

Contents

1 Introduction to Private Equity	1
Introduction	1
Notes	4
References	4
About the Editor	5
PART I The Structure of Private Equity Funds and Fund-Raising	7
2 Institutional Investment in Private Equity: Motivations, Strategies, and Performance	9
Introduction	9
Institutional Investment: Motivations and Behavior	9
Structure and Strategies	13
Performance	16
<i>Measuring the Returns to Private Equity</i>	17
<i>The Measurement of Risk</i>	20
Conclusion	25
Notes	26
References	26
About the Author	29
3 IPOs and Other Nontraditional Fund-Raising Methods of Private Equity Firms	31
Introduction	31
Recent Trends in the Private Equity Industry	33
Traditional Fund-Raising Methods	36
<i>Factors that Led to the Growth of Private Equity Industry</i>	36
<i>What Went Wrong?</i>	37
Nontraditional Fund-Raising Methods	38
<i>(Ir)rationality behind Private Equity IPOs</i>	38
<i>Then Why Are These Companies Going Public?</i>	39
Private Equity IPOs: Performance and Implications for the Future	39
<i>Short-Term Performance</i>	40
<i>Long-Run Performance and Implications for Future IPOs</i>	41

Sovereign Wealth Funds Complementing and Substituting for Private Equity Investments	45
Conclusion	48
Notes	49
References	50
About the Authors	50
4 Listed Private Equity	53
Introduction	53
Listed Private Equity: Definitions and Categorization	54
Terms and Definitions	55
<i>Investment Styles</i>	55
<i>Financing Styles</i>	56
<i>Categorization of Listed Private Equity</i>	56
Further Empirical Insights on Listed Private Equity	60
Conclusion	68
Notes	69
References	69
About the Authors	69
Acknowledgment	70
PART II The Structure of Private Equity Investments	71
5 The Syndication of Private Equity	73
Introduction	73
Motives for Syndication	75
<i>Risk Sharing</i>	75
<i>Risk Reduction</i>	76
<i>Access to Deal Flow</i>	77
Partner Selection	78
Structuring and Managing the Syndicate	81
<i>Equity Ownership Structure</i>	81
<i>The Investment Agreement</i>	81
<i>Contractual Enforcement</i>	82
<i>Monitoring of Investees</i>	83
<i>Decision Making</i>	84
Syndication and Performance	84
The Future of Syndication Research	85
<i>Emerging Themes in PE</i>	86
Notes	89
References	90
About the Authors	92
6 The Structure of Venture Capital and Private Equity Fund Portfolios	93
Why the Structure of Venture Capitalists' Portfolios Matters	93
Optimal Effort Levels	94
Optimal Portfolio Size and Profit-Sharing Rule	98

CONTENTS

vii

Empirical Tests	99
<i>Data Source</i>	100
<i>Summary Statistics</i>	101
<i>Regression Analysis</i>	103
Conclusion	105
Notes	106
References	107
About the Authors	108
Acknowledgment	109
7 The Rise of the PIPE Market	111
Introduction	111
What Is a PIPE?	112
Contract Terms in PIPE Offerings	115
<i>Antidilution Protection</i>	115
<i>Redemption Rights</i>	116
<i>Investor Registration Rights</i>	116
<i>Investor Board Representation</i>	116
<i>Trading/Hedging Restrictions</i>	116
<i>Company-Forced Conversion</i>	117
<i>Investor Call Option, Investor Right of First Refusal, and Company Put Option</i>	117
Firms Issuing PIPEs	118
<i>Why Firms Choose PIPEs</i>	118
<i>Cost of PIPEs</i>	119
<i>Stock Performance at Closing and in the Long Run</i>	119
Investors in the PIPE Market	120
The Role of Placement Agents	122
Issues in the PIPE Market and SEC Regulations	123
The PIPE Market Down the Road	126
Notes	127
References	127
About the Author	128
8 Private Placements by Small Public Entities: Canadian Experience	129
Introduction	129
The Canadian Context	130
<i>The Canadian Stock Market</i>	130
<i>Regulation of Private Placements in Canada</i>	131
Private Placements and the Issuers	132
<i>Data</i>	132
<i>Which Firms Issue Private Placements?</i>	134
<i>Industry Clustering</i>	135
<i>Financing Strategies and Clustering of Issuers</i>	136
<i>Operating Performance</i>	137
<i>Preissue Performance</i>	138
<i>The Postplacement Performance</i>	139

Returns Surrounding Private Placements	140
<i>The Estimation of Abnormal Returns</i>	140
<i>The Preissue Return of the Public Investors</i>	141
<i>The Postissue Return of the Public Investors</i>	144
<i>Analysis of Differences in Long-Run Performance</i>	145
<i>Discussion</i>	145
Discounts	146
<i>Previous Evidence and Explanations</i>	146
<i>Measure and Stylized Facts</i>	147
<i>Discount and Long-Run Performance</i>	148
Conclusion	149
Notes	150
References	151
About the Authors	152
9 Hedge Funds' Activism: A New Trend of Convergence toward Private Equity in Public Firms?	155
Introduction	155
Hedge Funds and Private Equity: Market Data and Trends toward Convergence	156
<i>Private Equity and Hedge Funds: Competitors or Allies?</i>	157
Hedge Funds' Approach to Activism	159
Features of Targeted Companies	162
How Hedge Funds Engage a Fight against Incumbent Management	163
<i>Stake Owned, Wolf Packs, Empty Voting, and Hidden Ownership</i>	165
Clinical Study of Carl Icahn versus Time Warner, Inc.	167
<i>The Parties Involved</i>	168
<i>Why Did the Activists Intervene?</i>	172
<i>What Happened: The Path Followed</i>	174
<i>The Event Study Analysis</i>	177
Conclusion	182
Notes	184
References	191
Reference Web Sites	192
About the Authors	193
PART III Financial and Real Returns to Private Equity	195
10 Projection of Private Equity Fund Performance: A Simulation Approach	197
Introduction	197
Related Literature	199

CONTENTS

ix

A Simulation Approach for Venture Capital Performance	
Projection and Risk Management	201
<i>Description of the General Approach</i>	201
<i>Data Description</i>	204
<i>Econometric Analysis and Modeling</i>	213
<i>Monte Carlo Simulation</i>	218
Simulation Results for Two Fictitious Venture Capital Funds	221
<i>Structure of the Fictitious Venture Capital Funds</i>	221
<i>Simulation Results</i>	222
Conclusion	224
Notes	226
References	226
About the Authors	228
11 Value Creation in Middle-Market Buyouts:	
A Transaction-Level Analysis	229
Introduction	229
Background, Context, and Prior Literature	230
<i>Sample and Data</i>	232
<i>Variables</i>	233
<i>Descriptive Statistics</i>	234
<i>Differences by Subsamples</i>	236
Regression Results	241
Conclusion	245
Appendix 11.A: Summary of PE Firms	247
Notes	248
References	253
About the Authors	255
Acknowledgments	255
12 Risk and Return of Private Equity: An Overview of Data, Methods, and Results	257
Introduction	257
The Data	258
<i>Publicly Traded Vehicles</i>	258
<i>Round Valuation Data</i>	258
<i>Investment Data</i>	259
<i>Fund Data</i>	260
<i>Sample Biases</i>	260
Methodology	266
<i>Publicly Traded Vehicles</i>	266
<i>Round Valuation Data</i>	266
<i>Investment and Fund Data</i>	269
Results	270
<i>Publicly Traded Vehicles</i>	270
<i>Round Data</i>	270
<i>Investment Data</i>	271
<i>Fund Data</i>	272

Additional Discussion	275
<i>Examples of the Challenge Facing Performance Evaluation</i>	275
<i>Other Approaches to Estimate Risk and Abnormal Return</i>	277
Conclusion	279
Appendix 12.A: Discussion on Staleness Correction	279
Notes	280
References	281
About the Author	282
Acknowledgments	282
13 Private Equity Fund Selection: How to Find True Top-Quartile Performers	283
Introduction	283
Hypothesis Development	284
The Research Approach	285
Measurement and Operationalization	285
<i>Performance Track Record</i>	286
<i>Deal Flow</i>	286
<i>GP Experience</i>	286
<i>Differences between the Focal and Prior Funds</i>	286
Which Factors Correlate with Future Performance?	286
Random Choice versus the Crystal Ball: An Approach to Measuring PE Fund Selection Efficiency	287
The Peracs Private Equity Selection Efficiency Measure™	289
The Selection Efficiency of Performance-Based Fund Selection Rules	289
Shortcomings of the Traditional Benchmarking Approach	290
Using and Interpreting the Right Public Market Benchmarks	291
Advanced Private Equity Benchmarking Based on Deal-Level Benchmarks	293
Quantitative Due Diligence Case Study: Advanced Private Equity Benchmarking	294
The Fund Selection Efficiency of Advanced Private Equity Benchmarking Techniques	296
Conclusion	297
Note	298
References	298
About the Author	299
14 Real Effects of Private Equity: Empirical Evidence and a Research Agenda	301
Introduction	301
Evidence of the Real Effects of Private Equity	301
Research Agenda	307
References	308
About the Author	309
Acknowledgment	310

CONTENTS

xi

15	Employment, Wage, and Productivity Effects of Private Equity Transactions	311
	The Universe of Private Equity Transactions	311
	Task of the Chapter	311
	<i>Pitfalls for the Unwary</i>	312
	Employment and Productivity Identities	313
	Employment, Wage, and Productivity Effects	315
	<i>U.S. Empirical Studies</i>	319
	<i>U.K. Empirical Studies</i>	321
	Conclusion	326
	Notes	327
	References	329
	About the Author	330
	PART IV International Perspectives on Private Equity and Regulation	333
16	Valuation and (Financial) Disclosure in the Private Equity Industry: Institutional Set-Up, Incentives, and Empirical Analysis	335
	Introduction	335
	Institutional Setup	337
	<i>Valuation and Disclosure Rules for Privately Held (Portfolio) Firms</i>	337
	<i>Valuation and Disclosure Guidelines for Private Equity Funds</i>	339
	<i>A Brief Evaluation of Valuation Guidelines</i>	341
	Main Problems and Conflicts of Interest	342
	Incentives for Voluntary Disclosure versus Mandatory Disclosure	343
	<i>Disclosure of Firm-Specific Information</i>	344
	<i>Determinants of Potential Reporting Biases of Private Equity Funds</i>	345
	<i>Financial Standards, Disclosure, and Regulation</i>	346
	Disclosure and Reporting Patterns of Venture-Backed Portfolio Firms	347
	<i>Reporting Biases of Private Equity Funds Valuation</i>	348
	Conclusion	352
	Notes	354
	References	355
	About the Authors	356
	Acknowledgment	357
17	Private Equity Regulation: A Comparative Analysis	359
	Introduction	359
	The Growth of Private Equity	363
	<i>The Performance of Private Equity</i>	364
	<i>The Supply-and-Demand Side of Private Equity</i>	365

Dealing with Agency Problems: Contractual Arrangements	368
<i>The Relationship between Investors and Fund Managers:</i>	
<i>The Limited Partnership Structure</i>	369
<i>The Relationship between Investors and Fund Managers:</i>	
<i>Restrictive Covenants</i>	373
<i>The Relationship between the Fund and Its Portfolio Companies</i>	376
Regulation of Private Equity Funds	379
<i>Self-Regulation</i>	379
<i>Coregulation</i>	382
<i>The Regulatory Response</i>	384
<i>Legal Tools</i>	386
<i>Regulatory Responses to Hedge Fund and Private Equity</i>	
<i>in Canada, the European Union, Germany, the Netherlands,</i>	
<i>and the United Kingdom</i>	388
Conclusion	389
Notes	390
References	392
About the Authors	393
18 International Private Equity Flows	395
Introduction	395
A Brief Overview of International Fund-Raising	396
International Investments of Private Equity Funds in	
Western Europe, North America, and Australia	398
<i>Most Important International Investor Countries</i>	399
<i>Most Important International Target Countries</i>	402
<i>Regional Clustering of the International PE Investment Market</i>	406
<i>International Syndication of Buyouts</i>	408
Private Equity in Emerging Markets	410
Conclusion and Avenues for Research	411
Notes	414
References	414
About the Authors	416
Acknowledgments	417
19 Private Equity in Emerging Markets	419
Introduction	419
International Comparison	420
What Determines Emerging Market PE Activity?	421
Survey among Institutional Investors on the Importance	
of Emerging Markets' Allocation Criteria	424
<i>Perceptions of Particular Allocation Criteria in Emerging Markets</i>	429
<i>Investors' Preferences Regarding Different Emerging Regions</i>	431
Conclusion	432
Note	434
References	434
About the Author	436

CONTENTS

xiii

20 Private Equity in Europe	437
Introduction	437
History	438
The Structure of Private Equity Funds	439
Private Equity Investment	441
Internationalization of Private Equity	446
Private Equity Performance	450
<i>The Literature</i>	450
<i>Performance Measures</i>	451
<i>Evidence from Europe</i>	453
Conclusion	455
Notes	458
References	458
About the Author	461
21 Private Equity and Leveraged Buyouts in Italy: To Prohibit or Not to Prohibit, That Is the Question	463
Introduction	463
The Buyout Market and Its Puzzling Trend	465
The LBO Scheme and Related Criticisms	468
<i>Critical Features</i>	468
The LBO Legal Environment: Past, Present, and Future Trends	469
<i>The Past Debate</i>	469
<i>The Inconsistent Case-Law and the Supreme Court Prohibition</i>	470
<i>The Investors' Reaction and the Subsequent Turning Point</i>	471
<i>Regulatory Restrictions of LBOs prior to 2004: A Closer Look</i>	472
<i>The European Context</i>	474
<i>The 2004 Reform: Conditions for the LBO Legitimacy and Unsolved Issues</i>	475
<i>New Criminal Prosecutions in Case of Financial Assistance</i>	478
<i>Consequences in Case of Bankruptcy</i>	479
The Economic Impact of the 2004 Reform	480
<i>Data and Methodology</i>	480
<i>Sample Characteristics and Representativeness</i>	481
<i>Impact on Investor Behavior: A Descriptive Analysis</i>	486
Conclusion	494
Appendix 21.A: The Past Debate on the Legitimacy of LBOs in Italy	496
A Closer Examination of Why LBOs Appeared to Be Illegal in Italy	496
<i>Article 2357: Share Buyback Restrictions</i>	496
<i>Article 2358: Financial Assistance Prohibition</i>	497
Appendix 21.B: The Regulation of Financial Assistance in the United Kingdom	498
Appendix 21.C: Survey Details	500
Notes	502
References	505
About the Author	510

22	Venture Capital and Private Equity in Germany	511
	Introduction	511
	The Development of the German Venture Capital Industry	513
	<i>An International Comparison of the Relative Importance of Venture Capital</i>	515
	<i>Sources of Venture Capital Funds in Germany</i>	518
	<i>Venture Capital Investments</i>	521
	<i>Specialization and Ownership Structure of Venture Capital Firms in Germany</i>	527
	<i>Financial Contract Design by Venture Capital Firms in Germany</i>	528
	<i>Exit Alternatives and Exit Strategies of Venture Capital Firms in Germany</i>	530
	Going Public as an Exit Route for Venture Capital and the Performance of Venture-Backed IPOs in Germany	534
	<i>Going Public as an Exit Route for Venture Capital</i>	535
	<i>Performance of Venture-Backed Initial Public Offerings in Germany</i>	536
	<i>Empirical Evidence on the Long-Run Performance and Exit Behavior of Venture-Backed IPOs in Germany</i>	537
	<i>Other Venture Capital-Related Issues</i>	545
	Conclusion	548
	References	549
	About the Authors	553
23	Private Equity in Denmark: Capital Structure and Taxes	555
	Introduction	555
	<i>History of Buyouts in Denmark</i>	556
	Consequences for Capital Structure of Portfolio Companies	558
	<i>Leverage and Takeovers</i>	558
	<i>Capital Structure of Private Equity Funds</i>	559
	<i>An Empirical Investigation</i>	560
	<i>Some Case Studies</i>	563
	<i>Financial Performance of Investments</i>	564
	<i>Summing Up</i>	564
	Implications for Tax Payments	565
	<i>Taxes and Takeovers</i>	565
	<i>A Simple Example of a Private Equity Takeover</i>	566
	<i>The Example with Numbers: Implications for Corporate Tax Payments</i>	567
	<i>Wider Tax Implications of PE Takeovers</i>	571
	<i>A Hypothetical Case</i>	572
	<i>More Complications</i>	573
	<i>Summing Up</i>	575
	Conclusion	575
	Notes	576
	References	576
	About the Authors	577

CONTENTS

xv

24	Venture Capital and Private Equity in Canada: Phasing Out an Inefficient Tax Credit	579
	Introduction	579
	Description of 2008 YORKbiotech Survey Data	582
	Multivariate Regression Evidence	588
	<i>Capital-Raising Hurdles</i>	588
	<i>Time to Failure</i>	594
	<i>The Extent of Value-Added</i>	596
	Conclusion	598
	Notes	599
	References	600
	About the Authors	602
	Index	603

<http://www.pbookshop.com>

<http://www.pbookshop.com>