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Count private equity flows as portfolio investment: EAC

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PRIVATE equity (PE) flows, which stood at $17 billion in 2007, should be treated as portfolio investment, feels the government's key economic policy think-tank, the Prime Minister's Economic Advisory Council (EAC). The panel has highlighted the lack of clarity on this count and called for simplification.

"PE investment inflows have also been quite large. Since in most cases PE flows constitute less than 10% of the capital of the company being invested in, they should ideally be reported under portfolio capital, and not under FDI," the EAC said in the review of economy for 2007-08.

While the EAC assumes that PE funds act like portfolio investors, ground realities point to a different scenario. In such cases, the investment is more like FDI rather than a portfolio investor. There are cases of PE funds taking management control of companies in a bid to improve financial performance even in case they do not have a majority stake. Blackstone, for example, took over Gokaldas Exports, a large player in the readymade garments segment. Similarly, Actis runs Punjab Tractors and Phoenix Lamps while ICICI Ventures manages RFCL. India Value Fund, another PE, holds the reins at Shringar Cinema.

The EAC review points out that in the first quarter of 2007-08, there was a difference of $2.5 billion between the sum of net purchases by foreign institutional investors and overseas equity issuance by Indian companies though ADRs and GDRs. It feels the differences could be on account of PE investments since many PE in-

vestors are registered under common ownership of registered FIIs.

With the overall capital inflows being pegged at $103 billion, much higher that the council's own July 2007 projection of $58 billion, the think-tank has recommended continued use of sterilisation to counter the excess flows in the remaining part of 2007-08.

The EAC had suggested a three-pronged approach to deal with large inflows in the economic outlook released in July: allowing rupee to appreciate, absorbing capital and sterilising imposing policy restrictions and facilitating outflows. The total foreign investment is estimated at $27.8 billion, a little more than first half of the current fiscal. However, the total surplus on capital account is estimated at $103 billion, or 8.7% of the GDP, in 2007-08, significantly higher than the $58 billion projected in July 2007 outlook.

Since this would put pressure on the rupee to rise, the council has advised the government to give clear signals to industry to make adjustments along with a transitional package.

"Clear signals should be given to industry to make adjustments through productivity increases and to tap the booming domestic market. However, some transitional packages targeted at labour-intensive industries may be called for," it said.

EAC chairman C Rangarajan also pointed that the capital flows may see some tempering in the next fiscal in the backdrop of developed economies witnessing recessionary trends due to subprime crisis.

The government has taken various steps to counter flows including tightening external commercial borrowings, clamping down on investments through participatory notes and liberalising remittances.