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Taking The Big Leap

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When Summit Chandwani, executive director of India's biggest private equity (PE) firm, ICICI Venture, quit last month, there was chatter in the industry on Chandwani following the footsteps of former colleague Renuka Ramnath in setting up his own PE shop. Rajeev Gupta, managing director of Carlyle in India and a member of Asia buyouts team, who quit the firm in January after a five-year stint, too, is reportedly starting his own fund.

Though Messrs Chandwani and Gupta are yet to make their plans public, the trickle of seasoned PE managers quitting their jobs to launch independent, non-institutional funds—a trend that started a few years ago when Ajay Relan quit Citigroup Venture Capital in 2008 after 13 years to start his $515 million CX Partners fund and Renuka Ramanath quit ICICI Venture in 2009 to float $375 million Multiples—has turned into a deluge of late.

The turn of year saw Vikram Gupta exiting as the COO of India Venture Advisors to float IvyCap Ventures, a $75 million fund. Alex Joy quit as senior consultant, Private Equity, Charlemagne Capital to co-promote Redwoods Capital a $50 million fund. In 2010, Warburg Pincus managing director, Rajesh Khanna, quit to launch Arka Capital, a $400 million fund; Varun Sahni quit as Acumen director to launch Global Impact Investors a $100 million fund; PE honchos Karam Butalia and Vibhav Panandiker quit Standard Chartered PE and are floating KV Asia Capital, a $500-million fund, focusing on India and South East Asia. Ranjeet Nabha, former MD and CEO of Indian operations of WL Ross & Co, is on way to launch his special situations opportunities fund of $250 million.

The venture capital (VC) space, too, have caught onto this trend. Tripat Preet Singh, senior associate with IndoUS Venture Partners, is setting up a social venture fund Ennovent, which will be a $50 million fund focusing on the bottom of the pyramid. Members of Mumbai Angels, Sanjay Nath and Karthik Reddy, too, floated Blume Ventures, a $20 million fund. As per VCCEdge data PE investment in India in 2010 was $8.2 billion, it peaked in 2007 at $17.4 billion and has already clocked in $4.8 billion in 2011. Bain & Company estimates that around 120 PE funds are currently on the road, seeking to raise approximately $34 billion in 2011, many of these from this breed of managers-turned PE entrepreneurs. To be sure, many of these new PE entrepreneurs out strutting their stuff may not succeed in raising capital, but then what's entrepreneurship without some risk.

The itches and riches

So what is driving these breakaways in the investment space? "I thought I have done it for 18 years, now it was time to venture out and become an entrepreneur. It was a question of why am I dreaming about it and not doing something about it? The last two years had been inspiring as a new breed of experienced PE professionals with impressive track records were venturing to create new firms," says PR Srinivasan, who started his career with TDICI Ltd, now ICICI Ventures in 1992. Srinivasan had made about 30 investments and had 23 exits to his credit, after having worked with ICICI Ventures, HSBC PE and Citi Venture Capital International (CVCI), he is leveraging his 18 years of experience in the PE domain to set up Exponentia. Srinivasan has been working on building the Exponentia team and meeting with potential anchor investors. He says they will hit the market in July.

Why did Srinivasan not venture out earlier, say in 1999-2000? "I did venture out a bit in 1995. I was the first Indian employee of HSBC PE—which was a semi-entrepreneurial venture. The fund had not been raised and we were given a tight budget and 12 months to raise the fund. If we had failed, then we would have had to leave," he recalls. Not many funds had made money in India at that time and only institution-sponsored funds were getting raised. "A few non-resident Indians had managed to raise small funds in 1999, more on promise than on track record. So in a sense, this is the first wave of professionals with track records that are setting up funds. Today, an individual or team without experience cannot raise a fund."

Hari Achuthan, founder and managing partner, Achuthan & Co, served as the director in the Alternative Investments group at Credit Suisse Asset Management, quit in April 2010 to launch his own fund. Having worked with global giants, Lehman Brothers, Morgan Stanley and being named one of the 'Rising Stars in Public Pensions' by Money Management Letter and selected as one of the emerging leaders in Credit Suisse Asset Management in 2009, Achuthan believed the time was ripe to cash in on the expertise and contacts he had built. "We wanted to tap into the team's expertise in operational turnarounds, utilise our global network of relationships, and invest in opportunities where a bigger organisation would not necessarily invest due to strategic or scale factors," he says. Achuthan adds that while a bigger financial organisation does have its advantages, lately a number of factors have tilted in favour of independent asset managers. Achuthan & Co is focused on building a growth strategy with a targeted fund size of $500 mn and a cap of $1 billion focusing on India and South East Asia. On the market dynamics, Achuthan explains that PE is a pretty competitive business and there is a definite investment need for building infrastructure and debt markets, and investors are cautiously optimistic about investing in India.

Birds of a feather

However, according to some observers, this trend of general partners, essentially PE firm managers, venturing out is sending out confusing messages to the limited partners or investors in PE funds, as there is a concern if the new team sourced from diverse firms would be compatible. No wonder, sometimes whole teams are flocking out together. As did Jayanta Banerjee, president, Anand Vyas, director-investments and Sunay Mathure, director-investments at ICICI Venture to set up Pravi Capital in mid-2010. Banerjee, Vyas and Mathure have seen full cycle of investments with over 25 deals and exited over a dozen investments.

Banerjee, co-founder and managing partner, Pravi Capital explains that globally it's common for experienced PE managers in captive firms to spin-out and in the West, very few captive PE firms have had consistency in their teams over a long period of time. "By the very nature of the PE business, it is inevitable that partners who take the investment decisions should have ownership in the business. PE investment is an individual-driven business, and institutions play a limited role. LPs like managers to have ownership in the GP and also invest in the fund, as this ensures alignment with investors. In a captive fund, a key question is whether the managers who don't have any ownership would stay through the life of the fund." Pravi is a $200 million fund and is targeting to raise funds from international institutions and Indian HNIs and looking at the first close in the October-December quarter.

Take the case of Nilesh Mehta and Sangeeta Modi who quit Aureos India in late 2009 to set up their own fund. They had worked together in Aureos for nearly five years and in 2010 they ventured out to set up Access Asset Managers aiming to manage $150 mn fund targeted at small and medium enterprises. Co-founder Sangeeta Modi says that apart from from the financial rewards, operational freedom and the sense of ownership that entrepreneurship brings are also important incentives. "As partners in a first time fund at Aureos, we were involved in both fund raising as well as investments. In such cases, the processes aren't significantly different whether you are on an institutional platform or on your own." Access Asset Managers is looking at a first close by July. These non-institutional funds, including Access Asset, Pravi and Exponentia are intending to bring on board successful entrepreneurs who have experience in operating businesses as well as investing in businesses.

Small and niche

So how have LPs taken to these breakup? Modi elaborates; "While we are a first-time fund, we are not a first- time team. Investors view us as a spin-out, since most of our independent investment committee members and the independent board member have moved with us. It helps that investors are familiar with the team. We are looking at a first close by July, which is largely from our existing investor base, and who have been investing with us for over 10 years." As a team, Access Asset Managers have had 17 investments and 14 exits over the past 1decade, the most recent ones being Accutest Research, Paras Pharma and Scope E Knowledge.

Interestingly, these funds are also focusing on smaller deals in niche segments that the bigger funds are not concentrating on. Sample this. Anuj Nautiyal and Alex Joy, who worked together at Jones Lang LaSalle in mid 2000s have teamed up to float Redwoods Capital, a fund focussed on second-tier real estate developers. Nautiyal, co-founder Redwoods Capital Management says, "We see tremendous opportunity in working with category B developers. These are the second and third rung players in metros, but don't get good attention from large PE players as they don't have large transactions to offer." Co-founder Joy adds that the opportunity was beckoning, "There is a clear opportunity for domestic fund management firms to address the constraints that Indian developers face in raising construction finance for projects especially commercial projects." Redwoods is in the final stages of regulatory approvals and will start the fund raising process soon. "Average deal size that we will target is $4-5 million," confirms Nautiyal.

Exponentia will target the $20-50 million deal space across sectors essentially focussing on companies that serve the domestic market. Srinivasan says that the Indian market sweet spot is R100-50 crore. Having raised a $ 4 billion fund, CVCI was moving up on deal size to more than $50 million and Srinivasan thought over the next decade or so he can build a firm that can carve a position in under $ 50 million deal space.

Pravi too is setting eyes on the $10-15 million space. Banerjee says they are focussing exclusively on the strategy of high involvement investing in small but high growth businesses and believe that the Indian lower mid-market offers excellent opportunities for investments of $10-15 million especially in consumer businesses and financial services. Following a similar low investment model, Access Asset is narrowing on the SME space. Modi elaborates, "There is a demand supply mismatch in the segment with PE transaction size under $15 million, with demand greater than supply of capital. There are relatively less funds under $200 million and generally both valuations and deal structures are more favourable in this segment. Also smaller companies generally have high growth rates on account of the low base effect." Modi adds that even international institutional LPs are recognising this, and some are consciously focussing on this space, unlike the earlier fund raising experiences in 2006 when it required effort to sell the Indian SME story.

So is the money rolling in? Overall, India PE is an exciting phase of evolution though the fund raising environment is tougher than what it was in 2007. Srinivasan says LPs have higher standards for GPs and that spells good for the industry, they are seeking GPs with full life cycle experience. Srinivasan, however, cautions that not all fund managers will be able to raise money, “To achieve success in fund raising, we may have to pitch with 200 investors to find about 20 to 30 who will back us. You have to keep your enthusiasm till you find your 20 investors!”