

# How to sew up a PE deal

18 Oct, 2007, 0222 hrs IST, Nitin Potdar,

A rising stock market and many PE players chasing one target have made promoters happy. The first challenge before any PE or VC investors today is to find good opportunities. Fortunately, unlike in early 2000, when IT and ITeS sectors attracted 70% of the investment in India, today sectors like engineering & construction, media & entertainment, healthcare, logistics, food & beverages, retail, and education offer good options.

Though companies operating in these segments are lagging in terms of global brands, new technology, competitive marketing, and novel business practices, the growth opportunities are immense. However, much depends upon how innovative and passionate the entrepreneur is.

Mid-sized companies in these sectors understand the need for innovation and improvement, and are open to value addition. But often their complaint has been that the younger fund managers do not completely understand the local nuances of the business nor are they able to demonstrate any understanding of global practices. Promoters expect fund managers to invest money and also help them fulfill their global ambitions. PE players with capabilities to help expand business by identifying new opportunities, support fund raising or assist in corporate governance are preferred.

Till such time as total buy-outs make sense in India, most businesses would continue to be family run. But faced with competitive pressures, promoters are open to new ideas and are willing to change, but to expect them to change their way of functioning overnight is a tall order. Commitment from PE fund managers to keep the family ownership intact and would help PEs.

A thorough understanding of the regulatory regime has become important to ensure smooth execution of any PE deal. There is ambiguity in most regulations dealing with investment. If the target company is a listed entity, structuring is a nightmare, as it would depend on the interpretation of certain provisions of the SEBI takeover code, insider regulation, listing agreements, delisting guidelines, FEMA and FDI regulations. The problem gets further aggravated, as other than informal guidelines, SEBI may not entertain any query on structuring and give any firm confirmation (and rightly so because unless the structure is frozen they will not want to express any opinion).

It would be desirable if SEBI comes up with some broad clarifications. For example it is not clear whether an investor can conduct due diligence on a listed company before investment, or whether an investor acquiring more than 15% in a listed company will be treated as an independent investor unconnected with the promoters. Regulators need to be proactive to address issues, at least when they keep appearing and remain unanswered.

Execution of a term sheet or heads of agreement is an important phase of any PE deal. In order to execute the deal smoothly, critical points including the management, registration rights, anti-dilution, tag or drag rights and exit clauses should be discussed and agreed. If the investment is from an overseas PE fund, structuring exit options is even worse because of the typical pricing regulations under FEMA, wherein there is not too much scope to play around. Despite knowing fully that there are fundamental regulatory issues, a lot of time is often spent on trying to structure the same which leads to colossal waste of lead time and interest from the promoters.

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