ASEAN Investment Flash

India

August 2014



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INDIA

Country Profile

Map

Southern Asia, bordering the Arabian Sea and the Bay of Bengal, between Burma and Pakistan

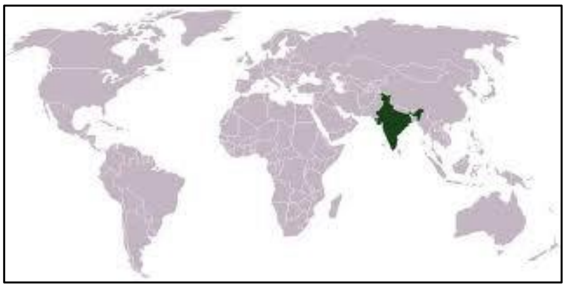


Figure: 1

About India

Languages

Hindi 41%, Bengali 8.1%, Telugu 7.2%, Marathi 7%, Tamil 5.9%, Urdu 5%, Gujarati 4.5%, Kannada 3.7%, Malayalam 3.2%, Oriya 3.2%, Punjabi 2.8%, Assamese 1.3%, Maithili 1.2%, other 5.9%

Capital City - New Delhi

Religions

Hindu 80.5%, Muslim 13.4%, Christian 2.3%, Sikh 1.9%, other 1.8%, unspecified 0.1% (2001 census)

Languages

Hindi 41%, Bengali 8.1%, Telugu 7.2%, Marathi 7%, Tamil 5.9%, Urdu 5%, Gujarati 4.5%, Kannada 3.7%, Malayalam 3.2%, Oriya 3.2%, Punjabi 2.8%, Assamese 1.3%, Maithili 1.2%, other 5.9%

Administrative Divisions

29 States and 7 Union Territories

Main Industries

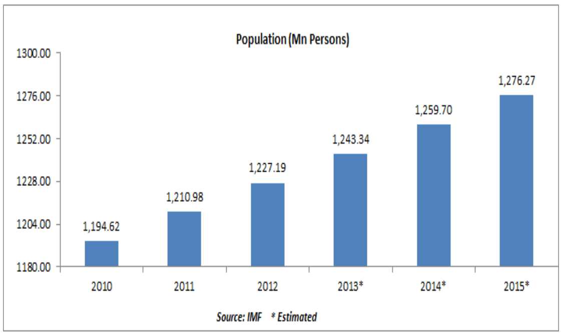
Textiles, chemicals, food processing, steel, transportation equipment, cement, mining, petroleum, machinery, software, pharmaceuticals

Flag

Figure: 2

Three equal horizontal bands of saffron (subdued orange) (top), white, and green, with a blue chakra (24-spoked wheel) centered in the white band; saffron represents courage, sacrifice, and the spirit of renunciation; white signifies purity and truth; green stands for faith and fertility; the blue chakra symbolizes the wheel of life in movement and death in stagnation

Population



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Age Structure

0-14 years: 28.5% (male 187,016,401/female 165,048,695)

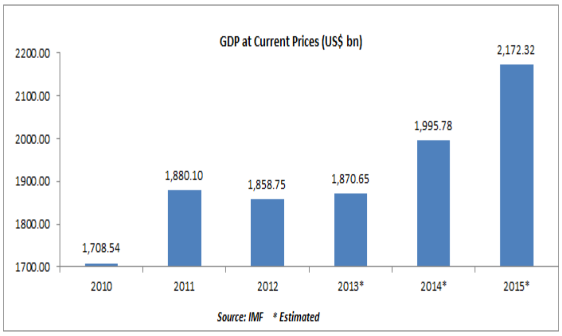
15-24 years: 18.1% (male 118,696,540/female 105,342,764)

25-54 years: 40.6% (male 258,202,535/female 243,293,143)

55-64 years: 5.8% (male 43,625,668/female 43,175,111)

65 years and over: 5.7% (male 34,133,175/female 37,810,599) (2014 estimates)

Economy



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International Organization Participation

ABEDA, ADB, AfDB (non-regional member), ARF, ASEAN (dialogue partner), BIMSTEC, BIS, BRICS, C, CD, CERN (observer), CICA, CP, EAS, FAO, FATF, G-15, G-20, G-24, G-77, IAEA, IBRD, ICAO, ICC (national committees), ICRM, IDA, IFAD, IFC, IFRCS, IHO, ILO, IMF, IMO, IMSO, Interpol, IOC, IOM, IPU, ISO, ITSO, ITU, ITUC (NGOs), LAS (observer), MIGA, MONUSCO, NAM, OAS (observer), OECD, OPCW, PCA, PIF (partner), SAARC, SACEP, SCO (observer), UN, UNCTAD, UNDOF, UNESCO, UNHCR, UNIDO, UNIFIL, UNISFA, UNITAR, UNMISS, UNOCI, UNSC (temporary), UNWTO, UPU, WCO, WFTU (NGOs), WHO, WIPO, WMO, WTO

World Rankings

World Bank Doing Business (2014)

Rank 134 out of 189 countries

Transparency International's Corruption Perception Index (2013)

Rank 94 out of 177 countries

Global Competitiveness in 2013-14

60th among 148 economies

Global Enabling Trade Index 2014 (World Economic Forum)

Rank 96

Currency –Indian Rupee (INR), Symbol - ₹

Political System and Government

India has the one of the world's largest democracy. The country implemented its Constitution in 1950 that provided for a parliamentary system of government with a bicameral parliament and three independent branches: the executive, the legislature and the judiciary. The country has a federal structure with elected governments in States

GDP Composition by Sector (2012 estimates)

Services: 57%, Industry: 26%, Agriculture: 17%

INVESTING IN INDIA

- In recent years, the country has become one of the most attractive destinations, both for investments and for doing business. The economy is one of the fastest growing in the region and was resilient in the face of the global economic downturn of 2008-09

- According to analysts, India is slated to grow at consistently higher rates during the next few decades. Some of the reasons which make India a magnet for investments include:

    - A large and fast growing middle class & graduation of poor to middle class and hence growing domestic consumption
    - The Indian government's constant evolving of investor friendly policies
    - Lower costs of production
    - Availability of skilled manpower
    - Availability of natural resources
    - Prevalence of English as one of the major business languages
    - Government's emphasis on infrastructure improvement
    - India's strategic location to markets of South East Asia, Middle East and Europe

- According to projections by the IMF, India is likely to become one of the largest economies of the world by the year 2025

Factors Driving Investments

- **Location:** Some of the emerging and established markets such as Middle-East and South East countries are closely located. It is also naturally connected via the sea routes, surrounded by the Bay of Bengal, Arabian Sea and Indian Ocean which facilitates most of its overseas trade in all directions

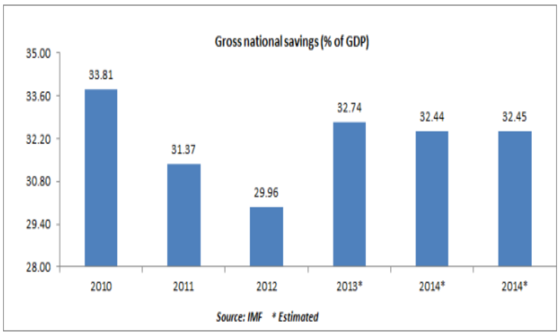
- **Population & Workforce:** The country's biggest asset is its huge size of its young and working population class. The proportion of population in the working age-group 15-59 years is expected to touch 64.3% in 2026, the the largest working age population in the world. Apart from this, the country's educational system ranks third in the world, after US and China

- **Natural Resources:** India boasts of being rich in a variety of natural resources such as coal, iron ore, manganese ore, mica, bauxite, petroleum, titanium ore, chromite, natural gas, magnesite, limestone, arable land, dolomite, barytes, kaolin, gypsum, apatite, phosphorite, steatite and fluorite

- **Infrastructure:** The Indian infrastructural landscape is expected to attract investments worth US$ 784 billion during the 12th Five Year Plan period (2012–17), with at least 50% funding from the private sector

Infrastructural Overview:

- **Roads** - India's total road network spans 3.34 million; second largest in the world
- **Rail** - Indian rail route is 63,028 Kms long which is largest in Asia and second largest in the world under one management
- **Ports** - There are 13 major ports and 187 minor/intermediate ports, handling over 90% of India's international trade
- **Airports** - India has a total of 125 Airports, which includes 11 International Airports
- **Special Economic Zones (SEZs)** - With a view to attract larger foreign investments in India, the SEZs Policy was announced in April 2000 by Indian government. There are 133 special economic zones operating presently



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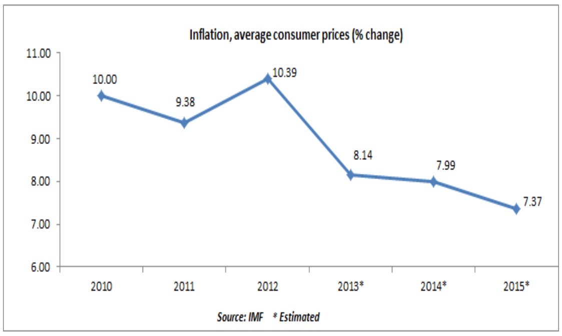

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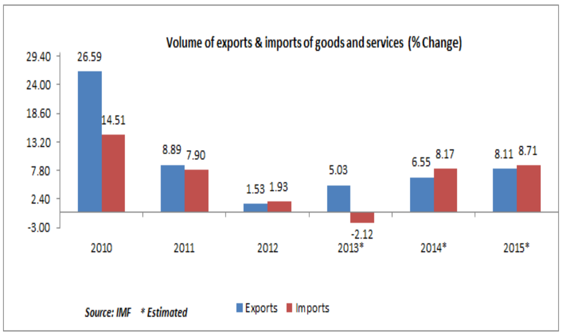

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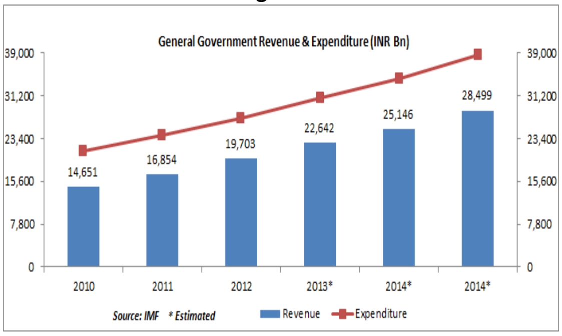

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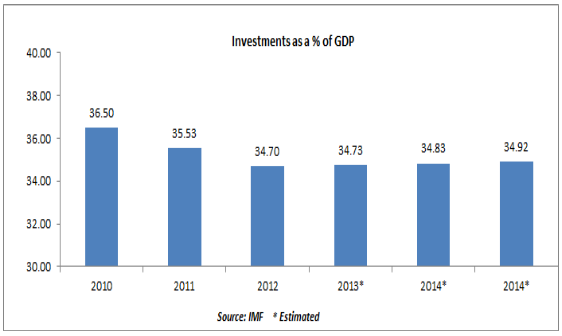

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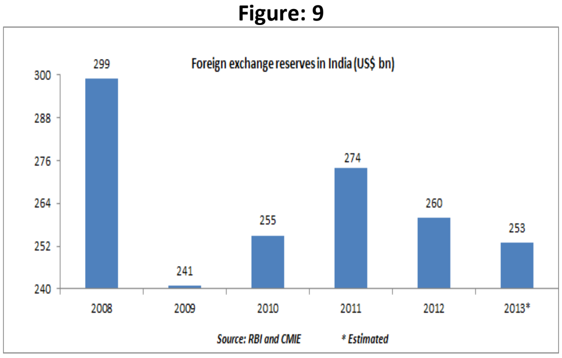

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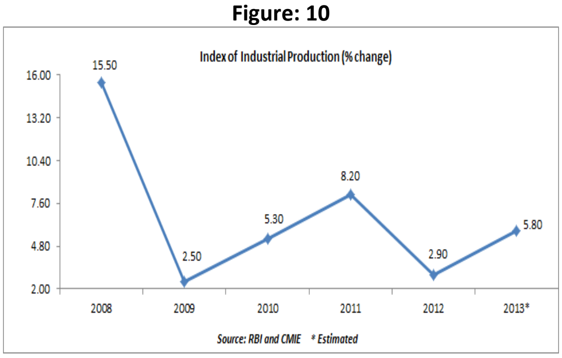

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Foreign Direct Investments (FDI)

- The Indian government has progressively liberalized its FDI regulations, with most restrictions on foreign investments being removed and simplified. Today, investment ceilings, which were applicable in certain sectors and cases, are gradually being removed or phased out

- The Foreign Investment Promotion Board (FIPB) is empowered and chaired by the Secretary Department of the Ministry of Finance (MoF). The FIPB has the flexibility to examine all the proposals in their totality, free from predetermined parameters or procedures

- According to UNCTAD's World Investment Prospects Survey 2012–2014, India is the third-most attractive destination for FDI (after China and the US) in the world. FDIs have continued to flow in, across several industries and sectors, indicative that investors believe in the growth potential and other investment opportunities that lie in the Indian markets

- The Government of India (GoI) permits FDI on an automatic basis, except with respect to a small negative list, which includes the following:
    - Proposals falling under the list of activities/sectors prohibited for FDI by the GoI
    - Proposals falling outside the ambit of notified sectoral policy/caps

- The total amount of FDI inflow into India (including equity inflows, 're-invested earnings' and 'other capital') from April 2000 to January 2014 stood at US$ 318,885 million, according to data released by Department of Industrial Policy and Promotion (DIPP). The cumulative amount of FDI equity inflows during April 2000 to January 2014 stood at US$ 212,031 million

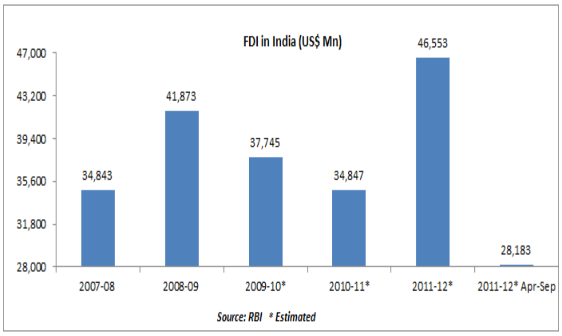


Figure: 12

(Refer Figure 13 for sector-wise details of FDI inflows)

- India has received total foreign investments of US$ 306.88 billion since 2000 – 94% of this amount came in during the last nine years

- During the first 10 months of FY 2013–14, the highest FDI was recorded in the services sector (US$ 1.80 billion), followed by the pharmaceuticals (US$ 1.26 billion), automobiles (US$ 1 billion) and construction development (US$ 966 million) sectors

- Countries such as France, Germany, Japan, Mauritius, the Netherlands, Singapore, the UK and UAE invested in India in 2013. Mauritius led inflows into India with US$ 4.11 billion of FDI during April–January 2013–14, followed by Singapore (US$ 3.67 billion), the UK (US$ 3.18 billion) and the Netherlands (US$ 1.7 billion)

- The GoI policy regime and a positive business environment have also boosted FDIs
- In 2013, the government relaxed FDI norms in several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others
- The government is also relaxing FDI norms in other sectors for foreign investors to invest. FDI in multi-brand retail has been allowed up to 51%. The minimum requirement for the FDI is US$ 100 million, of which at least 50% must be invested in 'backend infrastructure' within three years following the induction of the FDI. FDI limit in single-brand retail has been increased to 100%; 49% will be under the automatic route and the rest through the FIPB route
- Looking ahead, the government will require around US$ 1 trillion in the 12th Five-Year Plan to fund infrastructure growth covering sectors such as highways, ports and airways. This requires significant support in terms of FDIs

<u>FDI Policies and Incentives offered</u>

- Foreign investment is calculated on the basis of ownership and control of the Indian company
- FIPB considers proposals for foreign participation that do not qualify for automatic approval
- Free repatriation of capital investment is permitted, provided the original investment (on a repatriable basis) was made in convertible foreign exchange. Further, free repatriation of profits on capital investment is permitted, subject to payment of taxes and other specified conditions
- Use of foreign brand names/trademarks is permitted for the sale of goods in India
- All royalty payments, lump sum fee for transfer of technology and for use of trademark/brand names are permitted under the automatic route without any monetary/duration limits
- “Single window” clearance facilities and “investor escort services” are available in various states to simplify the approval process for new ventures

FINANCIAL MARKETS IN INDIA

- The Reserve Bank of India (RBI) is the central bank of the country

- The RBI regulates and supervises the nation's financial system

- Different departments of the Reserve Bank oversee the various entities that comprise India's financial infrastructure:

    - Commercial banks and all-India development financial institutions: Regulated by the Department of Banking Operations and Development, supervised by the Department of Banking Supervision
    - Urban co-operative banks: Regulated and supervised by the Urban Banks Department
    - Regional Rural Banks (RRB), District Central Cooperative Banks and State Co-operative Banks: Regulated by the Rural Planning and Credit Department and supervised by NABARD
    - Non-Banking Financial Companies (NBFC): Regulated and supervised by the Department of Non-Banking Supervision

RBI at a Glance

- Managed by Central Board of Directors
- India's monetary authority
- Supervisor of financial system
- Issuer of currency
- Manager of foreign exchange reserves
- Banker and debt manager to government
- Supervisor of payment system
- Banker to banks
- Maintaining financial stability
- Developmental functions
- Research, data and knowledge sharing

Primary Activities include:

- Monetary Authority
- Issuer of Currency
- Banker and Debt Manager to Government
- Banker to Banks
- Regulator of the Banking System
- Manager of Foreign Exchange
- Maintaining Financial Stability
- Regulator and Supervisor of the Payment and Settlement Systems
- Developmental Role

The main objectives of monetary policy in India are:

- Maintaining price stability
- Ensuring adequate flow of credit to the productive sectors of the economy to support economic growth
- Financial stability

Direct Instruments

- Cash Reserve Ratio (CRR)
- Statutory Liquidity Ratio (SLR)
- Refinance facilities

Indirect Instruments

- Liquidity Adjustment Facility (LAF)
- Repo/Reverse Repo Rate
- Open Market Operations (OMO)
- Marginal Standing Facility (MSF)
- Bank Rate
- Market Stabilisation Scheme (MSS)

Banking

- According to industry reports, India's banking sector is currently valued at US$ 1.31 trillion. It has the potential to become the fifth largest banking industry in the world by 2020 and the third largest by 2025

- With the Parliament passing the Banking Laws (Amendment) Bill in 2012, the landscape of the sector has transformed. The bill allows the Reserve Bank of India (RBI), which is the central bank of the country to make final guidelines on issuing new bank licenses

Refer Figure: 14 for the evolution of the Indian Banking Industry

Key Statistics

- Share of public sector banks in total deposits have also declined from 78.2% in FY05 to 77.3% in FY13

- This is largely due to the fact that private banks are rapidly capturing share in savings deposit

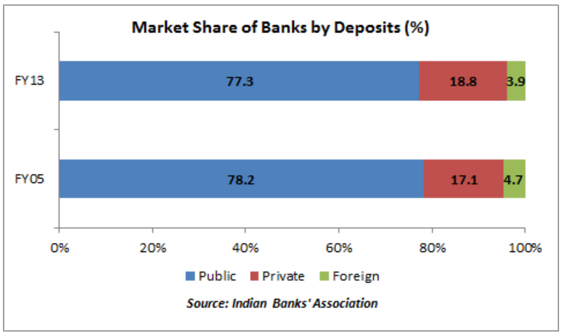


Figure: 15

- The Indian banking sector gained momentum:
  - Credit off-take has been surging ahead over the past few years, aided by strong economic growth, rising disposable incomes, increasing consumerism and easier access to credit
  - During FY06–13, credit off-take expanded at a CAGR[1] of 22.8% to US$ 991 billion
  - Demand has grown for both corporate and retail loans

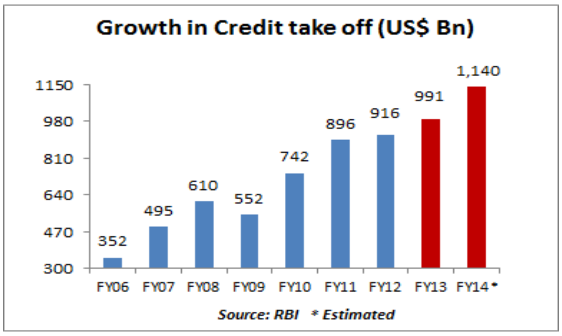
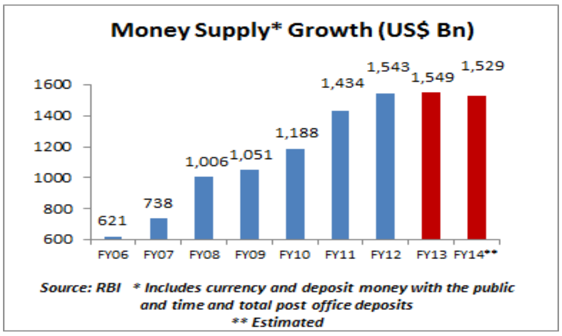


Figure: 16

  - Deposit growth has been mainly driven by strong growth in savings amid rising disposable income levels

[1] Growth and CAGR is in terms of Indian Rupee



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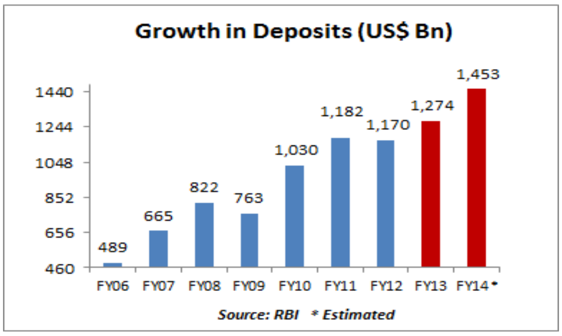


Figure: 18

- Asset base continues to expand:
  - Total banking sector assets have increased at a CAGR of 11.5% to US$ 1.7 trillion during FY10–13
  - FY10–13 witnessed a growth in assets of banks across sectors: public sector banks, which account for 72.7% of the total banking asset, grew at an average of 73.7%, while private sector expanded at an CAGR of 14.7%, and foreign banks posted a growth of 7.6%

- Total money supply increased at a CAGR of 14% during FY06–13

- Public sector banks account for over 73.3% of interest income in the sector

Drivers of the Banking Sector

- **Economic and demographic drivers**
  - Favourable demographics and rising income levels
  - Strong GDP growth
  - The sector benefits from structural economic stability and the credibility of Monetary Policy

- **Policy support**
  - Extension of interest subsidy to low cost home buyers
  - Simplification of KYC norms, introduction of no-frills accounts and other products to increase rural banking penetration

- **Infrastructure financing**
  - Banking sector is expected to finance part of the US$ 1 trillion infrastructure investments in the 12th Five Year Plan

- **Technological innovation**
  - Technological innovation has helped to improve products and services and reach out to the masses in cost effective way with the use of alternate channels like ATM, internet and mobile

Trends in the Banking Sector

- **Improved risk management practices:**
  - Increasingly focus on adopting integrated approach to risk management

- The embracing of the international banking supervision accord of Basel II
- Most banks have put in place the framework for asset-liability match, credit and derivatives risk management

- **Diversification of revenue stream**
  - Emphasis on diversifying the source of revenue stream to safeguard from interest rate cycle and its impact on interest income
  - Focus on increasing fee and fund based income by launching new asset management, wealth management and treasury products

- **Technological innovations**
  - Indian banks, including public sector banks are aggressively improving their technology infrastructure to enhance customer experience
  - Internet and mobile banking is gaining prominence
  - Customer Relationship Management (CRM) and data warehousing will drive the next wave of technology in banks

- **Focus on financial inclusion**
  - RBI has emphasised the need to focus on spreading the reach of banking services to the un-banked population of India and includes expanding branch network in the rural areas

- **Derivatives and risk management products**
  - Banks are developing Innovative financial products and advanced risk management methods to capture the market share

- **Consolidation**
  - Banks are increasingly looking at consolidation to derive greater benefits such as enhanced synergy, cost take-outs from economies of scale, organisational efficiency, and diversification of risks

- **Increasing focus on Woman Banking**

- **Wide usability of Real Time Gross Settlement (RTGS) and National Electronic Funds Transfer (NEFT)** are being implemented by Indian banks for fund transaction

- **Know Your Client (KYC)**
  - RBI mandated KYC standards, wherein all banks are required to put in place a comprehensive policy framework in order to avoid money laundering activities

Financial Services

Refer Figure 19: for Structure of the Indian Financial Services Sector

Capital Market

National Stock Exchange

- The National Stock Exchange (NSE) is India's leading stock exchange

- NSE was set up by leading institutions to provide a modern, fully automated screen-based trading system with national reach

- The NSE operates a nation-wide, electronic market, offering trading in Capital Market, Derivatives Market and Currency Derivatives segments including equities, equities based derivatives, Currency futures and options, equity based ETFs, Gold ETF and Retail Government Securities

  Refer Figure 20 for the products offered by NSE

- Today NSE's network stretches to more than 1,500 locations in the country and supports more than 2,30,000 terminals

NSE Indices

- The most important type of market index is the broad-market index, consisting of the large, liquid stocks of the country. In India, where clear categories of ownership groups exist, the performance of classes of companies sorted by ownership group are also examined

- For technical reasons, it turns out that the correct method of averaging is to take a weighted average, and give each stock a weight proportional to its market capitalisation

- The CNX Nifty is a well diversified 50 stock index accounting for 23 sectors of the economy. The CNX Nifty is computed using a float-adjusted, market capitalization weighted methodology, wherein the level of the index reflects the total market value of all the stocks in the index relative to a particular base period

- **Broad Market Indices:** CNX Nifty, CNX Nifty Junior, LIX 15, LIX15 Midcap, CNX 100, CNX 200, CNX 500, CNX Midcap, Nifty Midcap 50, CNX Smallcap Index, CNX Midcap 200 , India Vix

- Apart from the broad market indices, other segments of indices are also classified as sectoral Indices, thematic Indices, strategy indices, customised and fixed income indices

Bombay Stock Exchange (BSE)

- Established in 1875, BSE Ltd. (formerly known as Bombay Stock Exchange Ltd.), is Asia's first Stock Exchange and one of India's leading exchange groups

- BSE has facilitated the growth of the Indian corporate sector by providing it an efficient capital-raising platform

- Popularly known as BSE, the bourse was established as "The Native Share & Stock Brokers' Association" in 1875

- BSE is a corporatized and demutualised entity, with a broad shareholder-base which includes two leading global exchanges, Deutsche Bourse and SGX as strategic partners

- BSE provides an efficient and transparent market for trading in equity, debt instruments, derivatives, mutual funds. It also has a platform for trading in equities of SME

- More than 5,000 companies are listed on BSE making it world's top exchange in terms of listed members

- BSE's popular equity index - the S&P BSE SENSEX - is India's most widely tracked stock market benchmark index. It is traded internationally on the EUREX as well as leading exchanges of the BRCS nations (Brazil, Russia, China and South Africa)

Refer Figure 21 for BSE's Equity Market Capitalisation

- The SENSEX is constructed using the free float methodology, which refers to a company's share capital that is freely available for trading

- BSE provides trading opportunities for Equity and Index Derivatives and other specialised products

Securities and Exchange Board of India (SEBI)

- The Securities and Exchange Board of India was enacted on April 12, 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992

- Initially SEBI was a non-statutory body without any statutory power. However in the year of 1995, the SEBI was given additional statutory power by the GoI through an amendment to the Securities and Exchange Board of India Act, 1992. In April, 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the GoI

- SEBI has been vested with the following powers:
    - to approve by−laws of stock exchanges
    - to require the stock exchange to amend their by−laws.
    - inspect the books of accounts and call for periodical returns from recognized stock exchanges
    - inspect the books of accounts of a financial intermediaries
    - compel certain companies to list their shares in one or more stock exchanges
    - registration brokers

Asset Management

- The asset management industry in India is one of the fastest-growing in the world

- The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry

- AMFI, the association of SEBI registered mutual funds in India of all the registered Asset Management Companies (AMC), was incorporated on August 22, 1995, as a non-profit organisation. As of now, all the 46 Asset Management Companies that are registered with SEBI, are its members

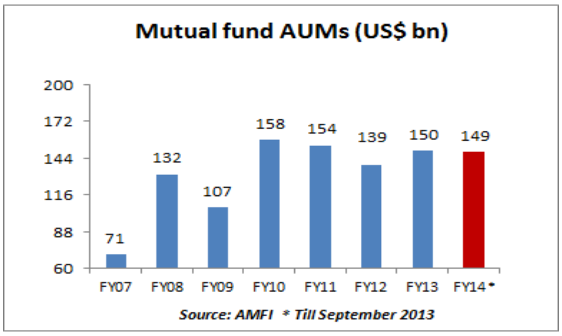


Figure: 22

- SEBI has announced various measures aimed at increasing the penetration and strengthening distribution network of mutual funds

Trends in the Mutual Funds Industry

- In FY09, SEBI removed the entry load to bring about more transparency in commissions, encouraging longer-term investment
- In its effort to encourage investments from smaller cities, SEBI allowed AMCs to hike expense ratio up to 0.3% on the condition of generating more than 30% inflow from these cities

Broking

- Steadily rising turnover in financial markets has led to rapid expansion of the brokerage segment

- The annual turnover value in NSE has witnessed a CAGR[2] of 26% between FY96 and FY13 to reach US$ 499 bn

- The number of listed companies on NSE and BSE increased to 6,877 from 6,445 over FY10–13. The number of registered sub-brokers rose to 70,242 in FY13 as against 62,471 in FY09. During FY14 (up to November 2013), total registered sub-brokers stood at 55,542

- The brokerage market is getting more competitive with the entry of new players and increasing efforts of existing players to gain market share

Wealth Management

- High Net Worth Individuals (HNWIs) – the primary focus of the wealth management industry, are estimated to have close to US$ 200 billion worth of liquid investable assets

- The investable assets of HNWIs in India has expanded at a healthy 26.2% CAGR over 2005–10

- At present, the size of wealth management industry in India is estimated to be US$ 20–40 billion, which represents 10–20% of total investable HNWI assets

- Advisory asset management and tax planning is the most demanded wealth management services among HNWIs, followed by financial planning

[2] In Indian Rupee terms

Insurance

- The Insurance Regulatory and Development Authority (IRDA), established in 1999 under the IRDA Act is responsible for regulating, promoting and ensuring orderly growth of the insurance and re-insurance business in India

Refer Figures 23 & 24 for the evolution and structure of the Indian Insurance sector

Key Statistics

- India ranked 10th among 147 countries in the life insurance business, with a share of 2.03% during FY13

- The country ranked 19th among 147 countries in the non-life premium income, with a share of 0.66% in FY13

Trends in the Insurance Sector

- Emergence of new distribution channels
- Growing market share of private players
- Launch of innovative products
- **The Union budget revealed that FDI in insurance sector raised to 49% from the current 26%,** with full Indian management and control, through the Foreign Investment Promotion Board (FIPB) route

Non-Banking Financial Companies (NBFC)

- NBFCs are rapidly gaining prominence as intermediaries in the retail finance space

- NBFCs finance more than 80% of equipment leasing and hire purchase activities in India

- The AUM of NBFCs in retail finance tripled during 2007–12; estimated to grow by 17% in FY13

- New RBI guidelines on NBFCs with regard to capital requirements, provisioning norms and enhanced disclosure requirements are expected to benefit the sector in the long run

Trends in NBFCs

- NBFCs have served the unbanked customers by pioneering into retail asset-backed lending, lending against securities and microfinance
- NBFCs aspire to emerge as a one-stop shop for all financial services
- New banking licence-related guidelines issued by RBI in early 2013 place NBFCs ahead in competition for licenses owing largely to their rural network
- The latest Union Budget provides impetus to the Indian Financial Services sector. Measures such as the adoption of uniform KYC norms, enabling the inter-usability of KYC record and adoption of new Indian Accounting Standards (Ind AS) would provide a great boost to the financial services industry

PRIVATE EQUITY IN INDIA

Introduction

- The economic boom in the early 2000s opened up avenues for Private Equity (PE) investors in the Indian market. Right from 2003 to H1 2008, PE investors were flushed with funds backed by low interest rates, favourable liquidity conditions and growing equity markets. Additionally, financial institutions wanted to deploy funds in buoyant emerging markets such as India

- Between 2006 and 2009, India had slipped from favour with private equity firms because they found it difficult to make money on their old investments made during the boom period. In 2006, at the height of the Indian investment boom, there were about 350 PE firms in the country

- PE funds wanted to take advantage of the country's strong middle-class population with growing disposable income, which led to opportunities in several sectors. However, these funds faced regulatory barriers, complex tax laws and the uncertainty of promoters. Further, PEs also faced competition due to alternative funding opportunities, access to low cost bank loans and fast growing stock markets

- In the latter half of 2008-09, when the global financial crisis surfaced, a flight of capital commitment to developed economies was noted among international PE investors. The high-growth period in PE investments in India came to a pause in late 2008, following the sub-prime mortgage crisis and global financial downturn that impacted credit markets. Total value of PE investments declined by about 70% in 2009 to US$ 4.5 billion, as the number of deals fell to 216 in 2009 from 448 in 2008. The promoter's mind-set shrugged off growth instead of a lower valuation and hence in 2009 there was a decline in total transaction value by 40% over 2008

- Earlier, the focus of PE was skewed towards high growth sectors such as Information Technology. After the global economic slowdown, investors diversified their interest into other high potential sectors such as manufacturing, infrastructure, e-commerce, pharmaceuticals and biotechnology

- With improved global conditions and recovery in the Indian markets, PE investors returned, but with a more cautious approach. The total investment value (for PE and VC deals) declined in 2012 to US$ 10.2 billion compared to US$ 14.8 billion in 2011 and US$ 9.5 billion in 2010. However, interest remained strong as indicated by deal volumes; total number of deals during 2012 increased to 551, from 531 in 2011 and 380 in 2010

- The topmost sectors which witnessed PE investments in 2012 included:
    - IT & ITeS
    - Pharma, healthcare & biotech
    - Banking & financial services
    - Real Estate
    - Power & Energy

- In May 2012, SEBI has introduced a comprehensive legal framework in the form of SEBI (Alternative Investment Funds) Regulations, 2012 [AIF Regulations]

- AIF Regulations were introduced to allow fund managers the flexibility to design fund products to cater to wider investor demand/ risk profiles, to provide targeted concessions to certain funds, as well as to bring within the ambit of regulation all types of domestic pooling vehicles

- The key highlights of the AIF Regulations are:

    - Under the AIF Regulations, all kinds of pooling vehicles, excluding some listed ones, are required to mandatorily obtain registration and comply with the investment and other conditions

    - Various new asset classes have been recognized and are provided the required investment flexibility pertaining to their investment objectives with minimal regulation

- Private equity funds have invested in almost all the sectors in India. Technology, Infrastructure, Telecom, Healthcare and Retail are some of the sectors highly benefited because of PE funding. PE has also played a vital role in providing employment opportunities in the country

Key PE deal drivers in India

- **Credit crunch** – The financial crisis is causing many business owners to reconsider PE. There is a continued need for growth capital and with less credit less available, private investment offers a means to fill the gap

- **Succession issues** – As business culture changes, some owners choose to sell to a third party rather than pass on their business to family members

- **The need for scale** – Businesses are coming together to achieve scale in the market and capital is required to finance these deals

- **Rationalization** – Conglomerates are selling non-core units, which provide deal opportunities for Private Equity firms

<u>Challenges in the PE landscape:</u>

- Overpricing by General Partners (GPs)
- Businesses failing to meet growth forecasts
- Mismatch of valuation expectations
- Poor performing IPOs
- Reluctance of Indian business owners to give up majority control, leading to fewer sale transactions

- Fall of the Rupee negatively impacting US dollar denominated funds, as currency hedging is not a market practice
- Cut throat competition for deals
- Unpredictable market for exits through IPOs
- Investment holding periods have lengthened
- Volatile Macro Economic Factors
- Non-supportive regulatory environment
- Difficulty in getting access to capital
- Poor corporate governance
- Unwillingness of promoter/CEO to sell stake
- Unwillingness of promoter/CEO to allow management oversight by a PE investor

Bird's eye view of India's Private Equity scenario in 2013:

- Indian PE and Venture Capital (VC) deal value increased by 16% to reach US$ 11.8 billion in 2013 over 2012; deal volumes grew even faster at 26% over 2012, driven by IT and ITES, healthcare and BFSI

- The number of PE and VC funds investing in India continued to increase. Approximately 150 funds from 2012 continued engaging in deals in 2013, while about 160 funds that did not invest in 2012 made investments in the following year

Deal making

- The average PE deal size increased significantly from US$ 35 million in 2012 to US$ 41 million in 2013, fuelled by a growing number of large deals

- The top 25 deals constituted 55% of total PE deal activity in 2013

- India continues to be a predominantly a minority stake market, with 50% of deal flow driven by early-stage deals; however, buyouts will continue to increase

- Looking ahead, GPs are cautiously optimistic about growth in 2014 for the PE and VC industry, especially after the general elections

- Due to underlying secular growth and dollar-denominated cash flows, the healthcare, technology & IT, and consumer products are expected to be the most attractive sectors for investment over the next two years

Portfolio management and exits

- The total number of exits climbed significantly by 43% in 2013, but the overall value of exits remained flat at 2012 levels of US$ 6.8 billion

- The IT, ITES and BFSI sectors have shown good returns on the invested PE capital

- As public markets continued to be tight and secondary deals are taking more time to close, buybacks gained a significant share of total exit volume in 2013

- GPs anticipate a 'rush to exit' post-2014, with secondary and strategic routes gaining importance even as the IPO environment remains uncertain. Potentially after the elections, GPs seem to be readying their investments for exit and waiting for a resurgence in valuations

Looking Ahead

- Over last year, deal values rose. However, it was a difficult year for PE in India, as both fund-raising and exits proved to be challenging

- The challenging macroeconomic situation and the slower-than-expected pace of exits have forced market participants to re-strategize

- PE funds are sharpening their focus on the best-quality deals based on their investment philosophies and are investing in relationships with promoters and management teams to conclude at reasonable valuations

- The PE industry anticipates favourable results especially after the general elections which will have spurred a series of economic initiatives and have led to policies that will promote further investments in multiple sectors to boost both short- and long-term growth

- Due diligence standards have improved. Most current transactions are being underwritten with prudent and conservative assumptions and transactions are being worked upon for several months before serious due diligence is commenced. Also, structured transactions are being increasingly implemented to provide for downside protection

- The primary growth drivers for private equity in India are Industrial growth and increasing opportunities for entrepreneurs

- According to reports, PE investments in India have the potential to touch the US$ 40 billion mark over the next 10 years. Consumer-centric businesses are favoured by equity investors and is expected to embrace the rural markets

SWOT Analysis

Strengths

- India has developed a diversified industrial base with a sophisticated financial sector

- India's biggest strength is the large size of its domestic market, especially the rapidly growing size of its middle class and a large proportion of educated population who are highly qualified, fluent in English and cheap to employ

- India's democratic political system offers a large degree of stability

- The government also places a high importance on infrastructure development and seeks domestic and private investment for its infrastructure sector development

- Abundance of natural resources

- High economic growth rate

Weakness

- Corruption and bureaucracy are concerns that challenge private investments in India

- India's emphasizes on import substitution and government intervention have created systemic weaknesses

- Presence of many unproductive public sector undertakings coupled with a high level of unionization has restricted labour reforms and technological

- Concerns related to physical infrastructure persist and huge population leading to scarcity of resources

Opportunities

- India's rapid economic growth and low per capita penetration rates of many goods and services, have created investment opportunities

- Areas that were previously the exclusive domain of the public sector now opening to the private sector

- Technology is opening up India's borders and enabling it to develop globally competitive products and services

- Problems with investing in certain industries at home (such as mining) and a growing need for raw materials to fuel industry are causing many Indian companies to step up their foreign investments thereby creating new cross-border business opportunities

- Huge domestic markets that are yet to be tapped with massive potential for foreign investments

Threats

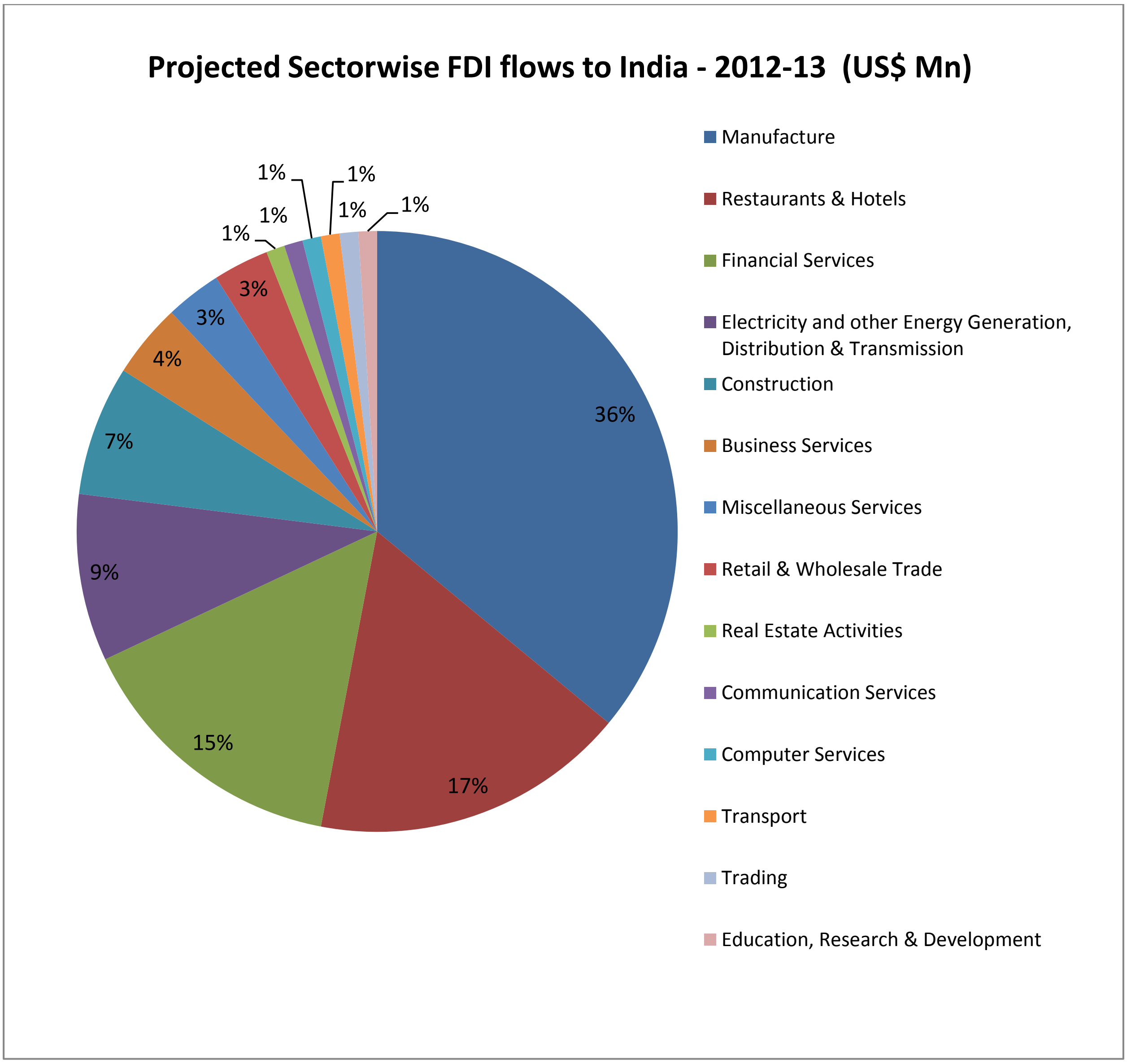
- Volatile capital flows have weakened the country's balance of payments position

- Land acquisition forms the main crux of concern of many Indian infrastructure and industrial problems

- Poor policy co-ordination among different government agencies and linkages

- Foreign buyers of Indian companies are vulnerable to tax surprises and other regulatory challenges by different government bodies

APPENDIX



Source: RBI

Figure: 13

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Evolution of the Indian Banking Industry

1921:
- Closed market
- State-owned Imperial Bank of India was the only bank existing

1935:
- RBI was established as the central bank of country
- Quasi central banking role of Imperial Bank came to an end

1936 -1955:
- Imperial Bank expanded its network to 480 branches
- In order to increase penetration in rural areas, Imperial Bank was converted into State Bank of India

1956-2000:
- Nationalisation of 14 large commercial banks in 1969 and 6 more banks in 1980
- Entry of private players such as ICICI intensifying the competition
- Gradual technology upgradation in PSU banks

2000 onwards
- Number of banks increased to 26 public sector banks, 21 private sector banks and 43 foreign banks
- Advent of mobile and internet banking
- Growing FDI in the Indian banking sector

Source: Indian Bank's Association
Note: The data on number of banks belongs to FY11
Figure: 14

Structure of the Indian Financial Services Sector

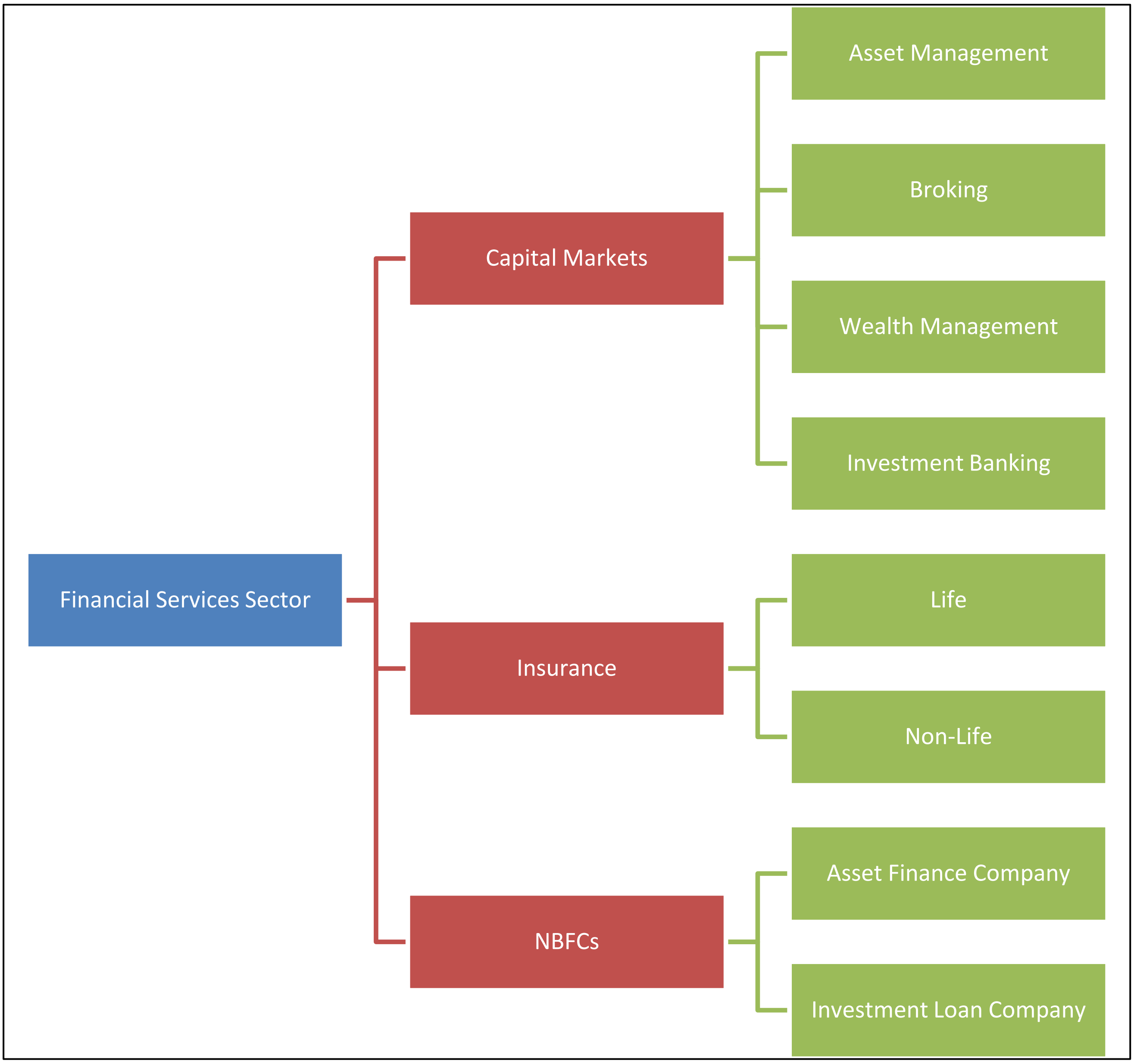


Figure: 19

Products Offered by the National Stock Exchange (NSE)

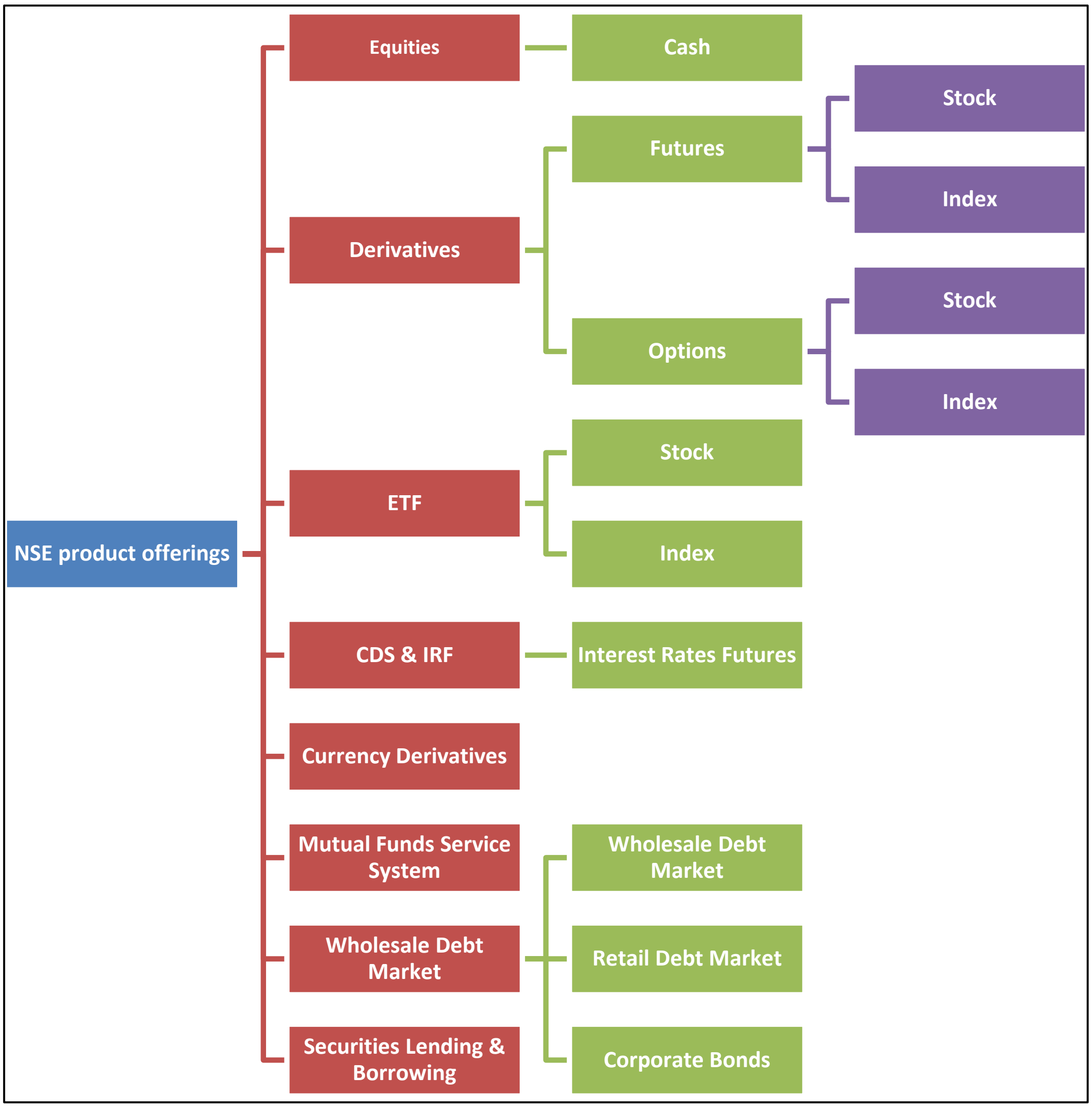


Figure: 20 Source: National Stock Exchange

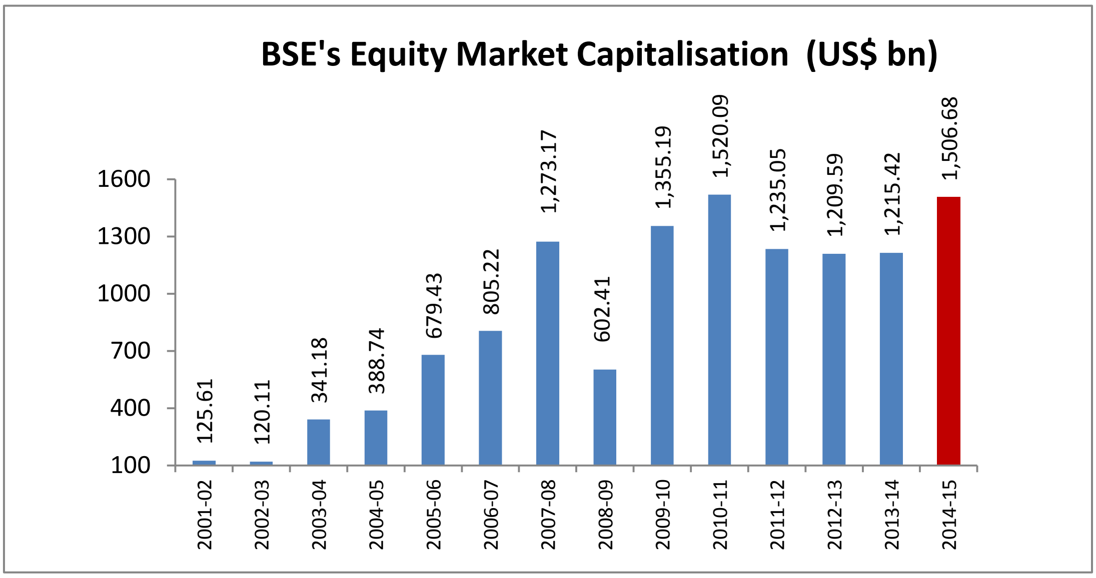
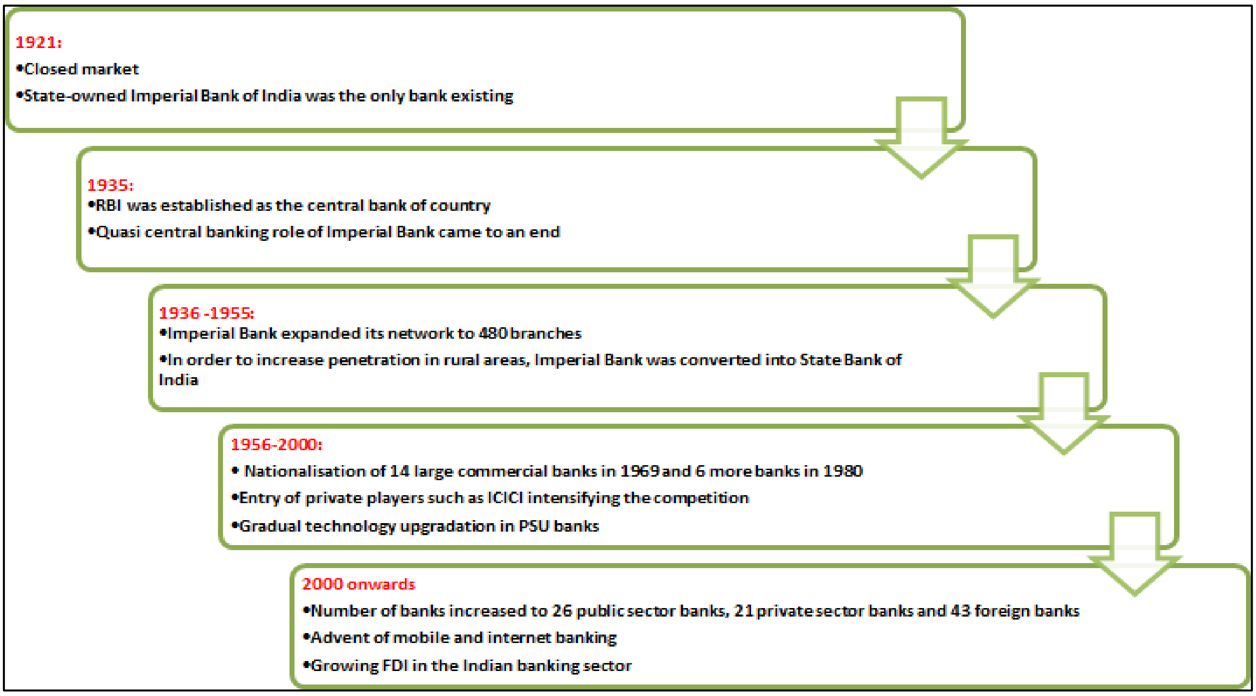


Figure: 21 Source: Bombay Stock Exchange

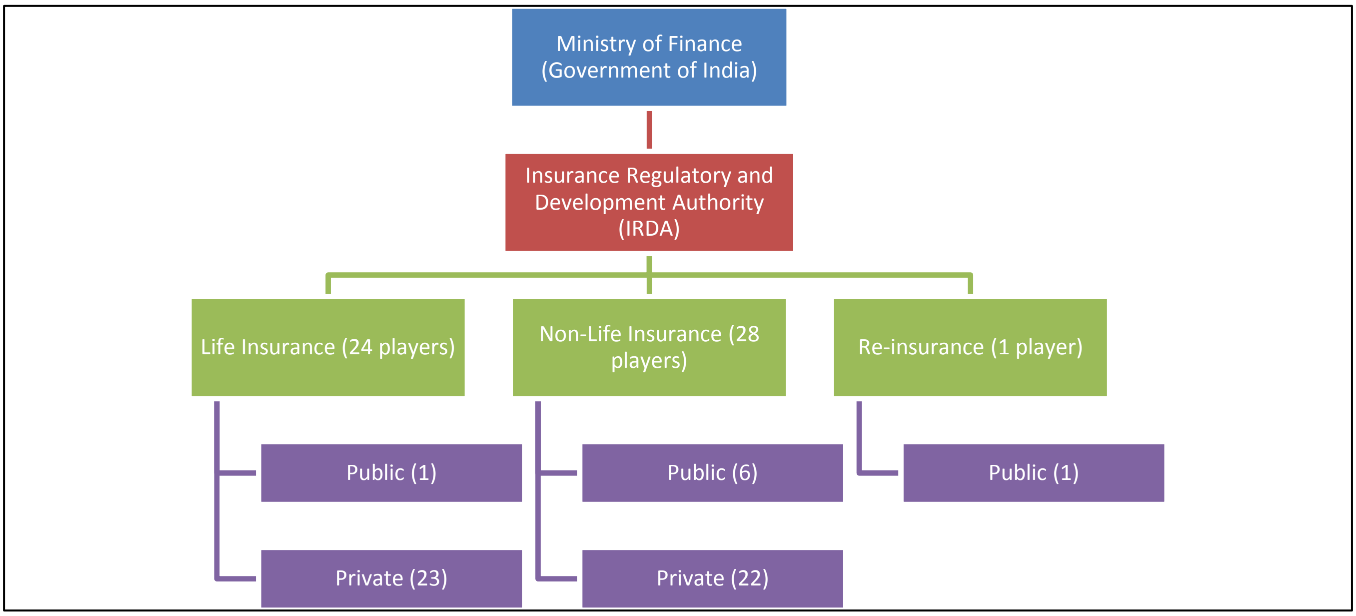
The Evolution of the Indian Insurance Sector



Source: RBI ; Note: The data on number of banks belongs to FY12

Figure: 23

Structure of the Indian Insurance Sector



Source: IRDA

Figure: 24

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