

An exclusive interview  
Sanjeev Kapoor



Celebrity chef,  
author, mentor and  
entrepreneur

SMALL MEDIUM

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## Investments in SMEs to Stage a Comeback

After two years of economic slowdown, private equity (PE) investments and mergers and acquisitions (M&As) among SMEs are expected to make a comeback in 2014.

**SANDEEP SONI**





The last **18-24 months** have been tough for Indian SMEs looking for PE funding or opportunities in the form of M&As. As per the research firm, Venture Intelligence, PE deals for SMEs dropped from **\$1,295.73 million** in 176 deals in 2012 to **\$970.24 million** across 132 deals last year. In the M&A arena, from 598 deals worth **\$35.4 billion** in 2012, things declined to around 500 deals worth near **\$30 billion** in 2013.

#### PE Climate in 2014

The coming of the new year has got many PE investors and advisors confident of a better investment climate for fund raising by SMEs. Most of the upswing will be on back of the consolidation in capital raising, longer and deeper due diligence processes, possible change in regulatory reforms after the general elections.

"From the SME deal making perspective, I would expect 2014 to be a stable year. There are enough PE funds, which consolidated last year, so I guess the number of funds has reduced slightly, the amount of un-invested capital has also reduced, which is a good thing for funds that are focused on this segment in terms of competitive intensity coming down and valuations becoming reasonable.

This is a good thing," says Jayanta Banerjee, Managing Partner, ASK Pravi Capital Advisors.

Furthermore, the intensity of due diligence had gone up significantly because of which many PE deals got cancelled last year. Investors have become more conscious in terms of what is the quality of the business, how the future projections are being created, etc.

"Due diligence is no longer a month or two months process, and hence deal making is getting delayed which I don't see changing in 2014, particularly among SMEs. However, I don't think there would any significant reduction in the number of deals getting completed, it would be stable," adds Banerjee.

Vishal Tulsyan, CEO & Managing Director, Motilal Oswal Pvt Equity Advisors, believes that the PE

amount, which got raised last year, was rock bottom and from 2014 there will be a spurt in deals though it might be slow and gradual.

"I am pretty much optimistic about the number of PE deals going up in 2014. In 2013, companies which were holding back their investment cycle and investors, both tried to adopt a wait and watch policy because of the political scenario, economic uncertainties, etc. (which matters to the overseas investors). Now everybody is expecting stronger reforms after elections that can help them overcome the policy logjam situation," says Debojyoti Ghosh, Vice President, BCP Advisors.

Echoing the similar sentiments, Rakesh Malhotra, Founder, Ncube Capital, says, "I don't think there will be lack of PE funding focusing



on the higher quality deals. So you will see big ticket deals in lesser number in 2014 as the risk on the execution and exits is now being felt more. Investors want to go where there is better chance of success rather than taking too many early stage risks."

### Need to Tailor Expectations

SME owners often end up focusing on presentations to attract investors, and once an investor gets on-board, the issues starts coming to the fore. "If entrepreneurs think that an investor would put money after being enamoured by the presentation then this does not happen anymore. Also there is an attitude among SME owners that equity money is purely risk capital. If business makes money, then you take some of it and if business is not making money then you lose all your money and go home. That is not how PE investors work. It is a capital that comes along with participation. SMEs have to be participative in nature; PE is a participative equity and not passive equity," says Banerjee.

Given that the sector is growing the focus must on business model. It is critical for entrepreneurs to emphasis on its corporate governance with a longer term view.

"Entrepreneurs need to have a more durable and sound business model with execution focus. Otherwise spaces like Internet and technology (where there are always growth possibilities because of its sheer growth size) companies in other sectors also get influenced by them. They try to do things that way which typically does not work in sectors they are operating in," explains Malhotra.

### Growth Sectors Attract Investors

For investors, every sector which shows growth is a hot and emerging sector to invest in. Primarily, the sectors which have been and will continue to attract investors' attention in 2014 will be related to consumers and Internet and technology. "On a broader spectrum, consumer story



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**Pankaj Karna**, Founder and Managing Director, Maple Capital Advisors

will remain intact and anything related to it will continue to get PE investors like retail and its ancillary, food and food products (particularly the ones getting into the branded space). So, branded businesses will probably attract some premium and investments in e-commerce are going to continue in 2014. The sectors which are getting hammered to a certain extent because of interest rate cycle like NBFCs, banks and to a certain extent auto can also probably see a revival,” says Ghosh.

He adds that lately, a lot of public sector banks are suffering with the quality of their credit portfolio. So the entire system is quite jittery in taking credit risk. As we know that in SME financing, the credit risk



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**Sanjeev Bhandari**, Managing Partner, TMG Advisory Group



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**Vishal Devanath**, Managing Director, SMERGERS

certainly goes exponentially high and this makes bank financing even more difficult to SMEs.

“Consumer, healthcare, financial services will continue to get PE investments. I also feel there will be an emergence of industrial plus capital goods sector in the second half of the year,” adds Tulsyan.

However, entrepreneurs might have to struggle with raising finance in case they don't have a proper team, business plan in place.

### Greater Impetus Needed

Yashwant Sinha, BJP leader and former finance minister had last month at a conference organised by Indian Merchant Chambers suggested the formation of an independent regulator Small



Business Financing Companies (SBFCs) to formulate a better framework for better growth and providing finance to SMEs. Along with such initiatives, it is crucial to control inflation and costs.

"The definition of SME should be widened to be more aligned to the market. The government should relook at the investment limits in plant and machinery and equipments in today's context. Also the lending to SMEs has to be risk adjusted. NBFCs should be given more incentive to finance SMEs. Ultimately, the amount of job creation in SMEs is huge and the government must keep that in perspective. They should look at the current limits on the asset size and increase it in line with the market and introduce flexibility in labour laws," suggests Banerjee.

"SBFCs will definitely help but that is not the first step to solve the issue of finance to SMEs. It is probably the follow-on step to boost the SME businesses but unless the basic factors get fixed like inflation and high cost with recent fall in rupee, the SMEs will continue to struggle with a high cost of capital. Improvement in these factors is likely to have significant and immediate impact and provide greater relief to the SMEs," asserts Ghosh.

### M&A Activity in 2014

Similar to PE climate, the revival of M&As among SMEs according to the M&A advisors and experts hinges on the upcoming elections.

"We see inbound M&A deals to increase this year based on economic reforms to take place post elections this year. Also valuations will remain attractive for global investors partly due to rupee value and also Indian companies would be looking for stability through cash infusion and other value being added by global acquirer/joint-venture company through technology and innovation," says Sanjeev Bhandari, Managing Partner, TMG Advisory Group.

M&As in start-ups should see an increase this year and moving

### Facebook's Acquisition of Little Eye Labs

Facebook's recent acquisition of Bangalore-based start-up Little Eye Labs that measure and analyse mobile apps for its developers proved that competent and innovative Indian start-ups are gaining interest from foreign companies as well. The acquisition whose deal size has not been disclosed will help Facebook boost its mobile development.

"Recent M&A activities such as Facebook's acquisition of Little Eye Labs, mark the beginning of successful exits for Indian product start-ups. This indicates that we are on the radar of the global business community and are being closely watched. I am sure that with a professional approach to the M&A process, we will see more such transactions in 2014," says Devanath.

upwards for at least three-four years from now. RedBus and JustDial are other examples to be emulated by new breed of entrepreneurs, adds Bhandari.

"On the backdrop of the challenging times in the last 18 months, 2014 starts with a new hope. Right now everybody is waiting for elections outcomes, which will give more clarity on the investment environment and direction on M&A activity," claims Pankaj Karna, Founder and Managing Director, Maple Capital Advisors.

SMERGERS, an online M&A firm helping buyers and sellers of SMEs, observes that the M&A activity in Indian SMEs is substantially unorganised. Many companies are not familiar with the M&A process, thus making it difficult for both investors and entrepreneurs. The focus now is on making the sector more organized and transparent.

"In 2014, we will see a steady growth in M&A in the SME segment. Our platform will provide a channel to facilitate many such transactions in an organized manner giving investors and entrepreneurs the widest network

possible. The core idea is that if we make it simple and transparent, businesses and investors across the globe can find each other creating value," says Vishal Devanath, Founder, SMERGERS.

"Organised M&As to SMEs will be driven by how well the SME entrepreneurs run their businesses and adopt best practices," says Karna adding that lot of times SMEs can unlock values for their businesses if they reconcile to smaller shareholding post M&A albeit of a much larger pie. Thus, they can unlock much more value than their higher shareholding in small company.

### Opportunities

In M&A space, commercial establishments like restaurants, salons, gyms, retail outlets will always be stable while IT services, IT-BPO, professional services, and manufacturing units will be evergreen sectors. The ones that are now picking up are water purification, aerospace etc where even foreign firms are looking at.

"Media and ad space will also be interesting because of the maturing nature of content delivery from traditional to new age which will create lot of opportunities. The traditional media houses will start looking at online much more aggressively given the reach and effectiveness of online medium," believes Karna.

"Sweet spot in M&As among small businesses remains from \$100-\$450 million. Consumer facing business (products and services), healthcare & pharma, financial services (against recent FDI guidelines in insurance and banking licenses being given) should increase this year," adds Bhandari.

The ecosystem plagued by forces like economic slowdown and poor market conditions have hindered entrepreneurs raise money or consolidates with larger players for growth. Now, how much the change would occur till the year end or post elections specifically would be interesting to watch out. @SME