Impact of Private Equity investment in Indian Capital Market

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Abstract

India has a sizable and complex financial system that features public and private sectors, as well as both traditional and cutting-edge components. Traditional institutions like families and moneylenders have been important sources of capital alongside modern financial organizations. Banking institutions are home to the vast majority of this money. Today, consumers are more likely to receive a loan through a local retail bank than from the capital markets or wholesale banks. In order to raise money, most businesses turn to the stock market, but if that doesn't work, they may approach private financial intermediaries. Private equity (PE) is a relatively new financial vehicle that emerged around the turn of the millennium as a development of venture capital (VC). The goal of this study is to find out how the presence of PE has changed the Indian capital market.

Keywords: financial system, financial institutions, Private Equity (PE) and Venture Capital (VC), Indian Capital Market.

Introduction

Since the turn of the century, private equity (PE) investments have become a significant non-market investment source for businesses, "particularly for start-up enterprises, private middle-market firms, firms in financial trouble, and public firms seeking buyout finance" (George et. al., 1995). To help unlisted businesses compete, private equity firms supply them with long-term, committed share capital. Private equity is not the same as a traditional loan or debt, and the returns for investors are tied to the success of the company in which they have invested. The expansion of the private equity market is a key factor in the expansion of the nation's economy (EVCA, 2013). The rapid growth of private equity has become an important issue in both developed and developing countries. This raises questions about how to best regulate and support its growth.

Growth in the world's economy can be attributed in large part to the efforts of private equity (PE) and venture capital (VC) investors. The private equity (PE) sector has taken on a paternal role in the economy, with productivity remaining its primary focus thanks to the ability of suitable investment to retain and gestate ideas into economic realities. With the advent of the private equity (PE) model, many of the economic reforms that were initially implemented through the open economy model have been given a broader scope through economic policy and regulation. Before the economic system was liberalized, there was no room for private investment, and private company activity was not even taken into account. After 1990–1991, there were many plans for privatization, liberalization, and globalization. The private equity model was used to help industries, businesses, and factories grow and develop.

An investment in PE and VC is carried out through dedicated investment funds. The parties in these funds are of two types –

1. General Partners – are responsible for managing the activities of the fund and its investments. They also undertake responsibility of managing the legal debts and other obligations under the fund.
2. Limited Partners – are the real investors who commit capital to the fund and have limited liability for the various debts and obligations under the fund.

Financing of PE funds is at times different from VC funds since they may use debt partly obtained from third parties and not base an investment solely on capital.

The Private Equity Ecosystem

A typical Private Equity deal consists of these essential elements –

- Structured financing by an investor who is external
- A very high component of risk

- A high potential of return.

The Private Equity funds are privately negotiated between the parties. The emergence of PE as a dynamic financial tool essentially requires three conditions:

- Presence of a supportive legal, social, and tax environment
- Adequacy of human talent
- Sufficiency of capital

All of the following crucial factors contribute to the growth of PE as a legitimate academic field: The "Private Equity Ecosystem" is an ongoing study of various factors and how they interact. The entrepreneur plays a crucial role in the private equity (PE) system. To maximize their returns, private equity (PE) investors have honed their skills in spotting promising business ideas, funding them, and mobilizing other critical resources. Private equity (PE) investors have learned how to optimize and reduce their exposure to risk. So they are responsible for the growth of the PE industry.

Private equity (PE) allows the investor to grow their wealth in a shorter amount of time but necessitates a different type of funding structure. The entrepreneur is the centre of attention in the world of private equity. The ability to think creatively, take calculated risks, and generate money beyond that available through traditional financial channels is what sets entrepreneurs apart. There is no guarantee that a concept will pan out, so incubation spaces are used to sort through and refine the best ones. In addition, there is an urgent need for new approaches to the banking sector. Most government efforts to aid entrepreneurs in getting their businesses off the ground fall short. This highlights the critical importance of physical education. PE markets are possible because of the widespread acceptance of the fact that business owners and investors have distinct personalities. It is critical for the private equity investor to have a clear path laid out in advance, as well as exit options in place.

Literature samples

Shankar R et al, (2021) opined that blue chip companies that raises finances through private equity predicts the stock price movements in NIFTY. Shankar R. (2018) found in his study that there is a significant impact of private equity investment towards the SENSEX and NIFTY. Shankar R. (2018) expressed that private equity is the blend of joint venture and venture capital that serves effectively the needs of the business. Shankar, R. (2017) identifies lack of clarity among the investors is the serious concern to be rectified by the investors. According to Miller (2008), there are three main purposes of information flows between investors in private equity funds and fund managers: decision support; enabling governance; and relationship development. In a 2008 study, Diller and Kaserer demonstrated that the success of a private equity (PE) fund is connected with the quality of the PE firm administering the fund, particularly the quality of their selection processes. The private equity secondary market was examined by Ulrich Hege and Alessandro Nuti (2011), who focused on its operation throughout the current financial crisis. They demonstrated that by early 2009, the effective market liquidity had shrunk drastically, to a level at which it accounted for only a small percentage of the whole market. According to Nathalie Gresch and Rico von Wyss (2011), who drew their conclusions from data from a large sample of 1,641 funds. When looking at the risk-return profile of different types of funds, including buyout, venture, and fund of funds, buyout funds come out on top.

Problem statement

In many third-world nations, businesses raise funds by taking calculated risks. They may use traditional funding methods like a bank loan, or they could raise money through a public offering or self-financing. However, at some point in its latter stages, a firm will need to look for additional capital for growth, and for a variety of other reasons, this source will likely be far too expensive and vast for the company to afford on its own. Private equity (PE) is one such funding option. It bridges the gap between personal savings and bank loans. Since PE is a concept that has been around for decades, it has received a lot of focus. PE is gaining more and more attention, but despite this, academics have not done significant work on the topic, primarily due to a lack of data pertaining to this opaque sector of the economy. The majority of the issues addressed in the current body of literature concern the risk-return characteristics and performance of private equity, the economics of the PE market, and the regulatory perspective of PE. Private equity is a type of asset that lacks liquidity. Fund managers can protect their investors from the detrimental effects of market volatility by holding public shares for an average of four to five years. The scenario at the time was that private equity capital was being invested at a faster rate than the returns on those investments could be generated. Investors were primarily motivated by a desire to diversify their holdings and earn above-average profits. In India's private equity market, investors should expect competitive deal possibilities because of the sector's favorable fundamentals and low firm valuations due to high priced corporate debt.

Private equity has been shown to be a rising trend and a growing sector that can boost a company's development through long-term investment, and this may have a profound effect on the national capital market. In addition, investors that use external sources of funding or their own funds are exposed to risk during the process. Investment returns are highly erratic. Greenfield investment increased after 2008, but returns plummeted due to macroeconomic and government arrangement delays that impeded infrastructure organizations. Additionally, while income increased across the board, benefits did not increase at the same rate due to the high inflation. Many people assume that PE isn't paying attention to the fact that the financial markets are volatile. In this situation, the goal of the current study is to find out if the private equity (PE) category has an effect on the Indian capital market or not.

Objective of the study

1. To identify the impact of Private Equity Investments on Indian Capital Market.

Research Methodology

The study covers the five prominent sectors of private equity investment in India namely Information Technology and Enabled Services, Healthcare and Life Sciences, Banking and Financial Services, Manufacturing and Energy. The study covers the period of 10 years from 2011-12 to 2020-2021. The data required for the study is collected from the websites of NSE and BSE along with Venture Intelligence database.

ADF for Private Equity Investment, SENSEX and NIFTY

H_{01}: There is no unit root among the private equity investment, SENSEX and NIFTY.

Table 1: ADF Test

Variables	Level	
	ADF Test Statistic	Prob.
PEI	-6.02	0.00
SSX	-2.20	0.04

NFY	-.83	0.00

Source: Venture Intelligence

The table 1 concludes that the null hypothesis of having no stationary for all the given variables is rejected at their level since the ADF Probability value lesser than the critical values and have become stationary.

Co-Integration Test of Private Equity Investment in India

The variables are integrated of *I(0)* and in this situation Auto Regressive Distributed Lag model can be used to extract both long run and short run relationship between the variables.

Co-Integration Test

H_{02}: There is no co-integration between Private Equity Investment, SENSEX and NIFTY.

Table 2: ARDL Test

Variable	Coefficient	Prob.
PEI	4.36	0.01
SSX	0.02	0.04
NFY	2.50	0.03
C	11.02	0.00

Source: Venture Intelligence

Table 3: Bound Testing for ARDL Co-Integration

Wald Test			
Null Hypothesis : PEI = SSM = NFY = 0			
F-statistic	9.62	**Probability**	0.01
Chi-square	1.82	**Probability**	0.01

Source: Venture Intelligence

The result indicated from the tables is that the probability values of the given variables are less than 0.05. Therefore the null hypothesis is rejected that means there is co-integration between the Private Equity Investment and SENSEX and NIFTY in India. In other words, Private Equity Investments affected SENSEX and NIFTY Movements in the long run. Since there is long run relationship between the variables in India, so to determine the short term dynamic an Error Correction model is used and the result is displayed in table below.

Table 4: Error Correction Model Results

Variable	Coefficient	Prob.
DLPEI	-3.54	0.05
DLSSM	0.11	0.04
DLNFY	-4.20	0.01

DLPEI(-1)	0.95	0.02
DLSSM(-1)	1.20	0.02
DLNFY (-1)	4.98	0.01
ECT(-1)	0.19	0.23
C	0.90	0.41

Source: Venture Intelligence

Table 4 shows the Error correction results of region wise Private Equity Investments and SENSEX and NIFTY in India. The coefficient of the error correction term in the model is statistically significant. The estimated coefficient value of error correction mechanism implies that the system corrects its previous period's disequilibrium from the long run. The high significance of the coefficient of Error Correction Model term supports the existence of a long-run equilibrium relationship between the variables. From the table it can also be report that there had a short term relationship between variables too.

Table 5: Granger Causality Test

Null Hypothesis	F- Statistic	p-value
PEI does not Granger cause SSM SSM does not Granger cause PEI	3.25 4.58	0.02 0.01
PEI does not Granger cause NFY NFY does not Granger cause PEI	1.01 0.90	0.05 0.29

Source: Venture Intelligence

Table 5 reveals the results of granger causality test between the private equity investments made and the SENSEX in India. It can be concluded that the null hypotheses are rejected since there is bidirectional impact between the variables. In terms of NIFTY there is unilateral impact caused by private equity investment on NIFTY but there is no impact caused by NIFTY on private equity investments.

Conclusion

India presents both difficulties and possibilities. Whether it's FDI, regulatory approval, or tax incentives, a framework is necessary for private equity to thrive in our country. India is among the few developing economies in the world and a hospitable framework is important for its success. Since lending rates have not truly dropped and stock markets have not been extremely vibrant, private equity has continued to play an important role in India's industrial sector. Private equity (PE) and venture capital (VC) firms have helped Indian enterprises secure institutional funding and finance capital investment in new plant and equipment for about a decade and a half. By streamlining operations, introducing new products, rationalizing assets, or providing buyout financing, the companies in their portfolios have been bolstered. This may have aided in the smooth transfer to new management and/or ownership. Private Equity has played a vital position in the growth of the SME market in the country, beyond that of supplying financing. As a result, PE plays a significant part in India's economic development, especially given the capital market's central role.

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