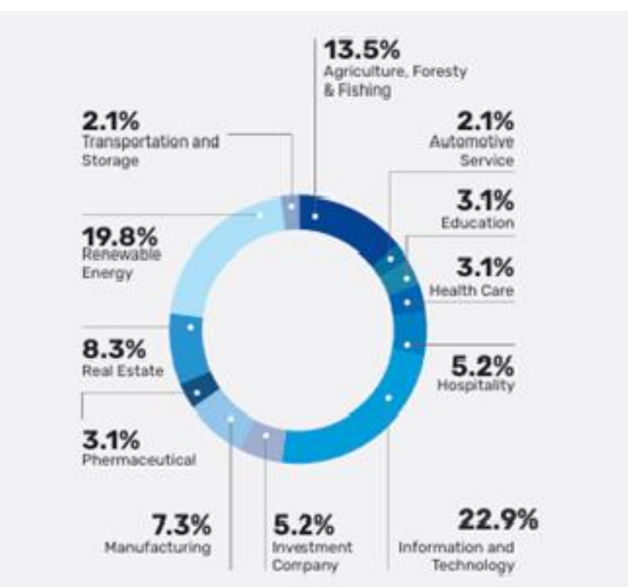


Figure: AMOUNT OF INVESTMENTS MADE (IN USD) VS. INVESTED YEAR





SECTOR-SPECIFIC TOTAL INVESTMENT AMOUNT BETWEEN 2012-23

OVERALL INSTANCES OF INVESTMENTS BETWEEN 2012 - 23

Legal landscape of PEVC in Nepal

The principal regulatory framework governing PEVC in Nepal is the Specialized Investment Fund Rules, 2075 (2019) (SIF Rules), issued by the Securities Board of Nepal (SEBON) on March 6, 2019 (2075/11/22 B.S.). These rules apply to private equity, venture capital, hedge, and other alternative investment funds operating within Nepal. In addition, the Foreign Investment and Technology Transfer Act (2019) governs foreign-origin funds investing in Nepal and mandates foreign investment approval from relevant authorities.

To operate a PE or VC fund in Nepal, a two-step registration process is required: first, obtaining a Fund Manager License from SEBON, and second, registering each specific fund under the SIF Rules.

Fund managers must be companies registered in Nepal, with at least NPR 20 million (2 crores) in paid-up capital, and must explicitly include "fund management" as one of their objectives in the company's MOA.

There are several key legal requirements for registering a specialized investment fund under the SIF Rules. Each fund must have a minimum size of NPR 150 million. The fund manager must hold at least a 2% equity stake in the fund unless waived in the case of international development agencies. Each fund is restricted to a maximum of 200 unit holders and must be structured as a close-ended fund with a minimum one-year lock-in period post-initial public offering. The lifespan of each fund must be between 5 and 15 years.

Challenges for PEVC in Nepal

Challenges Facing Nepal's PEVC Sector

Nepal's PEVC sector is still in its early stages and faces several structural and operational challenges that limit its potential. One of the foremost issues is the lack of viable exit opportunities. The Nepal Stock Exchange is relatively underdeveloped and concentrated in a few sectors, such as banking and hydropower, which restricts options for portfolio exits. Secondary buyouts are virtually nonexistent, and IPOs or strategic trade sales are the main exit avenues, both of which are limited and unpredictable.

Nepal's private equity and venture capital (PEVC) sector is still in its early stages and faces several structural and operational challenges that limit its potential. One of the foremost issues is the lack of viable exit opportunities. The Nepal Stock Exchange is relatively underdeveloped and concentrated in a few sectors, such as banking and hydropower, which restricts options for portfolio exits. Secondary buyouts are virtually nonexistent, and IPOs or strategic trade sales are the main exit avenues, both of which are limited and unpredictable.

The regulatory environment also poses barriers. Although the 2019 SIF Regulations provided a legal foundation, the framework is still incomplete and overlaps with directives from NRB and the Department of Industry. High capital requirements for fund managers, a cap on the number of investors (200), and mandates like close-ended fund structures and manager equity stakes discourage new entrants and innovation in fund structures.

Foreign investors face heightened challenges due to currency risk and bureaucratic processes for profit repatriation, requiring approvals from multiple agencies, leading to long delays and uncertainty. These risks are compounded by Nepal's volatile macroeconomic environment and lack of hedging instruments.

Another major issue is limited investor and entrepreneurial awareness. Many local business owners are unfamiliar with or distrustful of PEVC models, often reluctant to cede equity or adopt international governance practices. The lack of quality data on deal flow, valuations, and fund performance also hinders transparency and market maturity.

Conclusion: In summary, while Nepal's PEVC ecosystem is showing signs of growth, it remains constrained by legal, regulatory, operational, and market-based barriers. Without targeted reforms to improve exit pathways, streamline regulation, clarify tax policy, and promote investor confidence, the sector's ability to scale and contribute meaningfully to economic development will remain limited.

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