TOO MANY COOKS SPOIL THE BROTH – THE COSTS OF SYNDICATION IN PRIVATE EQUITY

Dissertation submitted in partial fulfilment of the requirements for the Executive Fellow Programme in Management at the Indian School of Business

by

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Declaration

This is to certify that the dissertation titled ‘Too many cooks spoil the broth – The costs of syndication in private equity’ have been carried out by me while studying at the Indian School of Business, Hyderabad under the guidance of Prof. Prothit Sen and Prof. Deepak Jena, both Assistant Professors in Strategy Area of Indian School of Business, and Mr. Sudarshan Sampathkumar, Partner with The Bridgespan Group, from the month of November 2020 till the current month of March 2023.

Based on my professional work, I am submitting this dissertation report in partial fulfilment towards the requirement of The Executive Fellow Programme in Management (EFPM) of the Indian School of Business, Hyderabad

I hereby declare that this EFPM dissertation is my original work and it has been written by me entirely. I have duly acknowledged all the sources of information and literature that have been used in the dissertation. This report has not been published and submitted for any educational degree to any other institute or university previously.

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Too many cooks spoil the broth – The costs of syndication in private equity

A) Introduction

The infusion of private capital, mainly comprised of debt, has played a significant role in shaping the market for corporate control in the latter half of the 20th Century (Jensen, 1989; Jensen & Murphy, 1989; Baker, Jensen & Murphy, 1989). This mode of funding, also known as private equity (PE) was considered a superior alternative to other modes of capital available at the time, with the debt acting as a disciplining mechanism beyond financial transactions (Jensen, 1986). PE firms created economic and institutional value from the restructuring of their portfolio companies through debt-related changes in capital structure, management, incentives, and governance principles (Kaplan & Stromberg, 2009, Casson & Nisar, 2007). = While evidence for the performance outcomes of PE-run corporate takeovers is mixed, there is no doubt that PE investment has emerged as the preferred instrument for funding for firms including start-ups, middle-market firms, and firms in distress across developing and developed nations (Wright & Robbie, 1998; Weir, Laing & Wright, 2005).

Over the years, the popularity of PE funding has increased, and the risk profile of investments taken up by PE firms has evolved, leading to the rise of alternate investment strategies to offset this risk. For instance, the PE industry has increasingly witnessed an alternate investment strategy of syndication to mitigate financial risk (Lerner, 1994), wherein the investment is made in a company by two or more PE firms in the same funding round (Bygrave, 1987; Lerner, 1994). Syndication is widely considered to be an effective strategy and the extant literature on PE syndication has overwhelmingly focused on benefits such as the *diversification of risk borne by a single firm* (Markowitz, 1952; Wilson, 1968; Lockett & Wright, 2001; Manigrat et al, 2006), *the use of window dressing to assure future deal flow* (Lerner, 1994; Sorenson & Stuart, 2001), *improved due-diligence as a result of knowledge sharing leading to improved selection* (Cumming, 2006; Lerner, 1994), *access to complementary skills* (Brander et al, 2002), *greater negotiating power for better investment terms* (Anand & Galetovic, 2000; Hochberg at al, 2007), *better exit terms by enhanced certification and lower under-pricing* (Chahine et al, 2007; Chowdhary & Nanda, 1996; Filatotchev et al, 2006), *portfolio diversification* (Cumming, 2006b), *deal flow generation* (Lockett & Wright, 2001), *value-addition* (Brander et al., 2002), *and collusion to increase their negotiating power* (Anand & Galetovic, 2000; Hochberg et al., 2007).

While the benefits of syndication in PE investments are clear, the process also entails certain transactions and relational costs given that it is conducted as a multi-firm arrangement. Literature has suggested many types of syndication costs; a study shows that there are horizontal and vertical agency costs associated with syndication (Meuleman et al, 2010). Syndication costs may arise for several reasons: one, *PE firms share a potential return with co-investors* (Brander et al., 2002), second, *there are agency costs due to informational asymmetries and potential conflicts of interest between the lead investor and other syndicate members* (Cumming, 2006; Pichler & Wilhelm, 2001), and third, *transaction costs reflected in terms of coordination and timing difficulties regarding decision-making* (Wright & Lockett, 2003). In addition to these, there are other costs such as the *informational disadvantage of non-lead investors* (Adamati & Pfleiderer, 1994; Wright & Lockett, 2003), *lower formal and informal control* (Sahlman, 1990; Wright & Lockett, 2003), *risk of moral hazard by the lead investor* (Pichler & Wilhelm, 2001), *less concentrated ownership leading to the lower incentive to monitor and free-riding behaviour* (Cumming, 2006), *incomplete nature of most contracts* (Hart, 1995), *expensive enforcement of complete contracts* (Al-Najjar, 1995), and *higher transaction costs* (Wright & Lockett, 2003). While it is clear that such costs exist and are felt by the lead investor as well as non-lead investors, there is inadequate research on the impact of these costs on the PE investment's performance. In understanding the impact of syndicated private equity investments, the need to compare the performance of solo and syndicated deals has been recognized but not attempted owing to difficulties in accessing data (Meuleman et al, 2009). So, there is no empirical study in the PE literature which has listed the major sources of syndication costs.

For this study, a proprietary dataset on PE deals was used to understand the various costs associated with syndication in these deals, examining them in the context of how they can impact deal performance at different stages of the PE deal life cycle, in an anecdotal manner. This study has been motivated by the knowledge of the above-referred gap in the extant literature and the counterintuitive observation from this proprietary dataset, where the syndicated deals performed poorly when compared with solo deals. In the absence of constructs available to explain this observation based on an overview of the literature on PE syndication, or any data models to isolate the effects of syndication from solo (Braun, et al, 2020), an inductive approach was adopted to theorize in this study. Chosen pairs of case studies from the proprietary dataset of PE deals were compared and contrasted and the inferences from the comparison of these case studies were used to form the arguments (Eisenhardt, 2007).

Interestingly, a look at the various deal characteristics of the dataset such as the investee companies' revenue, the size of the investment, the equity stake, industry sectors, location, and vintage of the investments showed that none of these characteristics could explain the counterintuitive findings of relatively poor performance of syndicate deals. This was the validation of the dataset which was thus considered suitable for the inductive research on the costs of the syndication. The inductive research design in this involved choosing a pair comprising one solo investment and one syndicate investment that shared several characteristics and observed the differences in their performance in a given stage of the private equity deal lifecycle. The observed differences would reveal the constructs which anecdotally explain the negative consequences of syndication, and the differences in solo and syndicated deals across the PE deal lifecycle were analysed over three stages – pre-deal, deal monitoring, and deal exit (Tyebjee & Bruno, 1984; Wright & Robbie, 1998; Klonowski, 2007). Across these stages, it is argued that the process of syndication entails challenges as it leads to prominence costs that are borne out of coordination or incentive challenges among members of the syndicate (Casamatta et al, 2007; Ivashina et al, 2016).

Within the pre-deal stage, it is argued that the due diligence phase in particular faces three broad coordination challenges in syndicated deals. First, when multiple partners exist in a deal, *there could be a tendency of the partners to herd towards the recommendations of the most reputed partner in the syndicate* (Tykova, 2007; Gopalan et al, 2011). This can lead to a suboptimal due diligence process, particularly when this reputation is not correlated with the sector or domain expertise of the focal deal. Second, *consensus forming on the most important metrics to evaluate the target can become cumbersome with different syndicate members weighing different performance measures of the target differentially* (Pichler & Wilhelm, 2001; Wright & Lockett, 2003). For instance, one investor may emphasize profitability while the other may focus on customer growth. Reconciling these differences can take time and lead to a partial or sub-optimal due diligence process. Finally, *there can be a potential conflict or disagreement concerning the ownership structure of the deal - "who gets how much stake?"* (Wright & Robbie, 2003). This problem may be exaggerated in cases when there is little clarity on who the lead investor is and who the secondary participants are, and this can contribute to a lack of consensus in the due diligence process.

Coming to the second stage of monitoring the investee company after the transaction, syndication faces several challenges. The foremost challenge in monitoring is to have a common metric amongst all investors, as each investor may have a unique perspective on the investment thesis as well as on what needs to be monitored. The co-investors need to have a formal information-sharing mechanism that involves the sharing of additional transaction costs (Meuleman et al, 2006). The very concept of syndication involves dilution of control; moreover, since the lead investors have a higher share than non-lead investors and also higher residual rights, this may lead to further reducing the accountability of members of the syndicate (Wright & Lockett, 2003). The syndicate also has to contend with moral hazard issues from members who may not be actively monitoring the investment and may delay the syndicate's efforts in times of emergency events (Pichler & Wilhelm, 2001).

Finally, at the exit stage, it is argued that in syndication their contractual arrangements may be inadequate or incomplete in terms of addressing potential issues within the transaction, which may later contribute to holdup problems during the exit stage. This may be owing to the insufficient application of efforts by the syndicate or cases of incomplete contract, which may both cause significant loss of value (Fluck et al, 2005; Hart, 1995). The syndicate members themselves may have different strategic priorities and motivations, and each member may have different reasons for the choice of the timing of exit and valuation of the stake at the exit. (Morse, 2011). For instance, large investors may look for higher returns over an early exit, while smaller firms may choose to focus on building a record of exits for growth (Hoskisson et al, 2013). This difference may manifest in some syndicate members having to make a sub-optimal choice of exit (Meuleman et al, 2017; Chinchwadkar & Seth, 2018; Eskilsson & Conradson, 2016).

This research study adds to the literature on the hidden costs of syndication by identifying specific ways in which they may affect an individual deal's performance, as envisioned in extant literature (Meuleman et al, 2009). The study also suggests a framework for the different stages of the investment lifecycle, which is another contribution to existing literature and provides a platform for further comparative research studies. Findings from this research study can have a significant impact on the private equity industry in India and outside India, by putting a spotlight on the costs side of managing syndicate PE deals and helping create awareness about the processes required to proactively manage them. This study will make PE fund advisories and PE firm managements aware of the need to differentiate their approach to the management of solo and syndicate deals, giving due regard to the sources of hidden costs.

This paper has significant managerial implications for PE fund managers. The findings may guide PE fund managers toward identifying and mitigating the sources of costs associated with syndication, based on the life cycle stage of the PE deal. This knowledge will allow them to employ internal measures such as using specialized skill sets for each stage of the PE deal lifecycle, as well as external measures such as tapping trusted syndication networks, staging investments, or innovating with newer types of syndicate structures (Casamatta and Haritchabalet, 2007; Ghemawat and Costa, 1993; Sharma and Tripathi, 2016; Gemson and Annamalai, 2015; Sen and Puranam, 2022).

This paper also offers directions for future research in the important domain of PE syndication. Future research may build on this study by tapping into a larger empirical sample size to validate this study's findings and identify the drivers of costs of syndication and their impact on various measures of deal performance based on thematic, sectoral, and geographical nuances. Future studies may also study the impact of innovative types of syndicates formed other than with the traditional PE funds (Sen and Puranam, 2022), such as with corporate venture funds or passive family wealth funds, on the deal performance in private equity.

B) Literature Overview

The literature on PE syndication is focused on the benefits of syndicated deals, which can be classified at the portfolio level or a specific investment level. The popular argument for syndication in PE deals is portfolio diversification (Markowitz, 1952; Wilson, 1968). Many empirical studies of PE investments in Europe show that risk-spreading is the main driver of such investments (Lockett & Wright, 2001; Manigrat et al, 2006). PE firms also want to associate with other successful PE firms to facilitate subsequent fundraising, and this need for window dressing can also be linked to risk diversification (Lerner, 1994). Syndication has been seen to help in the development of a network of PE firms that can provide access to new investment opportunities in future deal flows (Sorenson & Stuart, 2001).

At the investment level, members of a syndicate may collude and increase their collective negotiation power towards the promoter of the potential investee company and get a favourable valuation or financial terms (Anand & Galetovic, 2000; Hochberg et al, 2007). Syndication helps in the selection process through improved screening, due diligence, and decision-making (Cumming, 2006; Lerner, 1994). By syndicating, individual PE firms can share their specific industry knowledge and skills with other firms and together add more value to the investee company (Brander et al, 2002). Finally, at the time of exit, syndication helps to enhance the certification of the investee company and reduce the chances of under-pricing (Chahine et al, 2007; Chowdhry & Nanda, 1996; Filatotchev et al, 2006).

Despite these benefits, there are certain costs associated with syndication which have been identified in academic literature. First, by syndicating, PE firms give up a potential return to outside investors (Brander et al., 2002). Second, a syndicate arrangement imposes an agency cost due to information asymmetries and potential conflicts of interest between the lead investor and the syndicate members (Cumming, 2006; Pichler and Wilhelm, 2001). Finally, syndication involves transaction costs reflected in terms of coordination and timing difficulties regarding decision-making (Wright and Lockett, 2003), as well as moral hazards in teamwork (Holmstrom, 1982). These costs indicate that syndication has a potential downside; however, its impact on the overall performance of syndicate deals as a whole has not been studied.

A research study involving the comparative study of 390 direct investments by large PE funds during the years 1991-2011, with co-investments during the same period concluded that co-investments underperformed the direct investments (Fang et al, 2015). This was counter-intuitive, however as this comparison involved different sets of solo and co-investment deals, no clear insights on drivers for costs of syndication could be drawn. Another study involving over 400 funds with over 10,000 investments, of which over 1,000 were co-investments, found that funds that used co-investments as a dominant strategy significantly outperformed other funds. These contrary findings point to inadequate research on the causes of the costs of syndicate investments in private equity.

It is clear from existing literature that while there are horizontal and vertical agency costs (Meuleman et al, 2010) to syndication investments in private equity, there is inadequate research on the impact of these costs on the investment and thereby fund performance. This is perhaps due to the complex nature of the working of syndicated deals, which tends to be an informal working arrangement. Access to reliable data is difficult for outsiders and testing for validity and reliability is a challenging task for a researcher.

C) **Theory and Hypotheses**

To understand the hidden costs of syndicate investments in comparison with solo investments, it is needed that the two types of investments are compared and contrasted. For this, a framework is needed to isolate the effects on associated costs in distinct aspects of private equity investments. One way to go about this is to look at the PE life cycle and examine how its stages differ for each of the two types of investments. There are a few studies in PE literature that dwell on the deal-making stages over the lifetime of a deal (Tyebjee & Bruno, 1984). This deal life cycle is detailed in terms of the flow of information from deal screening to exit from the deal (Klonowski, 2007).

Based on a literature review of different studies that seek to identify stages of the PE deal life cycle, it may be noticed that the PE deal starts with the process of selection of the target and the deal execution, followed by the assumption of active ownership through monitoring of the investment deal, followed by an exit from the investee company (Wright & Robbie, 1998; Klonowski, 2007). This study considers the deal lifecycle in the same three stages, viz., The Pre-Deal Phase, the Deal Monitoring Phase, and the Deal Exit Phase.

In the following sections, the impact of the solo and syndicate investment management processes through each of the three stages of a deal lifecycle is observed, and a hypothesis is postulated in each case that may explain the source of higher costs of syndicate investments over solo investments. What does the academic literature suggest about possible explanations for the higher cost of managing syndicate deals in private equity?

Agency theory has traditionally been applied mainly to contractual relations within firms, even though it also provides a useful framework to analyse inter-firm transactional hazards (Holmstrom and Roberts, 1998). As syndication involves a cooperative effort by several partners, it is closely related to problems of moral hazard in team production (Holmstrom, 1982; Pichler and Wilhelm, 2001). Cumming (2006b) found that the extent of syndication had a negative effect on the optimal portfolio of Canadian venture capital firms, indicating the importance of agency problems among syndicated investors. Even though the investment agreement between syndicate members would stipulate the kind of information that should be reported and the frequency of reporting by the lead investor, problems of asymmetric information are unlikely to be resolved completely in these cases.

Further, lead investors in general hold a larger equity stake compared to non-lead investors to compensate them for their effort (Wright and Lockett, 2003). Overall, this means that lead investors have more informal control through their privileged access to information about the investee company as well as more formal control through their residual rights of control (Sahlman, 1990; Wright and Lockett, 2003). Given the long-term and uncertain nature of PE investments, the interests of the lead investor may not always coincide with the interests of the non-lead investors. The difficulty and costs for non-lead investors to oversee the actions of the lead investor could potentially lead to moral hazard by the lead investor and hence create an agency cost for non-lead investors (Pichler and Wilhelm, 2001).

Similarly, the potential costs of free-riding within a syndicate will be higher when agency conflicts between the investee and the investors are severe, highlighting the importance of monitoring the deal post-transaction. In such cases, each syndicate member could monitor the investee company to protect itself from the opportunism of the lead investor. This could raise the problem, however, of duplicative monitoring. The higher the potential agency problems about the investee company, the more monitoring will be needed from non-lead investors, increasing the costs of duplicative monitoring by syndicate partners. Thus, the agency costs imposed by duplicative monitoring are likely to outweigh the benefits of syndication when agency conflicts concerning the investee are more severe.

In the case of solo investment deals, many of these agency, coordination, and transaction costs identified in the extant literature may not be incurred. There may still be some costs between solo investors and investee companies of similar nature, and it will be important to identify how the costs of syndicate investments compare with those of solo investments. A variety of issues broadly categorized as time restrictions cost constraints, and situational factors may directly impact the level of due diligence during an acquisition process (Harvey and Lusch, 1995). Evidence from buy-ins (Robbie and Wright, 1996) identifies a major problem related to the ability to obtain adequate up-to-date information concerning the target investee company. While due diligence is expected to be undertaken thoroughly, the cost of transaction value in smaller buy-ins as well as time constraints in negotiations meant that this ideal was difficult to achieve.

Extant literature has identified the following themes for costs of syndicate investments, which have been classified into the three stages of the PE life cycle identified earlier. Based on these themes three hypotheses were identified for this study.

Pre-Deal Stage

Deal generation at the pre-deal stage is closely linked, at the strategic level, to a firm's preferences concerning investment stages and deal size, the availability of information, and the recruitment of its executives with the specific skills to seek out transactions (Murray, 1995; Bygrave and Timmons, 1992). At the time private equity investment is being considered, PE firms are faced with a potential adverse selection problem in that they are unable to gauge the investee company's performance before deal completion (Amit et al., 1990). The use of syndication involves giving up part of the stake, in place of debt, which may remove some of the disciplining mechanisms of debt (Jensen, 1986). Agency costs due to information asymmetries and potential conflicts of interest between the lead investor and other syndicate members lead to poor quality of selection (Meuleman, 2009).

These factors are akin to the agency costs between investors and investees and in the case of syndicate deals, additionally between the investors. The due diligence may yield better quality information in the case of solo investors, who have the opportunity to give feedback on the quality of due diligence and address perceived gaps in the investee company, than in the case of syndicate investments, where the lead investor may lack the sector expertise but still has the pressure and constraints and where he non-lead co-investors tend to rely on the lead investor.

H1: The quality of due diligence in a syndicated investment deal is less robust with higher chances of missing information as compared to a solo investment situation.

Deal Monitoring Phase

There are several reasons why the greater the agency costs imposed by a syndicate arrangement, the higher the agency costs of the investor-investee relationship, all else being equal. To begin with, PE firms play an important role in monitoring their portfolio companies to reduce informational asymmetries both for early stage (Gompers, 1995; Kaplan and Str¨omberg, 2004) and later stage buyout investments (Cotter and Peck, 2001). The higher the potential agency problems concerning the investee company, the more intensive the monitoring process will be required to be, and hence the monitoring role of the lead investor will become more important (Cumming, 2008; Meuleman, 2006). The very concept of syndication involves dilution of control; moreover, lead investors have a higher share than non-lead investors in the transaction, as well as higher residual rights, further reducing the accountability of members of the syndicate (Wright & Lockett, 2003). Less concentrated ownership in such deals leads to a lower incentive to monitor by members of the syndicate, leading to free-riding behaviour (Meuleman, 2010). In addition, the transaction costs in terms of coordination and timing difficulties regarding the decision-making of a large group of investors have to be considered (Meuleman, 2006; Meuleman, 2009).

Given the nature of syndicated investments, there is also a chance that non-lead investors will have to rely more extensively on the information provided by the lead investor and therefore run the risk of inadequate monitoring of the deal post-transaction. As the lead investor is more closely involved in monitoring the investee company, potential problems of asymmetric information between syndicate members are expected to be severe. As a result, problems of moral hazard are likely to intensify and agency costs are likely to be higher, reducing the attractiveness of syndication.

***H2*: Information asymmetry, differing individual perspectives, and diluted ownership will adversely affect the monitoring of syndicate investments compared to solo investments.**

Deal Exit Phase

At the time of exiting an investment in a syndicated deal, non-lead investors can reduce the potential hazards of opportunism by the lead investor by overseeing the writing of contracts and monitoring the lead investor and the investee company. One of the challenges is that since future contingencies are hard to stipulate, the investment agreement will always be incomplete (Hart, 1995). Studies find that under-provisioning of efforts in planning exits in PE deals contributes to significant value loss (Fluck, et al, 2005). Furthermore, even if complete contracts were theoretically possible, enforcement would be prohibitively expensive and time-consuming (Al-Najjar, 1995). If the lead investor is a reputed name, there may be an informational disadvantage for the non-lead investors in addition to dealing with lower formal and informal control (Wright, Lockett, 2003). Incomplete contracts can lead to confusion on the division of responsibility among syndicate members; expensive enforcement of complete contracts (Pichler, Wilhelm, 2001)

The motivations of syndicate members to exit PE deals differ based on their strategic choices and priorities; large investors tend to look for higher returns over an early exit, while smaller firms need to build a record of exits for growth (Hoskisson et al, 2013). This difference manifests in some syndicate members having to make a sub-optimal choice of exit (Meuleman et al, 2017; Chinchwadkar & Seth, 2018; Eskilsson & Conradson, 2016). In contrast, the control of exit decisions lies with the solo investor in solo PE deals, which is the most crucial determinant of the PE deal performance (Povaly, 2007). In syndicated investments, non-lead investors typically delegate certain monitoring functions to the lead investors and rely on their monitoring capabilities. Therefore, the lead investor acts as an agent for the non-lead members of the syndicate. Non-lead members of a syndicate may, therefore, suffer an informational disadvantage compared to the lead investor (Admati and Pfleiderer, 1994; Wright and Lockett, 2003). In planning the exit from an investee company, the views of the lead investors are likely to prevail unlike in the case of a solo PE deal where the investor can seek to maximize their financial return.

H3: The syndicate investors are less likely to get the exit of choice, both in terms of timing and/ or financial returns when compared with solo investor

D) Research Methodology

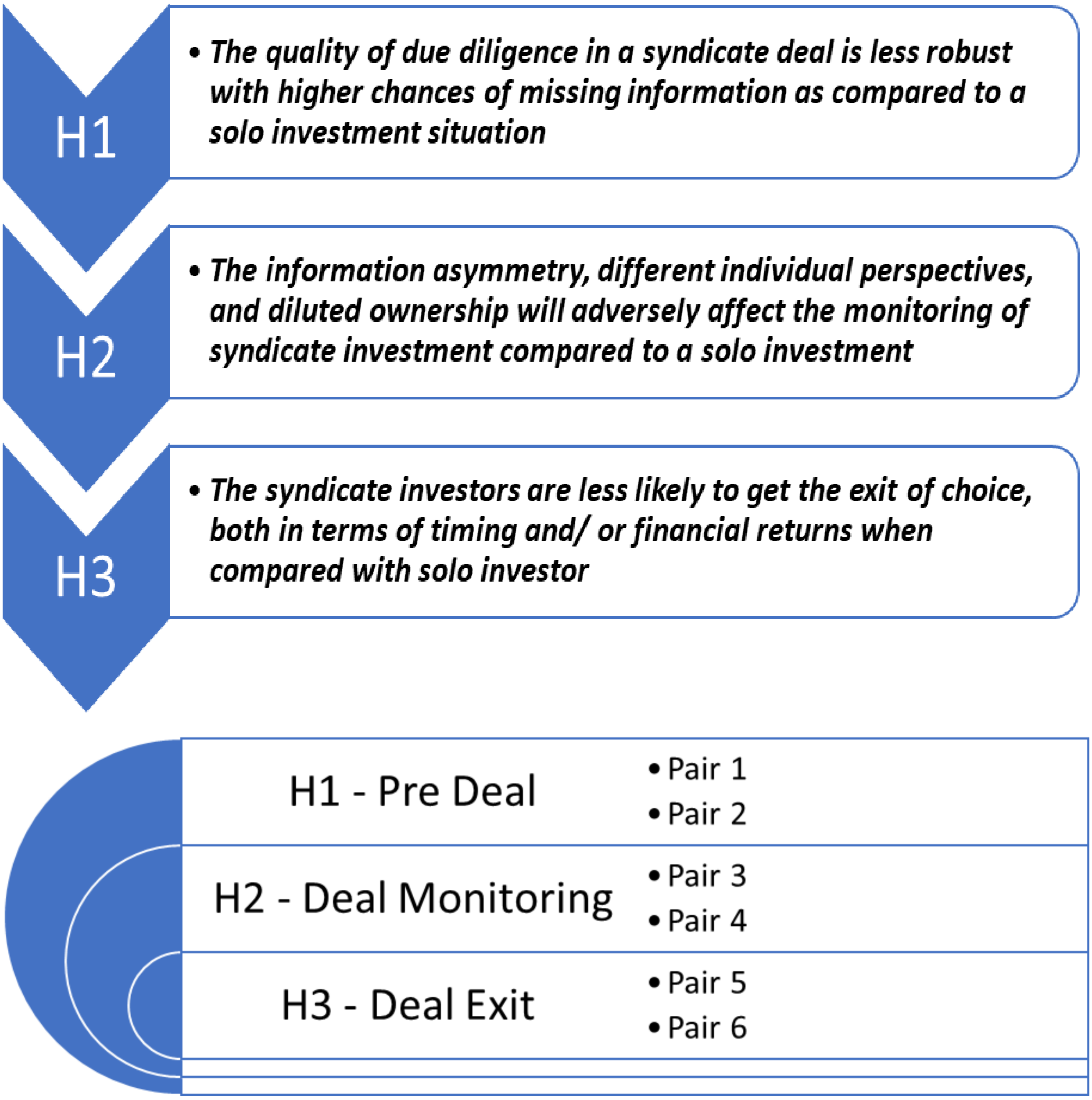
The factors leading to the deal performance by type of investment, viz. solo or syndicate have not been studied in any detail in the extant literature, as explained above, mainly on account of a lack of access to appropriate data (Braun, et al, 2020). As the prior theories do not explain the deal level performance, use of inductive research methods to observe associations and build theory is suggested (Eisenhardt, 2007). The observation of a complex phenomenon without any known variables to understand it and explain the behaviour needs qualitative research methods (Yimaz, 2013; Sandberg, Alvesson; 2010). Case study research is one such method that is purposeful – study cases [e.g., people, organizations, communities, cultures, events, critical incidences] are selected because they are "information-rich" and illuminative, i.e., they offer useful manifestations of the phenomenon of interest; sampling is aimed at drawing insights about the phenomenon, rather than empirical generalizations derived from a sample and applied to a population (Eisenhardt, 1989). A researcher has deep immersion and direct contact with and gets close to the people, situation, and phenomenon under investigation; therefore, the researcher's personal experiences and insights are an important part of the inquiry and critical to understanding a phenomenon (Eisenhardt, et al, 2007).

A PE fund advisor/PE fund management has access to the most relevant data including the financial performance data such as investment amount and realized amount on exit, timing, and duration of investment, corresponding data for co-investments (syndicate investments) as well as the implicit knowledge of the making of the investment by the syndicate. This implicit data may include details of the due diligence process, internal fund level and investment committee level appraisal process, internally accepted investment thesis, investment monitoring mandate received by the PE fund management, information sharing informal exchange between the PE fund and its investors, between the target firm and all the co-investors, between the lead and the non-lead investors, information flow on challenges faced from the investee company's management, perceived and realized risk profile of the investee company, etc.

Based on some differences noticed in the pre-deal, deal monitoring, and deal exit stages, it is proposed that if the costs of syndication are studied using the process approach, employing a multi-case embedded explanatory research method and theoretical sampling, and using pairs of cases which give insights on PE deal lifecycle stage-wise differences between solo and syndicate investments, new insights on costs of syndicate investments can be obtained. This data analysis can also bring out underlying causes for remedial actions and suggest areas for new research (see Figure 1 below)

Multiple-case study approach was used to generate a theory from data (Eisenhardt and Graebner, 2007). Such an inductive method is suitable when exploring a phenomenon that includes interactions between separate types of firms as well as within a firm. The inductive study involves immersion in the details and specifics of the data to discover important patterns, themes, and inter-relationships; it begins by exploring, then confirming findings, guided by analytical principles rather than rules. As the topic of understanding the costs of syndicate investments is novel and less understood, it has the potential to make important contributions to theory and help practitioners to in turn help improve investee companies' outcomes. Assessing multiple case studies has the added benefit of replication logic, leading to a more parsimonious theory than one which is developed using single cases (Yin, 2009).

Figure 1: Research Design



E) Data and Sample

Public databases on private equity investments do not have reliable financial data on investment amounts and duration, which is also the reason for the lack of research on factors affecting the financial performance of investment deals (Phalippou & Gottschalg, 2009). Against this backdrop, the availability of proprietary data is of significance.

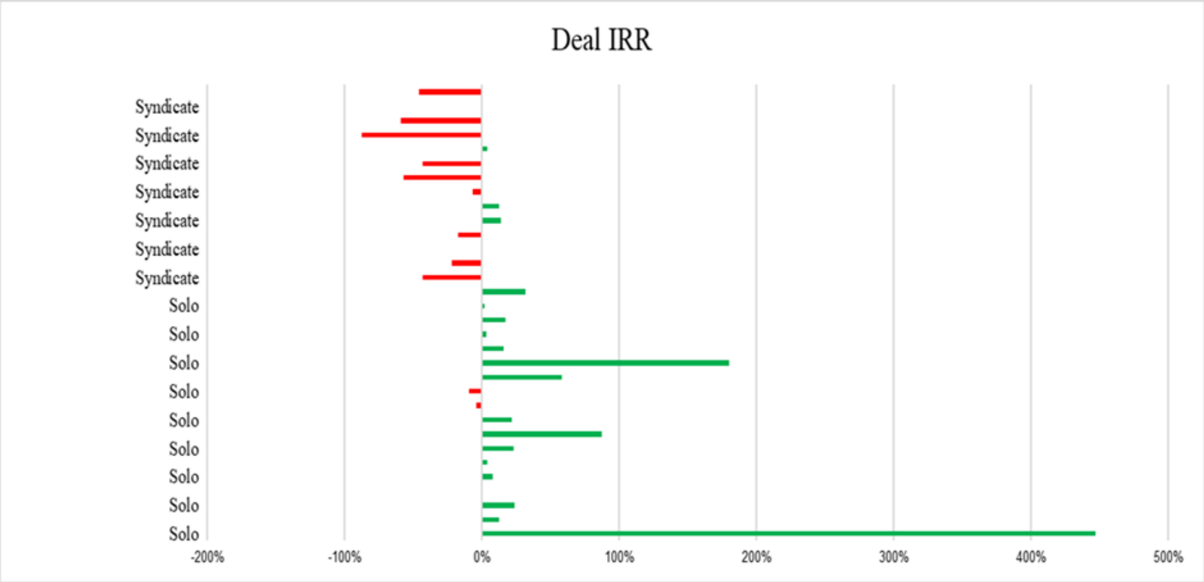
From a small base of $0.8 billion capital invested in 23 deals in the year 2003, private equity investments made in India grew to over $13 billion capital invested in 174 deals in 2017; total private equity investments during the period totalled $97 billion in 1931 deals (Indian Private Equity: Coming of age, McKinsey Report, November 2018). When this growth was taking place, one mid-size firm made 34 investments totalling approx. $250 million during the years 2003-2008. Access to this proprietary database of investments made in India, enabled this attempt to address the research gap by studying it. The researcher of this study was head of the investment advisory team of this PE fund and has intimate knowledge of all investments made by this firm, and it is supplemented with secondary published data. There is no reliable public data about private equity investments in India. Given the above context, this proprietary data provides a rare opportunity to compare the deal performance of syndicated deals with non-syndicated deals. The richness of the proprietary deal book in terms of the distribution of different variables – viz., period of investment, holding period, size of the investment, the share of the stake taken, type of structure solo or syndicate, sector focus, and the location is given deal-wise in Table 1 (see page no 29) and the summary is given in Table 2 below:

Table No 2: Characteristics of the proprietary deal dataset

Period of investment	**Between the years 2003 and 2013**
Holding period of investment	Average: 5 yrs., Min: 1 yr., Max: 10 yrs.
Size of investment	Average: $8m, Min: $2.7m, Max: $22.4m
% Stake in the investee company	Average: 10%, Min: 1%, Max: 34%
Solo % v/s Syndicate %	53% v/s 47%
The sector of the investee company	Automotive, Commodities, Consumer, Engineering, Facility Management, Fashion, Financial Services, FMCG, Garment Exports, Hotel, Information technology, Logistics, Media, Pharma, Stock Trading, and Textiles (10% > individual sector range >3%)
Location of the investee company	Spread over West, North, and South India

The deal performance data, the primary interest of this research study, was analysed by the type of arrangement -i.e. solo or syndicate type. The rate of return (%) for each of the deals was mapped and is presented in Table no 3 below:-

Table No 3: The distribution of IRR (%) by the investment deal type – syndicate & solo



The propriety data shows that the majority of solo investments (15 of 18) have provided a positive internal rate of return throughout the investment. In contrast, the majority of the syndicate deals (11 of 16) have provided a negative internal rate of return.

To confirm that there is no other explanation for this divergence, the PE literature was scanned for suitable frameworks. One framework was from a paper on the evolution of private equity firms using a 2x2 matrix of short and long-term versus niche and diversified portfolios (Hoskisson, et al, 2013). The proprietary data has shown a better performance of the solo deals as compared to the syndicate deals. This begs the question of the validity of this finding, as it is counter-intuitive to the conclusions found in the literature. All possible rival explanations were searched for and it was concluded that the type of deal characterized by the number of investors provided the best explanation for the difference in performance. Some of the characteristics of the deals considered were:

a) Size of the deal:- The size or the qualities it represents may explain the difference in performance, but this was not supported by the data.

b) Stake in a company:- Analogous to size, but representing the ownership size as against the dollar amount, the stake in % was checked for influence on performance. This was not supported by the data.

c) Size of the investee company:- There is a large variation in terms of the revenue size of the company in both cases.

d) The nature of the industry sector: - Niche or diversified – the difference in nature may have contributed to the performance. When the deal table was sorted on this basis, it was found to have approximately equal distribution, so this could not be a possible explanation for the finding.

e) Age of investment:- This could be another variable that could influence the performance of a deal, irrespective of whether it was solo or syndicate. The period of investment did not show any correlation with performance of the investment deal.

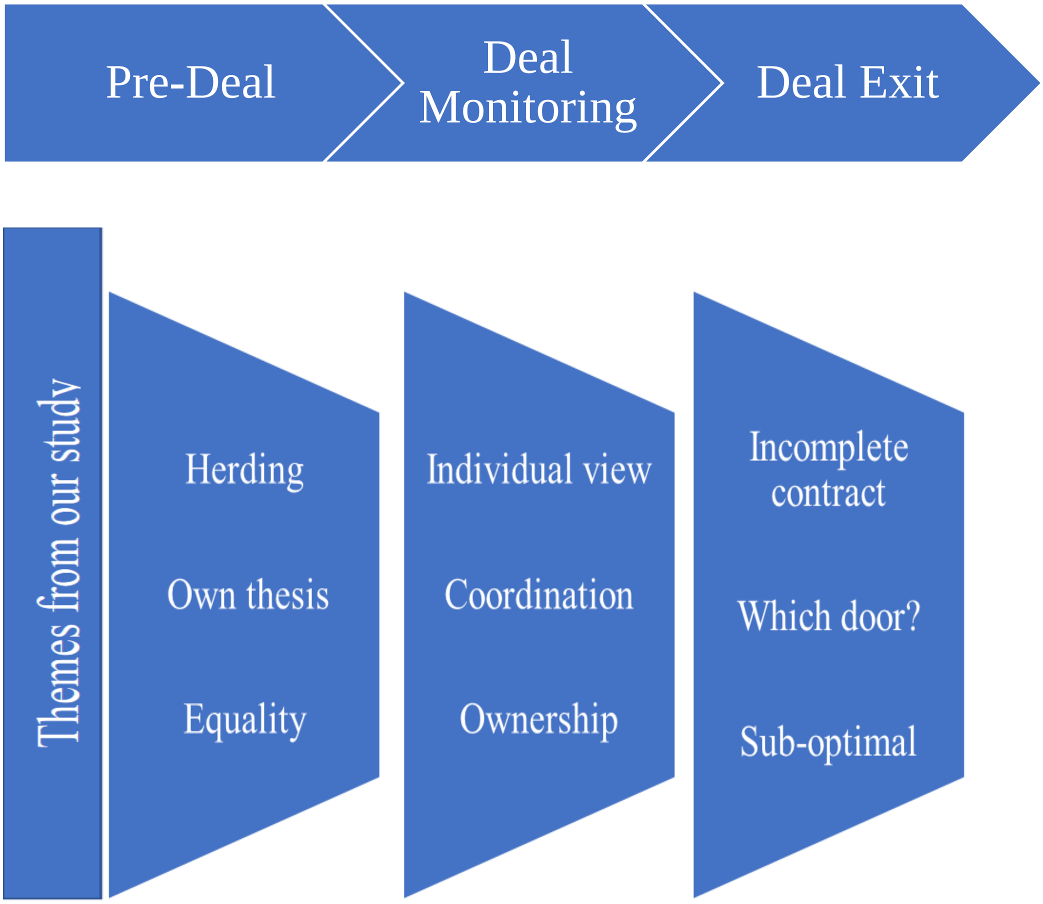
f) Location:- Companies in India may have locational advantages, and certain locations may support performance over other locations. The proprietary data set did not show any correlation between location and performance.

The distribution of performance was not influenced by any sector and it did not appear to offer any explanation. As the distribution of solo and syndicate deals across all variables in the table above also did not appear to provide any explanation, it may therefore be concluded that syndication in itself could be a major cause of divergence in performance.

The comparison summary of the solo group of deals with the syndicate group of deals is given in Table no 4 (please see page no 42)

The summary of the proposed theory can be captured by the following framework (see Figure 3 below)

Figure 3: Summary of proposed theory



	Pre-deal	Monitoring	Exit
#1	The herding tendency is often noticed in syndicate deals; solo investment by definition is made by a single investor	In syndicate deals there is multiple monitoring or compromised common monitoring which may make the monitoring process less optimal; solo monitoring is aligned to its investment thesis and is more optimal	The inherent uncertainty about the exit process at the contract writing stage reduces individual control of syndicate members on the exit process; the solo investor has control of the exit process
#2	Every syndicate member has its investment thesis which may not be aligned with theses of other members; the solo deal has a single investment thesis	Coordinating different monitoring requirements of syndicate members is a challenging process; solo monitoring is amenable to efficiency in meeting requirements	Syndicate members have individual investment strategies which may adversely affect arriving at an exit route decision; the solo investor has control of the exit route decision
#3	The syndicate members are seeking equality/parity with each other which is an elusive goal; a solo deal has no parity issues	Syndicate monitoring may result in conflicts among members and divided ownership and may affect resolution; solo monitoring has single ownership	In a syndicate deal, anyone exit route decision is likely to be optimal for only some of the syndicate members; a solo investor is likely to choose only the most optimal exit route

F) Results

Pre-Deal stage hypothesis testing

Two pairs of case studies were selected, comprising a solo and a syndicate deal that shared several similarities like the investment. Some of these similarities included the sector of the industries involved, the investee company, size of revenue, proportion of stake and its value, the length of the investment in terms of several years, the mode of exit by the investor, and the geographical distribution of syndicate members, whether domestic or global. Brief descriptions of these case studies are provided in Appendix A on pages 51-54.

Table No 5 (see page 42) presents the comparative values of each of these aspects for both pairs of cases selected for the due diligence hypothesis. The solo deal performed very well compared to the syndicate deal in both pairs.

In the case of the first pair, a summary of the findings is presented in Table No 6 below, where sharp differences were observed in managing the pre-deal stage of the deal cycle of the solo and syndicate deals in the media sector. In the case of the solo deal, it was observed that the due diligence was adequate and there was good alignment on the investment thesis, and though there was a difference in the level of expectation of growth, the path to be followed was transparently shared. The deal stake was based on a fair valuation, and there was no disagreement on that count. In the case of the syndicate deal, the herding phenomenon was evident and the level of diligence was minimal. The lead investor was under pressure to complete the deal, and the deal valuation was at a premium which may have contributed to disagreements and lack of parity which may have affected the resolution of gaps in diligence.

Table 6: Contrasting solo and syndicate media sector deals: Pre-Deal stage

	Solo	**Syndicate**
Herding effect on the investors	The herding effect was absent. The detailed diligence on the market opportunity was backed by a market survey and the available synergy from existing operations was verified.	High level of herding effect towards the lead investor, who in turn was influenced by the star value of the promoter. All participants were influenced by the size of the market opportunity and neglected even a basic level of diligence.

Common themes, differences in the investment thesis	The favourable macro situation and advantages of related diversification were the common themes. The differences were in the conservative approach of the promoter and the optimistic revenue projections, which were manageable by the investor.	The lead investor was looking for a first-mover advantage to take a leadership position amongst media PE investors. It had blind faith in the reputation of the promoters. Non-lead investors were interested in network effects for future benefit and didn't have sector expertise to ask for the business plan.
Stake allocation issues	The valuation was at a discount due to venture risk, and it was a fair-valued deal. The amount raised was lower than what the investor was willing to invest, and this was yet another example of the conservative approach of the promoter of the investee company.	The lead investor was forced to invest in the parent and subsidiaries at the same time. Non-lead investors were obliged to the lead investor for the invitation to the syndicate and believed that there will be opportunities for future adjustments.

In this case, the members of the syndicate were at the mercy of the promoter group and they did not carry out any diligence, and in addition, the promoter group was involved in illegal transactions which invited penal action and led to the loss of value for the investors. Non-lead investors could have insisted on due diligence or discussed the investment risks, yet they did neither. The solo investor, in contrast, was able to use the diligence information to align with the company's business plans and despite the new venture risk and a minor disagreement with the promoter on growth targets, was able to realize a healthy return on its investment. This observation supports hypothesis H1.

The summary of findings of pair no 2 is given in Table 7 below.

Table 7: Contrasting solo and syndicate auto parts sector deals: Pre-Deal stage

	Solo	Syndicate
Herding effect on the investors	Absence of herding effect. The PE investor carried out detailed and in-depth diligence and discussed findings with lenders and customers to resolve all historical red flags. The investor ensured that promoters have taken corrective action by introducing labour-friendly policies to prevent a repetition of labour issues.	A significant herding effect was noticed. The global expert view clouded the judgment of all investors; co-investors followed the views of the lead investor. Recency bias was evident in overlooking weak HR practices. The reputation of the US auto major blinded the lead investor from the uncertain export contract.

Common themes, differences in the investment thesis	A common theme was the anticipated increase in demand for new vehicles based on the forced obsolescence of old polluting vehicles. Confidence in design and technical capabilities as well as sound planning of the supply chain as revealed in due diligence was another common theme. The investor was also hopeful of entry in the aftermarket which was multi-fold in size of the annual OE demand, though the promoter was unsure of taking the bold step.	The only common theme was the macro one - India's low-cost design and manufacturing setup was attractive to global auto majors. The lead investor was banking on the potentially lucrative export contract, while the co-investor was focusing on its domestic business as the main thesis, giving option value for the export opportunity. This confusion also existed within the investee company and the differential treatment triggered labour unrest.
Stake allocation issues	The valuation was at a discount to fair value and the stake size was not contested. There were opportunities for both upstream and downstream investments, however, that would have increased the exposure to a single auto parts group beyond the laid down sector guidelines by the investment committee, and hence they were not considered.	The valuation was at a significant premium to fair value in anticipation of expected growth. There was little difference in the stake sizes of the lead and non-lead investors, and just the global presence of the lead investor earned it a board seat though the co-investor was the auto sector expert.

Both companies had many growth opportunities and sought PE investment. Both companies had red flags during the due diligence process; the solo investor was able to resolve the issues partly because they had sector expertise and partly because they were allowed to do so by the promoter. The lead investor of syndicate investment did not have the sector expertise and did not carry out the diligence with sufficient depth, and suffered from recency bias to ignore the risk to the supply chain, as was revealed shortly thereafter. This is other evidence of the herding phenomenon; a belief in a thesis based on a macro story rather than any company-specific evidence.

This comparison also supports the H1 hypothesis of less robust diligence in the case of syndicate contributed to the herding effect and accepting higher valuation without any evidence and missing critical information that can better inform the risks.

Deal Monitoring stage hypothesis testing

The selected four case studies are given in Appendix A (pages 55-58). Table No 8 (see page 43) presents the comparative values of each of these aspects for both pairs of cases selected for the deal monitoring hypothesis. The solo deal performed very well compared to the syndicate deal in both pairs.

The summary of the contrast in the first pair in the deal monitoring stage is presented in Table No 9 below. Both the investee companies were run by promoters who had excelled in their respective fields of providing innovative engineering solutions to corporate customers. The investment thesis was similar in terms of acquiring new customers while maintaining the profitability of the company. This was achieved in the case of the solo deal by a common view, close coordination, and total ownership extending beyond the board room to the organization. In the case of the syndicate investment, the divergent focus of the two investors who had equal veto rights pulled the investee company in different directions, and the unfavourable macro-industry factors aggravated the financial position of the company, causing losses to the company.

Table 9: Contrasting solo and syndicate engineering solution cos: Deal Monitoring stage

	Solo	**Syndicate**
Was there a common metric for monitoring	The metric was to closely track customer satisfaction and to monitor achieving high-margin revenue growth. The promoter's interest was to set targets for the organization and the investor's interest was a consistent increase in company valuation.	Two investors had two different metrics. The global investor wanted to track new order growth, with special emphasis on sugar by-product plant orders, while other investors wanted to track working capital management, due to the unfavourable macro environment.
How were the investor responses coordinated?	The metric was monitored at the board level and percolated down the organization. The investor gave references of blue-chip corporates to the promoter and the promoter ensured prompt corrective actions when gaps were observed.	The promoter and the top management team were conflicted in meeting the ask of both investors. The Sales Department chased new orders to claim incentives, and sometimes new orders were accepted from defaulting customers, thus increasing the working capital shortage. The coordination of response was lacking.

How was the ownership of monitoring handled?	The metric was owned by the organization over time. The setting of department-wise targets, incentive schemes, good work practices, etc. evolved from the data collected for the monthly metrics dashboard.	The different objectives for monitoring led to frequent clashes of opinions between the co-investors. The worsening financial situation precluded either investor from seeking an exit, and lack of consensus led to the distressed sale of the sugar plant and bankruptcy.

These observations support the hypothesis H2 that the different growth metrics and lack of coordination between the investors and disproportionate rights without full ownership between syndicate members adversely affected the performance of the investee company. There was no common ownership of the divergent metrics and the promoter could not get both investors on the same page.

The next pair at this deal Monitoring stage is from the infrastructure sector. In the case of solo investment, the growth opportunity and the strategy to achieve were accepted and the choice of the metric was acceptable to the investor. There was a significant challenge in the coordination of the metric across the organization as the implementation involved culture change, but the joint ownership enabled the transformation. In the case of the syndicate investment, each had an external interest in the road sector and that interest guided the monitoring process. The divergent interests - on bidding strategy, road construction equipment supply, or lender of long-term finance for building road assets made it impossible to decide on a certain kind of growth. There was no effort among the members of the syndicate to coordinate the views and advise the promoter on a specific bidding plan. When the road contracts eventually became unviable, there was no ownership to guide an alternate infrastructure-sector growth path. The growth plateaued and investee company performance was adversely affected.

Table 10: Contrasting solo and syndicate infra sector deals: Deal-Monitoring stage

	Solo	**Syndicate**
Was there a common metric for monitoring	The metric was derived from the investment thesis of improving the efficiency of the new global acquisition, in simple terms for effective global implementation. This metric was a cost variance for every customer order in % terms, taking the cost of best practices available as standard cost.	The syndicate of Corporate VCs used the common metric of increase in road contracts in both km and value terms, which later became complicated as new contracts passed on fixed-term ownership came into vogue. The individual interest however was only on a specific part of the metric related to the infra activity of their respective parent organization.

How were the investor responses coordinated ?	There was strong opposition to the metric and the management introduced incentive schemes for early implementation. The positive feedback from customers helped with the wide adoption of the metric. In some parts of the world, where the metric was not being followed, many employees were let go, and in PE investor was aligned in all actions.	The syndicate could not evolve comprehensive criteria for bidding for road contracts as each investor had a limited focus on say, either the bidding method, or bidding partners based on the geography, choice of bankers, type of equipment, source of hire-purchase, and so on…The investee company could only decide about the labour part of the contract. Later, when road contracts became unviable for many reasons, the lack of monitoring of other infra sectors severely affected the recovery process.
How was the ownership of monitoring handled?	Strong growth in net income helped wide ownership of the metric. It also led to a change in work culture and the metric became a common bond across all global locations. For the PE investor, simple tracking of metrics over three years allowed it to retain confidence in the investee company.	The piecemeal approach of investors to every bid meant an exchange of a huge amount of information for every contract, making it impossible to decide on a holistic strategy to achieve the objective of growth in road contracts. The metric was also incomplete as other infra sectors were not studied and no specific views were offered to the investee company.

The above contrast also supports the H2 hypothesis that in a syndicate deal, the divergent metrics and difficulty of coordination, with lack of ownership contribute to adverse performance.

Deal Exit stage hypothesis testing

The four case studies chosen for the exit stage are given in Appendix A (pages 59-62). Table No 11 (see page 43) presents the comparative values of each of these aspects for both pairs of cases selected for the deal exit stage hypothesis. The solo deals performed very well compared to the syndicate deals in both pairs**.**

Both the PE deals were from the textile sector and the investment thesis was export growth; in the case of the solo investment deal, it was by the acquisition of a denim manufacturing facility and garment manufacturing capacity expansion. In the case of the syndicate investment deal, it was the expansion of garment manufacturing capacity. The solo deal was with a publicly listed company, and the contract was specially designed to allow a period for the investee company to become convinced of the investment thesis before converting into equity, with an option to redeem the investment. In the case of the syndicate investment, the investee company was seeking to benchmark the valuation of the company for the upcoming IPO by inviting reputed corporate venture capitalists and private equity firms to invest in it. Though the investment contract in the latter case allowed all exit venues to the investors, the imminent listing of the company's shares would make the options void thereafter. Thus, the contract was not complete and did not include arrangements for the control on asking for a desired valuation from interested buyers.

The exit modes and the sequence were decided in the case of the solo investment deal,

	Solo	**Syndicate**
Did the contract discuss issues related to exit?	The investment contract specifically addressed the need for certainty of exit to the PE investor. The PE investor had asked for some time to conduct the diligence and an option to either convert the investment into shares or to redeem the amount in a fixed period yielding a short-term bond rate.	The contract provided for a variety of exit options, yet the fact that the company was already in process of listing its IPO negated these options to the investors, as they would not have veto rights to force the management to follow a course of action.
Was there an agreed exit mode or sequence of exit modes?	There was an agreed sequence of exit modes - first was the conversion of the investment instrument, optionally convertible preference shares, on a particular date into ordinary shares which could be traded on the stock exchange. If the option was not exercised, the amount will be converted into six redeemable debentures, payable over six quarters following the conversion.	There was no agreed sequence of exit modes after the IPO listing. The syndicate had opportunities before IPO listing as proposed by a non-lead investor, to demerge a domestic company from the parent to be listed company and shift all the stakes there, get the PE rights, and seek exit routes, but the syndicate did not agree.
Did the investors work together for the exit?	The company supported the choices available to the investor and in every board meeting provided the supporting documents for redeeming the investment both before and after the conversion choice was due. The PE investor chose to invest, even for a short period company benefited from it in terms of certification in financial circles.	The contract provided for a variety of exit options, yet the fact that the company was already in process of listing its IPO negated these options to the investors, as they would not have veto rights to force the management to follow a course of action.

while the syndicate investment deal did not plan this although the option could have been made available if they had proposed such an arrangement jointly to the promoter. The investors did not work together for securing an exit, leading to failure. These observations support hypothesis H3. Table 12 below details these observations.

Table 12: Contrast of solo and syndicate deals in the textile sector: Deal Exit stage

The second pair of deals in the consumer sector shows that the solo deal had an exhaustive list of exit modes, with an identified sequence, though the preferred exit route of the investor was not included in it. The syndicate deal, on the other hand, had no clause on any preferred mode of exit, and the control was with the Board of the company, and it tried different modes at different times without succeeding in any one mode. The PE investor in the case of solo investment made a strategic decision to not lose the deal as it realized the insecurity of the promoter group in dealing with a potential competitor after the exiting of the investor. In time, the promoter and investor jointly worked on a win-win situation by finding a foreign buyer who had no local presence. The syndicate's deal performance suffered because of an incomplete contract, lack of planning, and sub-optimal efforts to secure an exit.

The following Table no 12 details the contrasts and provides support for hypothesis H3.

Table 13: Contrast of solo and syndicate deals in the consumer sector: Deal Exit stage

	Solo	**Syndicate**
Did the contract discuss issues related to exit?	The investment contract is provided for listing IPO in a certain period, failing which the investor will be returned the capital at a 12% compound rate while protecting the rights of the investor to tag along in case of the promoter group sells its full or part stake.	The syndicate which fully owned the company gave all the powers to decide on exit to the board members, which comprised the lead investor, the VC incubator, and independent directors. The exit became a highly contentious issue, also partly because of the unsatisfactory performance of the company.

Was there an agreed exit mode or sequence of exit modes?	The investment contract provided for exit modes except for the one where the PE investor could sell its stake to a strategic buyer also referred to as a potential competitor by the promoter. So, the only two possibilities other than IPO were the promoter buying back or the promoter selling its stake to a third party. The PE investor believed that the resistance to the strategic deal by the promoter was manageable once the mutual trust level is built up.	The preferred mode of exit was selling to a strategic buyer. The IPO route was not preferred due to the onerous requirements laid down by regulators on part of the promoters, though some investors did suggest allotting ESOPs and naming the promoters from amongst old employees. The company made poor strategic choices for growth and the company lost ground in the market, creating several challenges in finding a buyer.
Did the investors work together for the exit?	Over some time, the PE investor and promoter developed a level of trust. The promoter family had many members and there were some related businesses and cross-holdings of family members, making the IPO listing process unmanageable. The investor was able to persuade the promoters to look for a foreign brand as a potential buyer to ensure growth and no clash in local markets. Both worked together to make it happen.	Each investor tried to find a buyer for its stake, rather than working together for a common buyer. This was also because there were many differences in the strategic growth choices made by the Board, but these efforts did not bear fruit. An investment banker was then appointed who found a buyer whose only interest was the large public sector bank clients of the company.

G) Discussion and conclusions

Major findings from the study

This paper addresses the hitherto unexplored area of understanding the hidden costs incurred in conducting syndicated investments over solo investments in private equity. On reviewing the literature on syndicated investments, it is hypothesized that the key differences between these modes of investments lie in their management by investors, and some of these differences contribute to the additional costs of syndication. It is proposed that these differences can be studied anecdotally using the inductive research method for each major stage in the investment deal life cycle, namely: the due diligence stage, the monitoring stage, and the exit stage. To conduct this research, proprietary data comprising both solo and syndicate investments conducted over a period of several years was relied on. For each comparison, pairs of solo and syndicate investments were carefully chosen so that are similar in several aspects so that the study and its findings are valid. By conducting a detailed study of the differences involved in each of the three stages of the investment life cycle in private equity as well as using inductive research methods, three hypotheses were tested to explore the sources of hidden costs associated with syndicate investments. There are costs arising from herding, misalignment of the investment thesis, and the lack of parity at the pre-deal stage; challenges in having a single monitoring dashboard, the high effort needed in coordinating monitoring response, and the lack of ownership are sources of costs at the monitoring stage and incomplete contract, dispersed efforts and conflicting investment strategies contribute to syndication costs at the exit stage.

Theoretical implications

This paper's findings that imply that the additional costs of syndication originate from the difference in the process followed in managing syndicate deals from the process followed in managing solo deals have important implications. The anecdotal case study method-based findings bring forth a few specific aspects of the syndication investment process which contribute to the costs and present this unexplored area, of study of newer variables that may affect the performance of syndicate investments for further research. The findings though not comprehensively applied to all PE deals, have great implications for practitioners, and provide a way to re-examine the existing process of managing syndicate deals. The findings have the potential to help stakeholders make a more balanced and informed decision on the choice of investment routes for private equity firms.

The findings present yet another application of established theories such as Agency theory, Information asymmetry theory, and Transaction cost theory in a new area in a practical setting in the relatively less explored and often mysterious world of private equity. The study finds that significant costs continue to be incurred by syndicate investors in private equity transactions, as academic research until now has not identified these costs/sources of costs in comparison with an alternative way of investing, viz. solo investing. The study also provides a process-based framework for further exploration of the costs of syndicate investment, for a wider choice of syndicate structures, different ways of investments such as staged financing, and for wider performance measures.

Managerial implications

This research study shows a new way of looking at syndicate deals, not just limited to an option for hedging risk but also as a strategic choice as an investment model. The study also shows some additional benefits of syndication while also being aware of the sources of costs in every stage of the deal life cycle. Based on the three stages of the life cycle of a syndicate deal, the practitioner can identify the different sources of costs and decide on the measures to mitigate the costs. Following are some of the key managerial implications for PE fund managers that emanate from this study.

First, private equity firms may use measures such as employing specialized skilled teams for each stage of the PE deal life cycle. The extant literature has recognized that for achieving complex objectives, the organization design has to employ a dual structure in which a trade-off between the static and the dynamic capabilities of the firm is achieved (Ghemawat & Costa, 1991). The tasks required vary by the life cycle; for instance, the due diligence phase needs more static-level skills; they are also classified as specialized skills requiring a mindful, active, and unbiased principle-based inquiry (Ghemawat, 1991). During the monitoring phase, a calculated cost-benefit analysis may be more useful, which would be an entirely different approach for the investor as compared to the approach in a solo deal, in the absence of inter-firm coordination and agency costs. During the exit process, highly creative and opportunistic skill sets are seen as more useful, which would help investor members achieve the best possible results in a syndicate (Julian Birkinshaw et al, 2015).

Second, a complete contract between the investee company and co-investors is crucial. A typical contract comprises the rights of all the participants and rarely covers the aspects of their behaviour, especially in cases of differences in approach and opinions. The merits of a complete contract, i.e., a contract that includes the investors' approach to exit as well as the expected response from each syndicate member will go a long way in mitigating the costs of syndication (Manigart et al, 2002). Private equity firms may also mitigate the costs of syndication by making strategic choices to create a diverse portfolio and seek a judicious mix of solo and syndicate deals as well as diversified syndicates, reducing free-riding behaviour among participants in the investment and also improving portfolio performance (Meuleman et al, 2009)

Third, if the deal size is large and consequentially the syndicate members are many, then the task of co-ordination becomes unmanageable and stage financing is one way to disburse capital in multiple stages by individual syndicate members, based on preidentified milestones of the investee, which can reduce uncertainty and growth risk (Gemson and Annamalai, 2015). This method is also used by experienced PE investors thus reducing the potential adverse selection problem (Sharma and Tripathi, 2016).

Finally, the PE fund manager has the choice of selecting an experienced syndicate partner. To develop internal knowledge and improve access to external knowledge, partnering with a lead investor with sector expertise, a large number of prior investments, long experience in the sector along with a successful exit track record, and operating from a central location are some of the aspects that may be invaluable (Clercq and Dimor, 2007; Wright and Lockett, 2003). Interfirm partnerships provide access to external knowledge (Dyer and Singh, 1998; Heimeriks and Duysters, 2007; Lane and Lubatkin, 1998). Finally, it is also found that the costs of syndication are inversely proportional to the level of syndicate experience (Casamatta and Haritchabalet, 2007). This may be a key factor to explore in future studies on the efficacy and performance of syndication. In transactions where an existing syndicate is not conducive to developing a new type of syndicate relations as demanded by the new deal situation such as a turnaround, the PE firm needs to innovate and balance its syndication model and acquire new partners with specialist skill sets as required (Sen and Puranam, 2022).

A high-level 16-step checklist of activities for a strategically managed syndicated deal is summarized below :-

S.No	Deal life cycle stage	Checklist for a syndicated deal
1	Receipt of the deal	Assess sector and task expertise and hire suitably skilled staff
2	Pre deal diligence	Robust due diligence (see Appendix B for a detailed list)
3	--do--	Seek partner(s) from a trusted network, with prior experience
4	--do--	Ascertain the syndicate size and capability with the need
5	--do--	Arrive at a common investment thesis, risks, and role allocation
6	--do--	Execute comprehensive contract arrangements with all partners
7	Monitoring	Build trust and converge to one monitoring dashboard
8	--do--	Observe, learn, and identify gaps in working with the investee
9	--do--	Motivate the syndicate to overcome the gaps and add value
10	--do--	Play allocated role; help verify the original thesis periodically
11	--do--	Demonstrate value addition across the investee leadership team
12	Exit	Scan investee for exit readiness a year before the planned date
13	--do--	Prepare thoroughly for more than one route of exit
14	--do--	Engage with the promoter with sensitivity, avoid conflicts
15	--do--	Protect the total value for the future joint benefit of the syndicate
16	--do--	Ensure value addition to the investee as well to build a reputation

Limitations

The study is based on proprietary data of investments that were made in a specific geography (India) and may be biased by prevailing market forces shaped by the demand and supply dynamics of the prevalent market for private equity investment, as well as comparative currency strengths. These market forces may be influenced by the demand for capital and supply of capital, and the intrinsic or perceived value of the venture may have a variable bearing on these values recorded over the existence of these deals. Some of the investments were made during the period when plenty of capital was chasing a few deals. A few years later, in the year 2008, global financial markets were adversely affected and these events might have affected the entry and exit valuations of some of the proprietary, and thereby their performance.

Another caveat to consider is that the purchase value, as well as the realized value of the investee companies (except in the case of a listed company), are a function of the competitiveness and the relative powers of the seller (promoter of the venture) and buyer (solo or lead investor). There may be a relatively small power with a non-lead investor, which in the experience of the researcher is a rare case. For the current study, it is assumed that the purchase and sale value and the timing of each transaction are largely a reflection and result of the investee company's performance and that all other probable confounding variables may cancel out when the ratios are compared in terms of their rates of return.

Given that the study is based on a small proprietary data set, there is room for bias, and no causal inferences are drawn or claimed. The correlations observed have been used to motivate a thorough investigation.

Suggestions for future research

The gap in extant literature suggests that syndication is a less understood phenomenon, the current study draws a comparison of syndicated deals with solo deals, dated a decade ago, over a single performance measure of internal rate of return, and brings out certain risks which have the effect of reducing multiple benefits of syndication. Future research should attempt a larger empirical present date global study to validate these findings and further isolate specific drivers of costs of syndication over solo deals, over many more performance measures.

These drivers may be checked using control variables of syndication composition, the experience of the lead investor, total investments made and IPOs achieved, size of funds invested, location, etc (Clercq and Dimor, 2007; Wright and Lockett, 2003). The interactions may not be limited to PE: PE funds, as in this case, but include newer types of syndicates such as corporate venture funds and lending partners (Sen and Puranam, 2022).

In the private equity industry, various performance measures are used, viz., expansion of EBITDA multiples, change in valuation multiples, exit to entry value or investment multiple, and changes in debt levels (Plenborg and Pimentel, 2016; Schlegel, 2019). The performance of a portfolio can be measured by the investment holding period and exit routes achieved (Schmidt and Steffen, 2010; Chinchwadkar and Seth, 2018). The performance can also be compared with public markets and also adjusted the for risks involved (Kaplan and Sensoy, 2015).

Syndication is a multiparty matching process, and the perspectives of non-lead investors and other investors need to be researched to further understand how syndicates are formed.

Special attention may also be given to minority and majority syndicate deals, in terms of how they contribute to the difference in the costs of syndication. Future research areas may focus on the role of organization development in controlling syndication costs.

End of text

List of tables

Table No 1: Details of the proprietary deals

S N	Equity $	% ownersh	Revenue $	Sector	Location	Model	Exit	Exit mode	Deal IR	# yea
2	10.1	3%	75.00	Car auto parts	Bhiwadi, Rewari	Platform	Y	OPEN MARKET	32%	2
3	7.1	4%	80.00	Fashion	Mumbai, Pune	Platform	Y	PE	-43%	3
4	7.8	19%	40.00	Garments	Chennai	Platform	Y	PE	-22%	7
11	21.3	6%	125.00	Share broking	Mumbai	Platform	Y	PE	1%	4
13	6.7	13%	30.00	Engineering	Chandigarh, Baddi	Platform	Y	BUYBACK	-17%	10
16	2.0	7%	15.00	Project software	Hyderabad, New York	Platform	Y	PE	14%	6
18	4.3	10%	16.00	Budget hotel chain	Mumbai + 15 cities	Platform	Y	PE	13%	7
29	5.3	10%	50.00	Auto parts	Gurgaon, Haryana	Platform	Y	PE	-6%	5
31	12.6	10%	40.00	Share broking	Mumbai	Platform	Y	PE	-57%	4
32	11.5	12%	30.00	Education	Mumbai	Platform	Y	PE	-43%	3
34	15.1	15%	30.00	Payment solutions	Mumbai	Platform	Y	PE	4%	8
35	13.7	10%	15.00	Media (TV Channel)	Mumbai	Platform	Y	PE	-87%	4
36	2.7	5%	15.00	Stock trading	Delhi	Platform	N			13
37	6.4	1%	50.00	Commodity trading	UAE	Platform	Y	BUYBACK	-59%	9
38	11.5	3%	125.00	Commodities trading	Mumbai	Platform	Y	PE	1%	5
39	6.4	13%	40.00	Wind Energy	Chennai	Platform	Y	PE	-46%	4
1	13.4	5%	25.00	Logistics	Mumbai, Antwerp	Single	Y	OPEN MARKET	13%	9
5	3.3	15%	30.00	Heavy auto parts	Kalol, Mumbai, Manchester	Single	Y	MIXED	24%	9
6	8.6	11%	160.00	Textile integrated	Delhi, Jaipur	Single	Y	BUYBACK	0%	5
7	3.0	0%	40.00	Auto parts	Punjab, Chennai and Jamshedpur	Single	Y	BUYBACK	8%	3
8	3.0	6%		Pharma	Palghar, Maharashtra	Single	Y	BUYBACK	4%	3
10	22.4	13%	75.00	Road construction	Hyderabad	Single	N			10
12	**4.5**	7%	50.00	Luxury hotel chain	Mumbai, Nashik, Pune, Agra & London	Single	N			11
14	8.1	15%	25.00	FMCG	Adimali, Kochi (Kearala)	Single	Y	STRATEGIC	23%	6
15	5.6	34%	10.00	Facility management	Chennai	Single	Y	STRATEGIC	87%	3
17	2.7	10%	15.00	Media (TV Channel)	Delhi, Kanpur	Single	Y	BUYBACK	22%	3
25	10.0	6%		Pharma	Mumbai Hyderabad	Single	Y	BUYBACK	-4%	3
26	12.7	8%		Pharma	Mumbai Hyderabad	Single	Y	BUYBACK	-9%	3
27	5.8	5%	80.00	Auto parts	Delhi, Pune	Single	Y	PE	58%	2
28	3.0	3%	450.00	Commodities	Kolkata, UP cities	Single	Y	PE	180%	2
30	4.7	8%		Pharma	Mumbai, Pune	Single	Y	PE	16%	3
33	7.1	8%	75.00	Engineering	Bengaluru	Single	Y	BUYBACK	3%	3
40	**5.7**	10%		Financial Services	Singapore	Single	Y	BUYBACK	17%	3
42	6.8	5%	45.00	CRAM	Noida, UP	Single	Y	PE	447%	1

The total no of deals is 34, of which IRR data on three deals are not available.

Table No 4: Proprietary deals grouped by solo and syndicate investments

	Solo investment		Syndicate investment	
Investment size ($m)	2.7 to 22.4; avg 7.2		2.7 to 21.3; avg 8.6	
Stake in the investee (%)	5 to 34		1 to 19	
Revenue of investee($m)	10 to 160		15 to 125	
Sectors of investee firms	Auto, commodities, consumer, engineering, facility mgmt, fin services, hotel, logistics, media, pharma, and road construction		Auto, budget hotel, commodity, energy, fashion, garment, information technology, media, and stock trading	
Due Diligence	Own due diligence with help of sector experts; several meetings with the promoter, the senior management and a few key customers and suppliers.		Commissioned due diligence report by a Big Four firm shared with firms after a non-disclosure agreement. Limited meetings by the lead investor with the Promoter only.	
Board seat, veto rights, etc	Board seat and membership of audit committee. Certain veto rights for senior hiring, new product marketing, or any major deviation from the approved business plans.		Only the lead investor gets a board seat and the non-lead may get to attend as an observer. Very limited veto rights as comapred to a solo investment.	
Exit mode	Buyback by promoter	50%	Another PE firm	75%
	Another PE firm	25%	Buyback	15%
	Strategic buyer	10%	Open market	10%
	IPO	10%		
	Not exited	5%		
Co-investors	None		2 to 10; avg 3	
Period of investment (yrs)	1 to 10; avg 5		2 to 10; avg 5.5	

Table No 5: Pre-Deal stage pairs of solo and syndicate investment case studies

	Pair No 1		Pair No 2	
	Solo	**Syndicate**	**Solo**	**Syndicate**
Revenue Size (US $ in m)	**15**	**15**	**30**	**50**
Stake in %	**10%**	**10%**	**15%**	**10%**
Value of Stake (US $ in m)	**2.7**	**13.7**	**3.3**	**5.3**
Industry Sector	**TV MEDIA**	**TV MEDIA**	**AUTO PARTS**	**AUTO PARTS**
Length of investment	**3 years**	**4 years**	**9 years**	**2 years**
Exit mode	**Another PE fund**	**Lead Investor**	**Open market**	**Open market**
Co-investors	**NA**	**Global**	**NA**	**Global**
IRR	**22%**	**-87%**	**24%**	**-6%**

Table No 8: Deal Monitoring stage pairs of solo and syndicate investment case studies

	Pair No 3		Pair No 4	
	Solo	Syndicate	Solo	Syndicate
Revenue Size (US $ in m)	10	30	25	75
Stake in %	34%	13%	6%	13%
Value of Stake (US $ in m)	5.6	6.7	13.4	22.4
Industry Sector	Technology service solution	Energy saving solution	Infra sector – logistics services	Infra sector – road construction
Length of investment	3 years	10 years	9 years	10 years
Exit mode	Another PE fund	Buyback by promoter	Open market	Open market
Co-investors	NA	Global	NA	Global
IRR	87%	-17%	13%	-3%

Table No 11: Deal Exit stage [airs of solo and syndicate investment case studies

	Pair No 5		Pair No 6	
	Solo	Syndicate	Solo	Syndicate
Revenue Size (US $ in m)	160	40	25	30
Stake in %	11%	19%	15%	15%
Value of Stake (US $ in m)	8.6	7.8	8.1	15.1
Industry Sector	Integrated textile mill	Readymade garments	Consumer goods	Retail payment solution
Length of investment	5 years	3 years	6 years	8 years
Exit mode	Buyback by investee	Strategic buyer	Strategic buyer	Strategic buyer
Co-investors	NA	Global	NA	Global
IRR	0%	-43%	23%	4%

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APPENDIX A - case studies (single page each)

I)Pre-Deal Stage – two pairs of cases:

- **a. Pair No 1**
  - **i. Case Study 1**
  - **ii. Case Study 2**
- **b. Pair No 2**
  - **i. Case Study 3**
  - **ii. Case Study 4**

II) Deal Monitoring Stage – two pairs of cases:

- **c. Pair No 3**
  - **i. Case Study 5**
  - **ii. Case Study 6**
- **d. Pair No 4**
  - **i. Case Study 7**
  - **ii. Case Study 8**

III) Deal Exit Stage – two pairs of cases:

- **e. Pair No 5**
  - **i. Case Study 9**
  - **ii. Case Study 10**
- **f. Pair No 6**
  - **i. Case Study 11**
  - **ii. Case Study 12**

I. Pre-Deal Stage: Case study 1 – Solo deal

This deal came through the personal network of the PE fund advisor. This is a solo investment case in a regional media (News TV) company, a related diversification by a 60-year-old print media company in North India, with a 15 million readership, into the television news and current affairs segment. The promoter CEO had said that the investment was "to meet the needs of true India, the India that lives beyond Delhi and Mumbai" when announcing the launch.

The promoter group used professional market research agencies to assess market needs and design brand promotion campaigns, ensuring that the advertising revenue budgets were matching the expense budget while maintaining a strong emphasis on ethical practices. The promoters invited the PE firm to examine all contracts and government approval documents. The accounting due diligence was carried out by a CA firm appointed by the investor, and employment contracts of senior employees and consultants employed were verified by the PE fund. The expected valuation was reasonable at a discount to similar deals in the recent past, with due consideration to new venture risk.

The outcome was satisfactory as all the major risks were identified and discussed at length, be it hiring talent or getting a share of the advertising revenue in TV media. The detailed plan and transparent discussions on challenges faced etc. along with the synergies with the print media division persuaded the investment committee of the PE fund to make this investment.

The fund advisor who was appointed to the board of the company had open access to the target rating points (TRP) of the TV channel, thereby allowing strategy discussions on the content selection and approval of changes in distribution budgets in real-time. The ratings started going up initially mainly due to the novelty of getting regional news, and as the growth slowed down, the board could authorize course correction and increase the share of national news with regional flavour and rationalize the distribution strategy, which provided the second leg of growth.

This synergy was also a limitation in the long run, as the TV channel could not venture out into performing arts or general entertainment, which were in more demand than the news. As the channel growth in terms of advertising revenue started plateauing, the media group felt that it would be useful to have a financial and strategic partnership with a national media group with diversified channels, and this was possible only after the exit of the PE firm. The PE firm facilitated the exit from this deal and enabled a win-win situation for the fund and the investee company's promoters.

I. Pre-Deal Stage: Case study 2 – Syndicate deal

This investment deal was received by the Partners of the PE fund from a global investor. The investment thesis was based on the star value of the promoter who led some of the most successful entertainment TV channels in India. His experience, ability to hire top talent, and the large-scale opening up of the media sector to foreign investment were considered attractive aspects of this investment. A new CEO for news channels was being appointed and due permissions for foreign investments were under process. It was conveyed that in due course the new CEO will make a detailed business presentation.

As the Foreign Investment Promotion Board was yet to consider the investment proposal, there was limited due diligence on the star promoter, and it was revealed that he had signed a non-compete clause with his previous employer, and instead of him, his spouse would be leading the new company for the near future. The detailed business plans of expenses and revenue were not available at the time of investment. It was understood by the lead investor and explained to other investors, that the promoter would confirm that all details would be shared after all due sanctions were received.

The co-investors did not have board representation and were solely dependent on the lead investor firm, who came from a highly reputed background. One of the general partners of the lead investor had served as CEO of the oldest and largest global management consulting firm between 1994 to 2003. The general partners of the co-investing firms wished to have cordial relations and did not conduct independent due diligence on this new venture.

There were several actions of the promoter group that was not in compliance with the prevailing laws. The FIPB approval was available only for the new media company, yet monies were diverted for setting up downstream media companies. The news channel CEO and his team left soon afterward. More money was diverted towards brand promotion than proposed earlier; the negative publicity generated by the exodus of employees, and negative word-of-mouth publicity kept the advertisers away and the new venture ran up huge losses.

The investment deal was made at a steep premium to other media company valuations, giving due regard to the star value of the promoter and his touted ability to attract advertising revenue. The investors were blind-sided by the past reputation of the lead investor and the investee company's head, and the glaring lapses in due diligence caused severe erosion of value for all PE investors.

I. Pre-Deal Stage: Case Study 3 – Solo deal

This investment deal was accessed through the personal network of the PE fund advisor. The investee company was a leading supplier of engine transmission products, in the Indian Heavy Commercial Vehicle (HCV) segment. As India was employing outdated engine technology and was falling behind the world in implementing Euro pollution norms, the Government made it imperative for the auto industry to adopt modern engines. The automakers in turn were keen to work with those vendors who could step up and adopt new designs of larger and more efficient transmission products. This investee company had located a firm in Europe to source the new designs and wanted to raise PE capital to finance the acquisition.

The operational/technical due diligence was carried out by the fund manager owing to his familiarity with the auto parts industry. The promoters had hired many retired employees of their major customer, a leading HCV manufacturer, in different areas of plant management such as quality, maintenance, after-sales service, etc. This helped the company in meeting the product technical requirement of the HCV manufacturers very well. The accounts and legal diligence presented many red flags on bank defaults which were related to past labour issues. The fund management investigated this in-depth at the plant level and also with bank officials. The root cause was established as a one-time labour strike engineered by a militant faction, which since then had left the company. The fund management also sought the feedback of all major customers on ratings and delivery performance and the findings were good. The marketing function was found weak as some profitable opportunities such as aftermarkets were not mapped. The holistic diligence equipped the fund management with key insights into areas that needed improvement. These red flags prevented many global funds from considering this deal, while this PE fund advisor was able to justify the risks involved and invested solo at a significant discount to market value.

The fund management played an active role in improving sales budgeting and expanding addressable market size, thanks to their knowledge of the prevailing gaps. The investee company entered aftermarkets which in turn reduced its dependence on OEM customers and increased its pricing power. The overall improvement in sales and profitability were the hits that brought results in terms of appreciation of share market price leading to a profitable exit for the PE fund and all-around benefit to employees, customers, and other stakeholders as well.

I. Pre-Deal Stage: Case study 4 – Syndicate deal

This is a syndicate investment deal received by the Partners of the PE fund from a global and the lead investor. India was at the time projected as the future sourcing destination of all global auto majors and this company was a leading supplier to the auto market leaders in India in 2-wheel and 4-wheel segments. This company was chosen as a Research & Development Partner by a top US-based auto major, for its new vehicle launches in Europe. This profile fitted the criteria of a desirable investment target for this global PE fund, and it approached a proprietary PE fund to co-invest.

A big four auditing firm carried out the due diligence and provided a good report on the accounting practices and compliances. The company used highly trained staff for planning and research purposes and employed only contract labour for all production operations. This firm also had a little history of labour trouble as it was located in a large industrial belt, and most manufacturing companies in this region relied solely on contract labour and labour unrest was common. The lead investor had detailed discussions on these observations and concluded that labour strife is an accepted phenomenon and it rarely causes problems as it is dealt with swiftly. The investment thesis was also based on large export orders expected from the US auto major in future years, based on the developed products at the company's research centre, though no firm commitment was on record.

Shortly after a few months, the US auto major declared a change in development plans due to the recession in Europe and it cancelled the research partnership in India. The new recruitment at higher wages and better working conditions in the Research Centre vis-à-vis production shops led to labour unrest, and the sudden dismissal of many contract workers led to violence and the temporary closure of the plant. The domestic customers of the company diverted the existing orders to other vendors. These events had a cascading effect on the company's finances, crashing the share market price.

The investment valuation was at a large premium due to the perceived scarcity factor, however, the outcome was unsatisfactory as the impact of unethical HR practices leading to an unreliable supply chain and loss of domestic business was not anticipated. The cancellation of the US auto major contract was not envisaged. These were not recognized as potential risks and were not monitored by the lead investor. The co-investor knew of the problems post-fact and both investors faced losses in this investment.

II. Deal Monitoring Stage: Case study 5 – Syndicate deal

This investment deal came through an investment banking firm, which is a subsidiary of an infrastructure advisory company. The investee company had constructed many types of infrastructure projects as a construction contractor. The company decided to raise PE funds to meet the equity capital eligibility threshold to bid for road projects. Three other investors offered to co-invest and support the company in accessing the global tenders; developing bidding strategies and getting entry to consortium membership for very large road projects respectively, based on their expertise, for common benefit. They all expected growth from the investee company in road contracts, though each had a different expectation of the kind of growth.

No single monitoring metric was agreed on by the investors and the board agenda items would focus on other aspects such as new bids made, bidding strategy used, bid outcomes with detailed reasoning, funds position, dues from NHAI (National Highway Authority of India), new bids announced, the trend of bids in terms of share of different types of contracts, etc. There was relatively far less discussion on ongoing projects. Almost no efforts were made to track other infrastructure segment projects such as airports, sea ports, irrigation projects, rail metro projects, commercial and residential real estate, etc., or consider alternate strategies for growth.

The investee company was not happy with the singular focus on road projects as the surge in demand for roads had forced NHAI to dilute qualification norms and allow small firms without much experience. These small firms adopted aggressive bidding strategies and forced experienced players to bid at below-cost levels. The investors were not open to the company diversifying outside the road sector. This restricted the investee company's growth plans and to add to the misery NHAI did not have sufficient funds to pay for completed construction. The investee company came close to bankruptcy. The investors had no agreement on a detailed growth plan based on market reality and there was no contingency plan drawn in the eventuality that the road contracts were no more offering an economical return on investment. The investee company was forced to raise debt to finance the ongoing construction projects in the face of delays in getting payments from NHAI. The company tried to list itself by raising an IPO but the valuation range proposed by the bankers did not meet the acceptance of the investors. The company’s growth stagnated and all investors faced a loss in investment value.

II. Deal Monitoring Stage: Case study 6 – Solo deal

The investment deal came from the personal network of the PE fund advisor. The investee company was a pioneer in NVOCC (Non-Vessel Owning Cargo Carrier) segment in India and aspired to be a global leader in that segment. This segment accounted for 6% to 10% of global trade, and the company used the PE funds to acquire a global leader having 10% of the global market. The acquired company was based in Europe with over 100 freight booking offices around the globe. The business plan of the promoter, and also the investment thesis of the PE fund, was an improvement in the efficiency of the acquired company, and on achieving this turnaround, listing on an Indian or a foreign stock exchange to realize the value for its stakeholders.

In addition to the customary profit and loss statements, the monitoring metric included a unique cost control measure using a single customer order as a unit of analysis (not $ revenue or $/container). Each customer order had a defined process flow and costs were allocated to each stage of that flow. The metric required monitoring of the actual use of resources and reporting of deviation between allocation and actual use. The challenge was to use this metric in newly acquired global operations, and it took several months for the company to achieve that, and the board patiently allowed that time considering that culture change was at stake. Non-compliance with the metric resulted in the letting go of employees in some Latin American and African countries, and the loss of some businesses; otherwise the metric was widely adopted and the new work culture became more aligned with the requirements of the global business where work efficiency became the sole determinant of the net earnings.

The challenges in implementing changes in the work culture were widely shared with the PE investor and it helped to brainstorm ideas on how to introduce the change. There were several questions and course corrections made in the field, based on local conditions, but the board had owned the metric totally, and it was gradually adopted at the total organization level.

The net earnings from global business tripled in three years. There was improved customer satisfaction and the company was able to expand its services to cargo handling at container freight stations and in areas of coastal shipping from the major ports to the minor ports. The company achieved 25% compound growth in sales and 35% compound growth in net earnings over 3 years. The company was listed and has given over 20% annual return to its shareholders over ten years.

II. Deal Monitoring Stage: Case study 7 – Solo deal

This investment deal came through the personal network of the PE fund advisor. The investee company addressed the shortage of blue-collar workers in Indian firms by providing skilled personnel on a contract basis. It provided skilled workers in electrical and air-conditioning operations, water supply and water quality management, effluent treatment plants, sewage treatment plants and maintenance, front office, mail room, vending machines, and pantry, and for the overall upkeep of a facility. The business plan of the promoter was to grow in new geographical areas and use the first mover advantage to grow quickly. The investment thesis of the PE fund was that the growth is consolidated over time and creates sufficient barriers to competition, to help increase the enterprise value.

The monitoring metric was jointly designed by the promoter with the PE fund manager and included three areas. First was weekly compliance with committed Service Level Agreements (SLAs) for each customer. Secondly, growth in value and quantity terms was tracked, both by the service category and the geography. Thirdly, the actual size of the pipeline of recruitment and training of employees was compared on monthly basis with the budgeted / target-sized pipeline to meet the annual growth target. The comprehensive metrics ensured that the path of profitable growth continued. Continuous monitoring of any deviation helped the board and top management identify the root causes and take required corrective action. The interests of the promoter and the investor were closely aligned and monitoring was a joint effort.

The metrics helped the CEO identify key responsibility areas of senior staff and the metrics were thus owned by the whole organization. The experiences learned in this journey became part of the training manual for future employees. The staff was awarded incentives for exceeding the targets and it became a major source of motivation.

The company grew handsomely in terms of revenue and net income, and there was interest from many strategic players to invest in this growth story. The PE investor was able to get a large strategic buyer to buy its stake and continue to support the promoter in future growth.

II. Deal Monitoring Stage: Case Study 8 – Syndicate deal

This investment deal came from a global investor based outside India. The investor had trading operations in raw sugar and ethanol in the world commodities market. This global investor was looking for a local co-investor in a company that was a leading supplier of energy-saving equipment to the sugar industry and enjoyed a monopoly position in India. It also owned a sugar mill in Western India, which was set up as a demonstration/training unit for the company’s products. The company’s technical expertise was vouched for by many independent sources who had first-hand user experience with the company's innovative products. The company had won many national awards for its innovations. The investment thesis was growth in sales and profits from the company's products, diversification into total sugar plants, and an increase in the sugar mill profits accruing from the use of its energy-saving equipment.

Two investors monitored the company on different parameters. The global investor was keen for the company to grow its sugar plant business, and would look for new customer addition while the local co-investor asked for monthly financials and recovery of receivables from sugar mills, which was showing an increasing trend due to the unfavourable government policies of providing a minimum sugarcane price to farmers and also having price control on sugar exports. Both investors had equal veto rights, but they could not design a common metric to monitor the investee company.

The interference of the global investor with top management led to a preoccupation with new business development, and they paid less attention to managing the working capital cycle. New equipment was supplied to old customers even when they had not fully cleared dues for earlier supplies. The task of credit control was assigned to the accounts department while the sales department chased new orders, even from defaulting customers. There was no resolution as the global investor would take a position that global recovery was around the corner and sales growth is preferable to credit control. There were new opportunities to serve the wastewater treatment industry with its energy-saving designs yet there was no support from investors.

The poor financial discipline led to the company's borrowings exceeding the bank’s permissible limits, leading to a shortage of the working capital to buy raw materials, loss of production, and distressed sales of the sugar mill for the survival of the company. The company’s financial reserves were wiped out, and it was necessary to infuse new funds at a distressed valuation of the company. This led to a large loss in the investment value of the PE investors.

III. Deal Exit Stage: Case study 9 – Solo deal

This investment deal came from the personal network of the PE fund advisor. The investee company was the first in India to manufacture polyester blended yarn, and the largest manufacturer and exporter of synthetic spun yarn from India. It had four modern plants in North India and had integrated operations to make garments and fashion brands. The share of exports for the company was 40%, and the removal of export quotas provided the company with significant export potential which had higher net margins, and it decided to raise capital from a PE fund to part finance the expansion of capacity. The business plan was to increase the export share to 50%.

The PE investor felt that there was some financial risk to the project because of the energy cost increase and pressure on the dollar price from increased Chinese competition. These risks were further discussed with the promoter and it was decided to use an optionally convertible instrument of share. The investment agreement allowed the investor the option to convert the investment into shares (OCPS), and if the option was not exercised the investment would be returned in six quarterly instalments. This would ensure that the exit clause was incorporated into the contract.

The promoters of the company expected the PE investor to convert the shares; the PE investor was expecting to carry out extensive interaction with company management and the internal investment committee before making the decision. Even without conversion, the investment would be a powerful signal to the shareholders as well as customers about the prospects of the company. The long-term prospects of the company as determined by the PE team of the investor would be the only determinant in that decision.

The contract was key to the exit stage. The PE team decided against the conversion of the investment into shares as the financial risks escalated, and the redemption clause in the contract helped the PE investor to get back the investment. As the contract provided the redemption option to the investor, the Board of Directors of the Company asked the Director of Finance for periodic confirmation of the cash reserves of the company to ensure liquidity at all times till the decision is taken by the investor. So, the contract ownership was at the organizational level. The redemption option saved the capital for the PE investor. In the four-year period, which included the crash of the year 2008 which affected global contracts, the share value of the company was eroded by 75%, yet the investor was able to reclaim its investment at no loss.

III. Deal Exit Stage: Case study 10 – Syndicate deal

This investment was referred by two large PE investors, both part of large Indian conglomerates and may be identified as Corporate Venture Capital firms. The investee company was a large ready-made garment exporter raising PE capital to partly finance a large acquisition to augment its export production capacity. The company also planned to list for an IPO in a few months; the draft red herring prospectus was ready for submission.

There was a discussion and undertaking by the promoter for a listing of the shares (IPO) of the company on an Indian Stock exchange within a certain period from the date of the investment. If the listing did not happen in that period plus one year (grace period), the promoter gave an undertaking that he would arrange for all the investors' stakes to be liquidated at the best possible value, and in no case lower than the original value +6% compound return. Failure to offer such an exit two years post the IPO date would give the investors the right to find a buyer for the whole or part of the company including the total or part of the stake of the promoter. if the company's shares were listed, then the investors' shares would be locked in for one year post the date of allotment. This was an elaborate contract, on paper, and suffered from some logical mistakes which made it incomplete.

The fact that an IPO would take away the ability of the investors to protect the share price from business exigencies was not addressed in the contract. The preparation of the IPO prospectus without investor involvement blindsided them on the business risks. Further, the possible risks were downplayed by the two prominent investors belonging to leading corporates in India. They assessed that this company had a healthy export order book and high-quality manufacturing assets in India, and in the unlikely event of the IPO not happening, finding strategic buyers would not be a difficult exercise.

Two adverse events affected the company's performance in the following months, which caught the investors off guard. First was the discovery of a breach of an existing export contract agreement, by the largest buyer, who then cancelled open orders resulting in a loss of over 30% of annual order volume. The second was a highly speculative futures forex transaction in a volatile currency exchange market which went bad and caused a large financial loss. Both events affected the share price and eroded the market value of the company, affecting the exit plans of all the investors. The investment contract had assumed the IPO status would ensure satisfactory due diligence, and did not require the company to share past contracts and internal controls when doing a speculative transaction.

III. Deal Exit Stage: Case Study 11 – Solo deal

This investment deal was referred to by the personal network of the PE fund advisor. The investee company was a leading consumer food supplement brand in South India as well as in countries in the Middle East. To further grow the exports and expand product lines, the company raised PE funds from the PE investor. The business plan was to increase production capacity and also invest in its distribution network.

The investment contract provided for an IPO in three years or redemption at a 12% compound return. There was a tag-along right, meaning that if the exit was not provided to the PE investor in three years, and the promoter decided to sell or issue any amount of stake, the investor had a right to tag along. As the consumer brand of the company was well known, there was already active interest amongst strategic buyers, and exit was not considered a challenge by the investor. The promoter was from a rural area with limited exposure to corporate deals and depended on the PE investor to facilitate the IPO / strategic sale process. But the contract terms for an exit, though comprehensive, were a little cumbersome for the PE investor. As the promoter preferred the IPO mode of exit to a strategic sale mode, fearing loss of control, the PE investor did not insist on specifying the exit mode in the contract, allowing it time to identify exit opportunities to inform and guide the promoter in creating a win-win situation in the future.

The complexity of the listing process and the need to reduce cross-holdings in family and related party transactions as advised by merchant bankers appeared to be an unsurmountable task for the promoter's family, even though the head of the family had been vocal on the IPO mode of exit. The promoter family was convinced of how an exit can happen without loss of control to a strategic buyer. While exit by IPO was not a feasible option, the realization of value was affected by the ultimate choice of the strategic buyer who provided maximum strategy fit for the company; some strategic buyers were willing to pay higher value but were not keen to continue local market presence and they were not considered for final negotiations. The comfort level of the promoters, as captured in the contract was the key to getting an exit.

III. Deal Exit Stage: Case study 12 – Syndicate deal

This investee company was owned by a PE syndicate comprising seven investors – the lead investor was a leading VC in New York, holding 30%, followed by four investors holding 15% each, which included the VC who incubated the investee company for three years. The remaining 10% was held by two smaller VC funds holding 5% each.

In the absence of a binding contract for an exit, the board of directors of the company had the power of deciding on the offers from buyers. The board could also appoint merchant bankers and give the mandate to find buyers offering more than a floor value. There was no consensus on what the floor value would be. The consensus was to get a value using a revenue multiple within 10% of the median, for comparable deals reported in the past 12 months. This was later abandoned as there was no reliable deal data available.

The VCs dominated the syndicate, and they planned to scale up the venture and exit at a high revenue multiple in the range of 3 to 5 in three years. As there was no promoter per se, the board discussions involved the choice(s) of business model, growth strategy, and talent hiring strategy, to name a few aspects. The exit was thought of in terms of a sale to a strategic buyer or a larger PE fund. A team was monitoring the daily average financial transaction volume and value, which were tracked more than the monitoring of profit and loss statements.

The lack of a contract or a consensus on a business plan was caused by the different experiences of investors in different geographies. The company secured a high share of online bank transactions which grew significantly in a short time but reached a plateau, while the merchants had low volumes for a longer time, but eventually dominated the online markets. The company fell behind the competition as this business required a different kind of talent for acquiring merchants. The competition was neglecting banks and adding merchants, and also helping the merchants with additional data on user-level experience, etc. and thus creating more value for its customers.

The sub-optimal growth strategy of the investee company adversely affected the value, and after many years, the only strategic buyer who offered to buy the company was in the business of selling computer monitors. The disconnect between value in the market and a sub-optimal growth strategy caused a loss of realizable value to all the PE investors in the syndicate.

APPENDIX (B)

Due Diligence Checklist which yields an investment thesis

1) Financial – balance sheet, cash flow, management information system
2) Regulatory, Tax – compliance requirements and track record
3) Legal, Intellectual Property = competency and competitive
4) Information Technology – adequacy for the present and future period
5) Human Resources – management team competency, fair practices
6) Technical – state of art, maintenance practices, safety record
7) Operational – efficiency and preparedness to respond
8) Market – product, service, pricing, and customer base
9) Supply chain - robustness

Investment thesis

1) Market position and revenue growth
2) Sustainable competitive advantage
3) Avenues of future growth and capital expenditure
4) Favourable industry trends and risk areas
5) Management team track record
6) Founder promoter background

APPENDIX C

Industry feedback

Feedback from a few senior VC/PE practitioners in India with whom major findings were shared is that the practitioners were unanimous in endorsing the relevance of the research area. In their common view, this study lays the foundation for future research and identifies sources of the hidden costs of syndication which need further broad research including those related to investee companies as well.

Based on interactions with these practitioners, some suggestions for the new research areas included *the investee company's management bandwidth to engage with multiple investors s, the corporate governance culture of the investee company, potential conflict areas between syndicate members outside the specific deal under study, the impact of past decisions by the original investor in a future period, and the impact of a reset of exit timelines after every new round of fundraising.*

Another common feedback was about making a distinction between controlling and non-controlling syndicate investments. The rationale offered was that under a controlling syndicate investment, there is a smoother working relationship among the members. Comparison of syndicates of both these types could be another future research area. Another view was that there has been a growing influx of high net-worth individuals (HNI) and portfolio management services (PMS) funds which are allowing PE funds to have a solo approach to syndicate investments.