

# What is Private Equity Investment

**Meta Description:** *This blog provides an investor's perspective on private equity investment, covering its meaning, investment strategies, benefits, risks, tax implications, and trends in the Indian market. Private equity is an investment strategy where investors put capital in unlisted companies or startups with high growth potential, and it has become integral to raising funds for businesses and an alternative fund for investors.*

From the investment perspective, the overall popularity of Private Equity Investment as a part of Alternative Investments has increased rapidly in the past few years. With the increased demand for funds by the corporate sector due to a flourishing startup scene and a consistently expanding MSME sector, private equity has become integral to raising funds (for businesses) and an alternative fund (for investors).

This blog aims at understanding the meaning of private equity investment from an investor's perspective. The write-up shall take account of the meaning and investment strategies along with the trends that private equity investments have witnessed in the country. The blog article shall also take an understanding of the benefits and risks of putting money in this investment category, along with a brief discussion of the tax implications.

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## **What is private equity?**

Private equity is an investment strategy whereby HNIs (High Net worth Individuals) invest capital in an unlisted company or a startup idea. The company or the idea often has a significant potential for growth and scaling up in the future. This means by committing a significant amount of money to an idea or an enterprise during the early stages of its growth; the HNIs expect a more-than-normal growth of their investments after a few years.

Institutional or individual investors with a large corpus can allocate some of their investments to private companies, unlisted enterprises, or startup ideas. These companies utilize such funds for expansion, marketing, boosting business operations, and ensuring constant growth for the business. Private equity shareholders have decision-making and voting rights just as the regular stockholders of a company; hence, they are bonafide company owners to the extent of their shareholding.

## **Private Equity Strategies**

Private equity strategies could be widely categorised into the following:

**Venture Capital:** Venture capital (VC) is a form of private equity typically invested in early-stage or startup companies with high growth potential. VC firms provide funding to these companies in exchange for an equity stake and often take an active role in helping to develop and grow the company.

**Growth Equity:** Growth equity is a private equity investment focused on more mature companies looking to scale their business. Unlike venture capital, growth equity is typically invested in companies that have already established a track record of success and are looking to accelerate their growth through additional funding.

**Buyouts:** Buyouts are a form of private equity investment that involves acquiring an existing company by a private equity firm. This can take the form of a management buyout, where the existing management team buys out the company with the help of a private equity firm, or a leveraged buyout, where the private equity firm uses debt to finance the company's acquisition. Once the private equity firm has acquired the company, it will typically look to improve its operations and increase its value before selling it for a profit.

## **Private Equity Investment: How it works**

Private equity firms typically invest in companies that are not publicly traded or need restructuring. Once a private equity firm has identified a promising company, it will negotiate a deal with its owners to buy a controlling stake in the business.

The process of private equity investment generally includes four steps. The first step is *fundraising*, where the private equity firms raise capital from institutional investors and HNIs. These funds are

typically raised in the form of a limited partnership, with the private equity firm acting as the general partner and responsible for making investment decisions on behalf of the fund.

The second step is *deal sourcing and due diligence*, where a team of professionals representing the private equity firms analyse financial statements, market trends, and the competitive landscape. This step is critical in evaluating whether an available opportunity or a startup idea is worth investing in or not.

The third step is *investment and value creation*, whereby the private equity firm negotiates a deal with the target company and its shareholders. This may involve acquiring a controlling or minority stake in the company to implement various value-enhancing strategies, such as operational improvements, cost reductions, and expansion into new markets or product lines.

The final step is the *exit*, undertaken after holding the investment for several years. Some common exit strategies include selling the company to a strategic buyer or another private equity firm, conducting an initial public offering (IPO), or recapitalising the company.

## **Trends of the Private Equity Market in India**

As explained before, India has some of the most exciting opportunities for startups and MSMEs. Some of the new-age companies have been able to transform how people live and have a massive impact on society. This is why startups, new ideas, and MSMEs have a lot of promise, which the investors want to tap to increase the overall return on their investments.

The total investments (private equity) during the year reached an unprecedented level of [\\$70 billion for the first time](#) in the year 2021 as per a report published by Bain and Company.

These trends in private equity investments could be closely linked with the unprecedented growth in the startup culture in India. The startup growth in India has been unprecedented and unparalleled. India had a touch more than [84000 registered start-ups](#), more than any other country except the United States, which tops the list (as per government sources). The flourishing MSME sector had contributed around 27% of the country's total GDP in the previous year, [as per GOI sources](#).

Hence, it is clear that investors have trusted putting money in private equity due to the growth expectations and the overall positive impact that the startups and new-age companies have been able to create.

## **Taxation of Private Equity Investment in India**

For a private equity investor, the returns are subjected to income tax under the relevant regulations. An investor receives periodic repayments (such as interest or dividends on investment) and capital appreciation. Whereas dividends and interest are taxable under income from other sources/income from business and profession, as the case might be, the taxability on capital appreciation is to be categorised under the head of capital gains.

For details about the tax regulations and tax rate, we advise you to go through [this blog](#) by Vinit Kulkarni from *Wint Wealth*.

## **Benefits and risks of investing in private equity**

One of the biggest benefits of investing in private equity is higher returns than other traditional investment alternatives. In addition, private equity investment can offer a range of benefits to investors, such as diversification and exposure to investments not available in public markets.

Private equity investments are not correlated with public markets, meaning they can help mitigate risks in a portfolio of traditional investments. Additionally, private equity investments can offer exposure to different sectors and geographies unavailable in public markets, providing further diversification benefits. Private equity investment can also provide investors access to investments not available in public markets, such as early-stage startups and mature companies that are not publicly traded.

However, the investors must spend a significant time before these investments give returns. There is always the risk of product/idea failure. Private equity investments pour money into growth potential; hence, the overall risk is higher.

## **Summing up**

Private equity investments can serve the interests of HNIs by providing diversification of portfolios, exposure to multiple sectors at their early growth stages, and a potential for high growth in the long-term period. With the Indian economy growing faster than most developed countries and the startup scene blooming with new ideas, products and services, the overall demand for funds by the corporate sector shall also increase in the future. For HNIs, this could be an excellent opportunity to

be a part of the new-age industrial revolution, and private equity investment could be a perfect way to achieve multiple goals of these investors.

## **Frequently Asked Questions on Private Equity Funds**

*Can individual investors put money in private equity investments?*

Yes, there is no restriction on individual or retail investors to invest in private equity funds until the minimum investment requirements are fulfilled.

*Can I have a monthly SIP of Rs. 5000/- with a private equity investment firm in India?*

No, all the investments are to be done in a lump sum, and the minimum investment requirements are to be fulfilled.

*Is there any principal protection clause in private equity investments?*

Such clauses are not typically part of private equity investments, thereby making them a highly risky investment alternative.

*What if I (an individual investor) disagree with the exit plan of my private equity investment firm?*

There is little control of an individual investor on a private equity fund as highly experienced and qualified fund managers undertake the decisions.

*Will the entire investment be poured into high-risk startups only?*

Not necessarily; you must discuss the investment plan with the fund manager or the in charge of an investment plan.

*Is there any regulator that takes account of private equity investments in India?*

The Securities Exchange Board of India regulates private equity investments in India.

*Which are a few private equity investment firms in India?*

Some popular financial services companies, such as Motilal Oswal, Kotak, ICICI, and JM Financial, have dedicated ventures dealing in private equity investment.

