The Economics of Private Equity Industry: A Case of the U.S and Europe

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Private equity is an investment capital mostly funded by high individuals and institutions including stakeholders and managers. The main purpose of private equity is to invest and acquire equity ownership in various corporations. Often, the partners or proprietors of this kind of investment fund it by raising money and managing the money raised for purposes of yielding profits through buying of large shares and consequently acquisition of private companies as well as public companies, which have been short listed from public stock exchange via private deals. Unlike the public equity, which advertises its shares to the public for trade, private equity (PE) only focuses on a few rich individuals and institutions capable of facilitating buyouts as they target specific companies of interest (Levin, & Light, 2015). In other words, PE is a pool of funding that purchases or invests largely in huge businesses with the aim of making it private or owning it. This paper seeks to explore the economics of private equity in the U.S with a view of providing a greater understanding of its operations and perforce while making reference to European developing countries in an attempt to predict to predict its future.

These investors in PE are widely known for investing using debt financing technique. The main participant of this kind of trade includes insurance companies, credit unions, pension funds, and corporate finance. This article will be looking into private equity in details. Wealthy individuals and institutional investors tend to use private equity to capture abnormal returns and diversify a portfolio(s). Since there exists limited literature on full potentiality of the private equity firms is available the actual profit potential and/or diversification is largely unknown (Gompers, Kaplan, & Mukharlyamov, 2016). It helps to introduce working capital into a business that is promising, refine products and management while at the same time it compensates the shareholders for the risk they have taken.

Private equity has promoted the economic growth in a variety of ways. The tendency of PE of not investing highly on low value added industries and instead targeting high value added and emerging industries that needs no funding seems to yield economic benefits. Overall, PE tends to improve the economy by promoting the development of trade activities on stock market. Besides, private equity tends to increase productivity through efficient use of resources while also enhancing the development and growth of new businesses (Harris, Jenkinson, & Kaplan, 2014). Large buyouts associated with private equities enhance the creation of job opportunities since it is associated with economies of scale that leads to the demand for more human resource at any given time (Davis et al., 2014). While encouraging a pool of human resource, it also promotes experience relocation and sustainable employment of new employees thus contributing the growth of economy via standard expenditure multiplier effects. Nonetheless, PE firms also have an effect on profitability and growth of companies as they facilitate the improvement of management practices through their less entrenched business practices compared to public owned or family owned companies.

History of Private Equity

Although the coining of the term private equity dates back to the 1980's, the origin of the market typically traces back to the formulation of groups like Charterhouse Development Capital 3i in 1934 and 1945 respectively in the Europe and the American Research and Development Corporation (ARD) in 1946 in the U.S. The 3i, for instance, was initially named Industrial and Commercial Finance Corporation, and its principle goal was to facilitate the satisfaction of small companies capital need on a long-term perspective. After the WWII, famous universities like MIT and Stanford alongside the entrepreneur in the Silicon Valley developed the kind of private equity firms. Following the expansion of the industry in the U.S., the practice became famous in

Europe especially in the 1970's. Nonetheless, the PE typically became popular under the Leverage Buyout (LBO) impulsion during the 1980's with funds like Kohlberg Kravis Roberts (KKR) that closed emblematical transactions such as the acquisition of RJR Nabisco for over 36 billion dollars.

For over three decades now, leverage buyouts and private equity investment activities have developed cyclically, contingent to conditions of the stock markets, the developments of fiscal policies, and the establishment of new tools aimed at stimulating and expediting the fund raising processes. With reference to France for instance, the blending of low inflation rate in the 1990's and establishment of practices like Common Fund of Innovative Investment (CFII) in 1996 has continued to allow the growth and expansion of PE activities, although such impacts seemed to be at lesser rates compared to North America (Harris, Jenkinson, & Kaplan, 2014). However, the PE industry has been under the influence of several economic crises and particularly the internet bubble burst that lead to the radical decrease in investment from venture capitalists.

Nonetheless, the effects of the internet bubble did not exclusively prevent the diversification of capital sources of capital. In fact, the investors' spectrum in the PE industry has steadily grown to include a varied range of investors. According to EVCA (2014), for instance, there are over 1,200 private equity firms with over 91% of the available statistics showing a total capital investment of €548bn being managed. The figure 1 below shows the relative distribution of the investment funds over a 15-year period from 2000 to 2014.

The rate of investments and the investor diversification endowed in the PE market prove this market is stable and a mature market in general. Therefore, it is a fact that the private equity industry has gone through a cyclical evolution over the last decades with peak between 2005 and

2008, with 2007 recording the highest fund raising of €112bn as recorded in Europe (EVCA, 2014). Hence, with the relative stability, much is still expected.

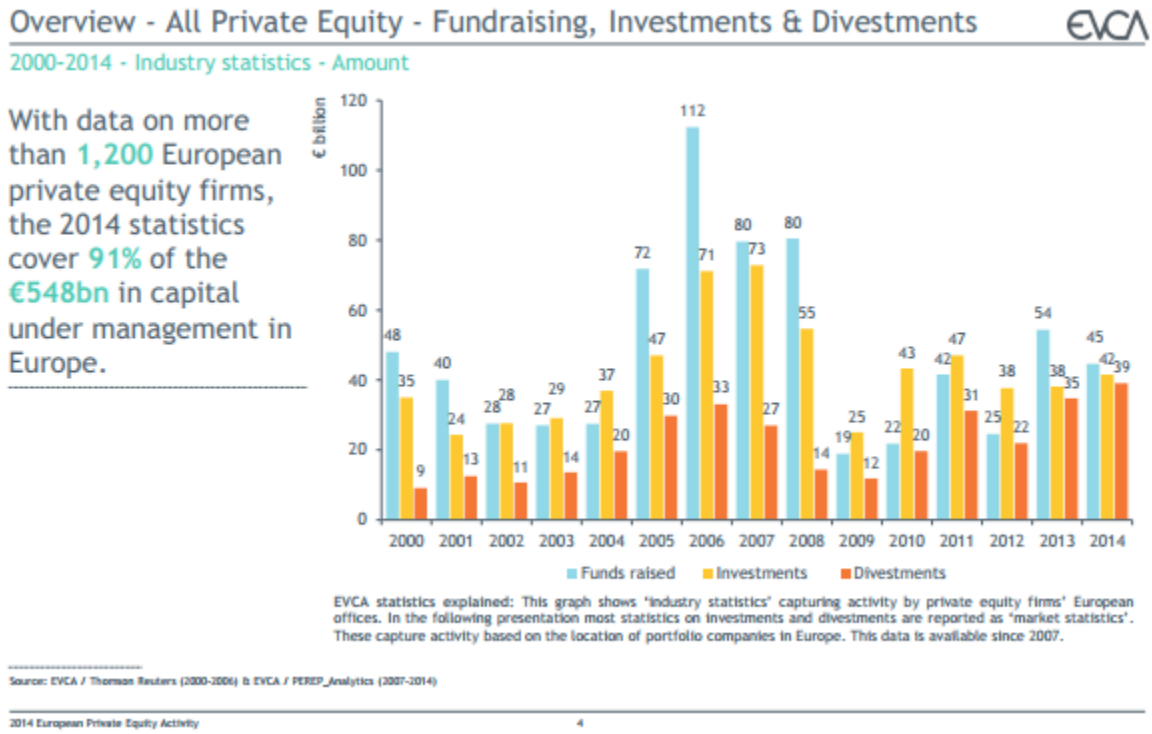


Fig 1: Figure 1: All Private Equity Firms -Investments, Fundraising, and Divestments (ACVA, 2014)

Research Problem

Over the years, private equity has tried to spread across the globe. The rise in the volume of large leveraged private buyouts has continued to persist despite various prevailing credit and financial crises experienced over years. The fact that PE survived prior to the credit/financial crisis, and consequently succeeded by a quick decline following the crisis, has made many economic observers to observers to believe that private equity is not that better than leveraged PE. Based on the limited available literature review, private equity creates big returns via high leverage especially at the times of negligent credit market that makes previously

financially healthy corporations more probable to become strained in times of apprehensive credit markets. There seems to have limited research on the economics of private equity industry. There is a scanty knowledge regarding current state of private equity particularly in the U.S and Europe. Lack of effective analysis on the global economics of private equity and consequent lack of proper considerations across the globe has led to difference in the rates of expansion of the industry in the U.S and across Europe.

Across the U.S and in Europe, the rates of growth in investment and large leverage buyouts are different. Although the returns to the operational improvements are likely to be among the reasons facilitating the significant financial performance and persistence of funds run by these firms, little seems to be known on the difference financial and operating performance across European countries in comparison to the U.S. Consequently, there is a considerable growing interest in understanding in detail the kind of participation and involvement of private equity firm in the global economy. There is a literature gap concerning the availability of effective knowledge regarding the operative performance, financial performance, incentives from future findings, and value creation of the private equity firms across the Europe and the United States at large. To fill the gap in literature regarding performance and PE's value creation.

There is need for the provision of a more robust evidence on how the performance of private equity and the large leverage buyouts relate to value creation in the PE industry and its role in the global economy. Through greater research, there would be the development of a deal-level data prepared with the assistance of the private industry to predict the future state of private equity in in the global market. There is also a limited literature from which concepts for establishing creative ways of understanding both long-run and shot-run impacts of PE investment

impacts of on the global economy as well as the effect of large leverage buyouts of other firms in the market (Harris, Jenkinson, & Kaplan, 2014). The activity of private equity as a market force assists in mitigating managerial agency problems. Consequently, there is need to have improved and greater research on the economics of private equity not only in the U.S or Europe, but also across the globe.

Furthermore, since private equity owners undertake majority stakes in companies, the owners of these private equity firms should have enhanced knowledge on various aspects of PE including fundraising, investments, operative and financial performance, as well as value creation and impact on global market. Providing precise data on the current state of private equity can help in monitoring and supporting the management. Various management gains that could be obtained from proper literature on PE may include understanding more effective way of diversified public equity concepts and effective management skills necessary for comprehending the dynamics of PE industry. Consequently, there is need to explore the concept of PE while comparing the growth and development of the industry in U.S in comparison to the Europe and developing countries as well.

Purpose and Focus of Research

The core purpose of the research is to explore the economics of private equity in the U.S and Europe with a view of providing key information needed to understand the performance, operations, growth and development, as well as its value creation. Through the study literature review and key concepts of the private equity industry would be explored for purposes of understanding the nature of the acquisition, large buyouts, trends, and future state of the public equity firms in the global market. Besides, the study explores the level performance and

quantification of the potential value added by private equity firms through the analysis of financial statements of the prevailing and potential private equity portfolio companies.

Besides, the paper focuses on level of returns of private firma and their capability of to generate long-average returns compared to the public market while justifying the placement agent role in facilitating PE fundraising and investment particularly in developing nations with reference to the U.S and European countries. Fundamentally, the research focuses in exploring the oeperating and financial performance of the private equity buyouts particularly in the U.S in comparison to the Europe. The exploration thus seeks to establish if there exists any significant change in profitability of PE with reference to employment, liquidity, leverage, investment, value addition, operating performance, investment, and improved management potentials for the firms in the U.S and developing European nations that went through a private equity.

Literature Review

The Current State of Private Equity

In the recent years, private equity has widened its scope and its investment is presently covering all most every part of the globe. The industry has not only invested but also build an image for itself across the globe. Early this year, private equity firms had increased in number and a total of 2296 firms were operating in the global market. As compared to 2017s investment, this was an increase of 25% (Espinoza, 2018). The period between 2000 and 2016, private equity firms have tripled in number with a total increase of almost $ 2500. Private Equity has been able to acquire high returns mainly because of the use of debt financing. Up to date, the firm is very aggressive in using debt financing for their operations. Debt financing occurs when the private equity offers loan to an institution, with the loan being paid in installments depending on the agreed amount for a specific duration (Schock, 2013). In such a case, private equity has invested

and they are entitled to repayment of their money in whole, together with the interest rates. Private equity has exploited this technique, which has proven to be beneficial to them since the failure of an organization to pay results in the lending institution seizing the property. Most of the time, they acquire such institutions, modify them and sell for a higher amount.

The Growth of Private Equity

Private equity has tremendously grown over the years. It has expanded in terms of investment and income. Private equity buyouts rose from approximately $28 billion in the year 2000 to about $502 in 2006 (Harris, Jenkinson, & Kaplan, 2014). This is evidence that the private equity buyouts are doing great in the world market. The companies, just like any other financial lending institutions, have faced challenges such as increased interest rates and government policies that interfere greatly on their budget. However, the companies are still able to attain a value of $ 501 in 2007 (Harris, Jenkinson, & Kaplan, 2014). The industry has experienced a tremendous growth in 2017 as well. The private asset managers established a new high score of about $750 (Kovac et al, 2018). Similarly, 2017 registered an increasing amount of mega fund investments. The buyouts have also increased during this year. Currently, the industry is investing in a different focus that is an opportunity for growth. Value creation efforts are all given priority by the companies and commercial excellence capabilities are expanding. This is necessary for the growth of this industry since it acts as a guideline for these companies in selecting their markets.

Over the years, private equity has registered a tremendous value in its economics. Presently it is valued at approximately one trillion US Dollars. Two-thirds of that, represents the buyout funds made by the private equity (Harris, Jenkinson, & Kaplan, 2014). Besides, buyout funds have seen a great improvement from a quarter in the twenty-first century to two thirds in

the present times (Prowse, n.d). These equity firms operate by plowing back profits that are later used to open up new firms. This explains the wide coverage by the private equity in the present world market. Most of these investments are with the limited partners and they run to a duration of about ten years. When investing, the private equity firms calculate the amount and duration to be paid after considering all the available variables. This includes the lifetime fees, investment capital, as well as the establishment cost. Given that the payment of loan borrowed from Private Equity is to be paid in installments for a given duration, it is treated as a risk-free investment (Bratton& Joseph, 2015). Overall, the ability to raise funds in large amounts and subsequent investments and buyouts seem to be the driving force.

Private Equity in Emerging Markets

The PE market is an essential wellspring of assets for new companies, private middle market organizations, firms in money related pain, and open firms looking for buyout financing. In recent past, it has been the quickest developing market for the corporate, far outperforming others, for example, people in general and security markets and in the demand for private arrangement obligation (Daniel, 2013). Lately, PE capital raised by organizations has coordinated, and once in a while surpassed, reserves raised through first open contributions and open return corporate securities. Likely, the most praised part of the private equity market is the interest in small, frequently innovative, beginner firms. These speculations frequently fuel hazardous development in such firms. For instance, Genentechm, Dell Computer, and Microsoft all got PE support in their beginning periods. Besides, the PE market provided offered assets in the primarily utilized buyouts of such substantial open various organizations in the 80s.

Presently, private equity is establishing grounds in emerging markets and it is thriving, just like in the existing markets. Presently, over 186 emerging markets are focusing on private

equity financing. The smooth excellence of the Private Equity in emerging markets is as a result of an increase in the control positions. In other words, the large owners of the private equity firms are capable of letting loose a certain level of control (Mietzner & Schweizer, 2014). By doing this, they allow the private equity to flourish in the emerging markets given that they acquire new owners through shares. Many institutions and individuals are presently investing in the private equity that is based on the emerging markets. Presently, over eight hundred institutions and individuals have invested in the private equity that is in the emerging markets. Emerging markets currently cover approximately 14% of the globe's private equity investment, the revenue is encouraging, and the persistent of PE due to intensive investment and large buyouts play a significant role (Braun, Jenkinson, & Stoff, 2017). Consequently, through the LBO, firms continue to emerge and grow across the globe.

Usually, private equity put more pressure on directors to find deals even if it means paying a premium beyond a prospect's EBITDA (Karolyi, 2015). However, some directors are basically holding off creating investments. This is clearly seen by the drop in deal number over the course of 2017. With private equity fund increasing effectively, limited partner lenience will be established if their money is not set up in timely custom. Most of the limited partners are usually soliciting whether private equity realtors are justifiable in the long period given a quality assessment.

Other than its emotional development and expanded noteworthiness for fund, the private equity market has gotten little consideration in the money related press or the scholastic literature, hence more needs to be done. The absence of consideration is expected in the idea of the instrument itself. According to Cumming & Johan (2013), data about private exchanges is regularly restricted, and examining advancements in this market is troublesome. Consequently,

the paper would explore financial establishments in private equity markets with a view of depicting institutional structure and the potentialities in the PE industry. Examining the development of the constrained organization as the real middle person in this market over the last two-three decades would be essential in predicting the future and understanding the current private market situation. This would also help in clarifying the general structure of the market, concentrating on the real financial specialists, mediators, and backers in this sector. At this point, it takes a bias at returns to private equity in the course of the most recent years. Besides, understanding the concept of PE market helps in comprehending how the firms break down the job of constrained organizations.

As more cash enters private equity, it puts more noteworthy weight on supervisors to recognize bargains, regardless of whether it implies paying a top notch well over a prospect's EBITDA. A few administrators are holding off making ventures, as for confirmed by the decrease in arrangement numbers through the span of 2017. While private equity capital raising has been effective, a restricted accomplice will be tried if their cash is not sent in a hopeful manner (Reid, 2018). Many companies are asking whether private equity real estate brokers are practical in the long haul given resource valuations. Private equity directors comprehend that all around estimated bargains are not in the bounty. The requirement for alpha and the craving to procure resources at reasonable valuations is driving some private equity firms to take a gander at developing markets all the more intently (Fang, Ivashina, & Lerner, 2015). Generally, individual equity portfolios have been North American and European driven, yet this is changing as supervisors spot promising development regions in rising economies.

A wary methodology towards developing markets has been a result of a few elements. Right off the bat, various private equity directors have taken a gander at developing market

chance with some worry while others have a home inclination, to be specific they are more open to putting resources into more natural neighborhood markets. What's more, just 14% of private equity financial specialists are situated in developing markets. Attitudes are, in any case, moving with directors winding up all the reader to try things out in some rising or boondocks market organizations as the understanding of the danger the administration methods advances (McGettigan, 2013). The reviewed increment inaccessibility of value nearby assets and accomplices has additionally made a difference.

In spite of the way that a portion of these economies needs liquidity, resources are sensibly estimated, and constrained remote venture makes incredible return openings. Developing markets offer a compelling enhancement apparatus. A few firms are likewise hesitant to assign more money to created exchanges because of political precariousness in the US, and the uncertain outcomes of Brexit (Contractor, 2013). By putting resources into developing markets, firms can accumulate new wellsprings of profits. The expansion of developing market putting will likewise likely bring about extending the auxiliary market. Consequently, many PE firms regularly see ancillary markets as a valuable asset for emptying failing to meet expectations resources or secure returns at respectable costs.

Financial and Operating performance of Private Equity Industry

In light of the common monetary emergency that started in 2007, governments are reevaluating their way to deal with managing money related organizations, with private equity (PE) assets explicitly being focused by controllers. Most drastically, in 2010 the European Commission embraced the Elective Investment Fund Managers mandate (European Commission 2010), which contains a clearing set of principles managing the PE business. An assortment of different measures, including the Dodd-Frank Act in the United States and the European Union's

Solvency II mandate, have likewise had significant ramifications for private equity reserves and their financial specialists. Controllers, government officials, and work coordinators have since quite a while ago communicated worry about the effect of PE reserves, indicating their need to quickly return funding to financial specialists and the possibly harmful impacts of such practices as the broad utilizing of firms. Pundits have reported contextual analyses that outline the negative results of the exchanges. For example, Achleitner & Figge (2014) focus on the buyout of Britain's Automobile Association, which prompted large scale cutbacks and administration interruptions while creating considerable benefits for the exchange's support.

Controllers, legislators, and work coordinators have since quite a while ago communicated worry about the effect of PE reserves, indicating their need to quickly return money to financial specialists and the possibly malicious impacts of such practices as the broad utilizing of firms. The Service Employees International Union (2007, 2008) demonstrates the malicious impact that unreasonable use, cost-cutting, and reduced administrative choices by PE gatherings can have on firms and enterprises in cases, for example, Hawaiian Telecom, Intelsat, KB Toys, and TDC. The successive dialogs amid the 2012 U.S. presidential decision of cutbacks led to liquidations at organizations under the control of Bain Capital give another precedent.

Future State of Private Equity in Developing Nations

The expanding appeal of developing nation much of the enthusiasm for private equity putting resources into developing countries must be ascribed to their monetary advancement over the previous decade. A primary driving force to a lot of this advancement, thus, has been the financial changes embraced by a considerable lot of these nations (Mazzucato, 2015). The pace at which private enterprise has moved through developing economies is fantastic. It is anything but trying to overlook that as of late as ten years prior, just a single billion of the world's natives

were in entrepreneur economies. Today, three times that number are in economies that are firmly industrialist in the introduction.

While a point by point discourse of these progressions is past the extent of this note, it is significant a couple of these changes. A standout amongst the most considerable macroeconomic movements was the 1989 Brady Plan. This movement enabled a few Latin American nations to rebuild their outer obligation (Raymond, 2014). The significant decrease owing debtors benefit prompted a substantial lift in the financial wellbeing of these markets. The fruitful change process prompted an expansion in real financial specialists' trust in developing nations: as observed, for example, in the increment in the market costs of these nations' obligation.

Other macroeconomic changes were started by the developing nations themselves, however frequently with the nudging of such worldwide bodies as the International Monetary Fund. One field for such changes has been real duty changes. Many developing nations understood that restricted to fuel the economy is by bringing down charges on capital additions, in this manner empowering equity venture and securities exchange development (Newell & Mulvaney, 2013). Similarly, in numerous nations, limitations on remote speculation which regularly precluded interests specifically businesses stipulated that outside financial specialists expected to hold a minority stake, or constrained the repatriation of benefits - have been loose. At last, a few developing nations have gained extraordinary ground in enhancing their bookkeeping and divulgence principles. These progressions have served to bring down the expenses of putting resources into these nations and in addition to reducing the data asymmetries that the remote financial specialists confront.

Although the future of PE still appears shaky, hope is still alive that better outcomes awaits. Currently, most financial institutions are not doing so well due to the dominance of the

private equity in all markets. This is a very unstable progress in the market and the length of the stability of private equity in the markets has become a concern (Bernstein & Sheen, 2016). So far, there has been a decrease in the equity mega buyouts, the firm's main reason behind its flow of income. This and many other reasons have brought forth the question as to whether this business opportunity will last for long in the global market (Ferris, 2013). Recently, it has come to the attention of many economic analysts that limited partners are now investing in mega buyouts without passing through private equity. Soon all its activities will be substituted and it will no longer be relevant in the markets. Besides, Kaplan & Sensoy (2015) argue that the use of debt financing significantly affects various companies. For a company to run properly there must exist a steady circulation of money in the company to enhance the efficiency of its operations. Insufficient funds as a result of over lending leave the Private equity company distressed (Aarekol, 2016). Some of the companies backed with this kind of funding have already gone bankrupt and this speculates demise in the future of the industry. The company should begin a better management system in terms of their portfolio, limited partner management, and even funds available in the industry.

The current state of private equity is that it has diversified in the global market and tremendously improved since 2000. As of 2016, the private equity industry generated a total of $2500 (Kovac et al, 2018). In the recent years, private equity has grown very fast in the market. This growth can be attributed to the use of debt financing and buyouts in their endeavors. Private equity economics highlights the calculations made before an investment and the period taken. The private equity offers a discount of small percentage depending on the payment duration. Currently, many emerging markets are focusing on private equity investments. However, the

future of private equity is expected to be inoperable given that limited partners are now investing on their own without passing through private equity.

Research Questions

1. What is the economic role of private equity in the global economy?
2. Is there a significant difference in operating performance and investment of private equity between U.S and European countries?
3. What factors are responsible for private equity performance and persistence?
4. Does private equity industry have a future?

Methodology

As an explorative research, the study would involve exploring various available data for purposes of effective evaluations and interpretations. The study involves exploring the history, current state, and performance of private equity firms. Through the study of literature and available primary sources, the study explored a variety of questions to facilitate the understanding of the concept of private equity. For purposes of effectively explore the topic, articles were reviewed for effective analysis of the nature of the private equity with respect to the U.S and European countries. Additionally, descriptive statistics was obtained by analysis the existing records of return series in some selected private equity firms.

Data collection was obtained from primary research studies. Several databases were explored for potential articles that were no older than five years. Keywords were used to search for relevant scholarly articles to support the concepts in the research. The data on financial and investments sections were obtained from both European Private Equity and Venture Capital Association, EVCA (2013) and EVCA (2014) reports, and the findings supported with existing literature are explored. For the analysis of private equity fund level, operative and financial

performance, portfolio company level, and the state of the industry, global data from EVCA and Milken Institute Global Conference were useful in provide a comparative analysis of key global data level.

Discussions

Financial and Operating Performance of Private Equity

Private equity is often a process associated with risky capital that is invested in mature firms, hence requires constant assessment of their operations. The industry of private equity has faced constant critique and scrutiny as it has shown focus on opportunism and capitalism. The private equity firms have significant underlying aspirations and the contributions that they make in the economy has become questionable more so to analysts in the US economy (Brown, Harris, Jenkinson, Kaplan, & Robinson, 2015). The operating performance of these firms is measured using different profitability and efficiency measures. As a result, different perspectives of the corporate governance and uses of the agency model can be applied to measure the operating performance of private equity (Castellaneta & Gottschalg, 2016). This is because these models completely explain all underlying features and factors behind the growth and development of private equity operating performance. In order to assess the entire operating performance perspective of private equity, effects on the leverage operating performance, the ownership management of private equity, and the participation of the board in private equity managers should be investigated within this framework.

Critiques have argued that some of the factors that should be put into consideration have a significant impact on the operating performance of private equity among most firms' portfolios. The main contributing factors that private equity corporations create value in their portfolio companies are capital restructuring and operating performance (Harris et al., 2014). In

addition to this, acquisitions and mergers, which lead to external growth, are the main contributors of increased operating performance in private equity firms. This is because the mergers and acquisitions add something new to the firms' portfolios (Bloom, Sadun, and Van Reenen, 2015). Based on the evaluation of the different U.S private equity firms, no significant statistical correlation has been identified in private equity firms that are backed and those that are not backed by IPOs. However, it has been noted that post-IPO-backed private equity firms perform positively than private equity firms that are partial or non-backed (Sensoy, Wang, and Weisbach, 2014). This is because the ownership and participation of board of these backed private equity firms are much more active than that of companies that are not backed up by IPOs.

On the other hand, it has been noted that unlike firms that have not been backed with IPO, those that are fully backed have been reported to have larger terms of total assets. This is because the firms tend to have a higher leverage and control on the different cost drivers and factors that affect their operating performance. In the assessment of the operating performance of private equity firms, it has been noted that the investments of these corporations enrich the private equity funds at the cost of other asset acquiring companies in the market. Some critiques have argued that this is however beneficial to the economy of a country as they increase the creation of value hence increasing their profitability (Harris et al., 2014). The risk carrying business commonly known as private equity has played a significant role in shaping the economies of most countries through value creation.

In addition, private equity firms are seen as guarantors of the quality of investor firms. It is therefore arguable that private equity plays a fundamental role in the optimization of management resources by managing the perception of the market. It has also been ascertained that private equity firms have adopted destructing measures that help them improve the

performance of their firms. This is because private equity firms have been viewed as businesses that are more focused on creating huge returns rather than creating jobs. Therefore, their operating performance should be scrutinized in the perspective of return creation rather than job creation firms. Private equity encompasses different investment types. It involves unregistered securities and includes development and venture capital, distressed investing, mezzanine capital and LBOs (Harris et al. 2014). The investments on private equity are distributed through specialized intermediaries, which are often called limited partnerships

Performance Persistence in Private Equity Funds

Performance persists in the short-run and comes to a halt in the long-run. Time gap has an impact on performance persistence. A partnership of private equity lasts approximately 10-13 years, meaning that the neighboring funds have at least ten years of overlapping in their periods of investment (Robinson & Sensoy, 2016). This feature of the private equity industry implies that successive funds have a higher chance of being exposed to prevailing economic circumstances. Buchner, Mohamed, & Schwienbacher (2016) similarly suggest that the means of consecutive funds' performances could become correlated because of the real commonality in economics. A prediction is that the longer the period of investment shared by successive funds, the greater the correlation of performance. Performance persistence is also affected by the common market conditions of the successive funds. Fundraising occurs months and which is dependent on the conditions of the market and different factors including reputation and past performance of private equity (Crifo & Forget, 2013). Only investors who are accredited could make investments in private equity funds.

The major investors in this market include the university endowments, pension funds, insurance organizations, family offices, foundations, and trusts. A typical private equity fund is

often managed for a decade (Marquez, Nanda & Yavuz, 2014). These private equity funds could improve returns through increasing or minimizing multiples improve the performances or use the right leverage at lower prices. Thus, different market conditions at the time of investment, funds' inception, and divestments affect the performances of the funds (Crifo & Forget, 2013). For instance, the liquidity and pricing of capital are crucial determinants of the performance of private equity. Past studies found out that capital tends chasing past returns in the industry of mutual funds. Their impact is decreasing these funds as summarized in figure 1 below.

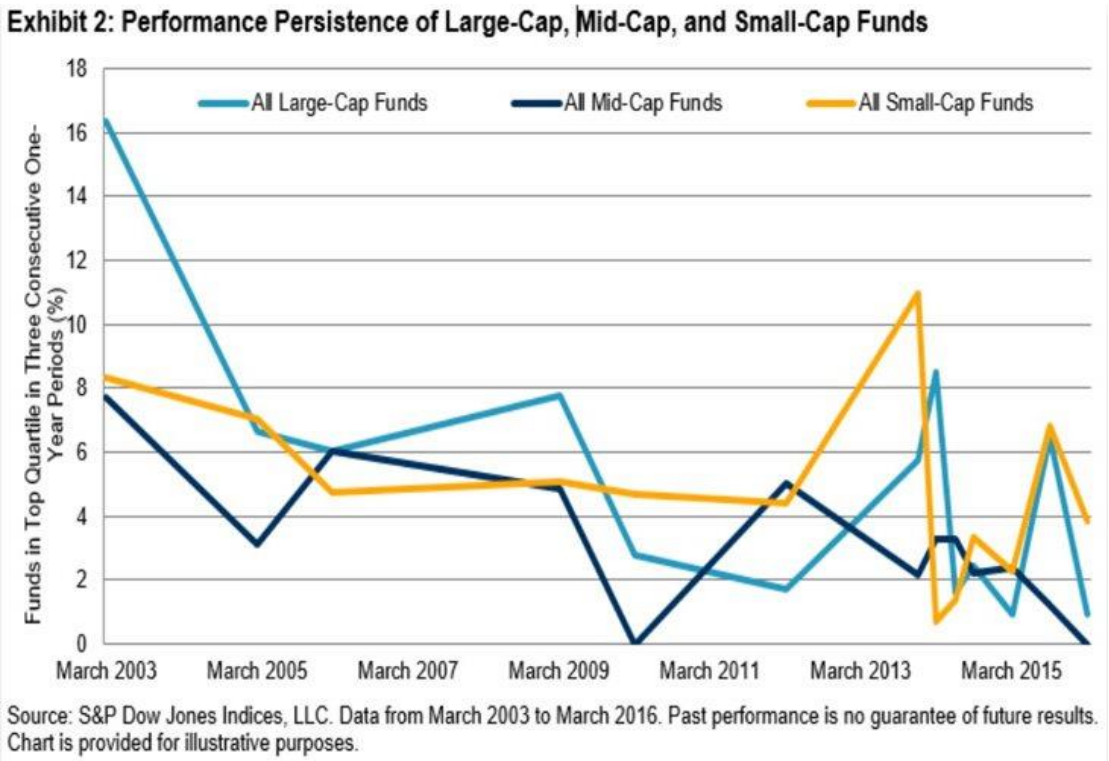


Fig 2: Performance Persistence (Stockton, 2018)

Operating Performance of private Equity after Buyouts

Approaching this question needs an understanding of the determinants of buyouts. The private equity organization emphasized investments in companies having a high potential for growth (Davis et al. 2014). These investments are not based only on capital but also competence,

networking and ownership. Increase in the form of employees turnouts, changes in the levels of debt-equity have effects on the chances of being bought by a private equity organization. The types of buyouts in private equity have changed in the history of private equity, from public-private buyouts to the middle markets buyouts of firms that are not listed. Figure 2 below shows the global buyouts. The general question is whether private equity results in the creation of value from these buyouts.

The operational value in private equity buyouts is created relying on three main theories. These are the working capital management, wealth transfer and agency costs. These private equity buyouts result in increased operation incomes before depreciation, increased the flow of net cash and decreased capital expenditures compared to the changes in the industry. Operating performance in private equity buyouts has also been analyzed from three different viewpoints (Kaul, Nary & Singh, 2018). These are in the forms of working capital management, employee management, and profitability. The agency theory focuses on risk, incentives, and conflicts in the company. In buyouts, the control of the firm acquires a substantial stake in the target organization. This action removes possible misalignment between the shareholders and the administration.

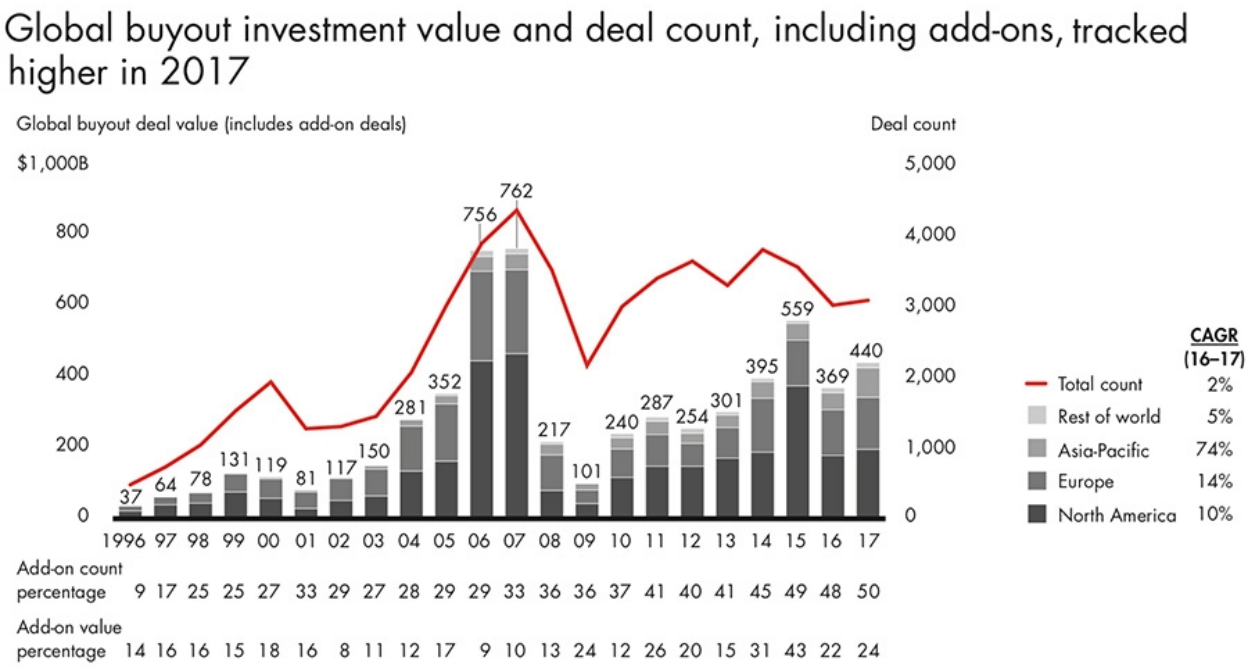
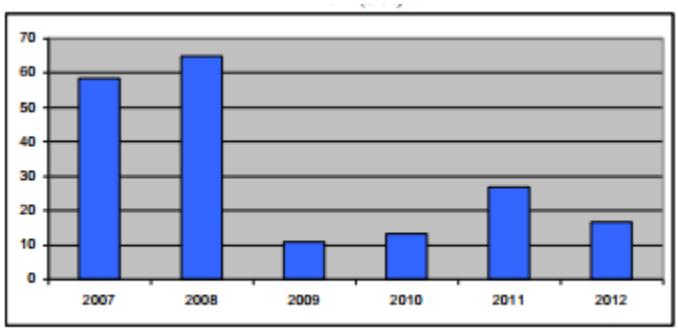


Fig 3: Global Buyout Value (Consultancy.uk, 2018)

Private Equity Fundraising with Respect to the U.S and Europe

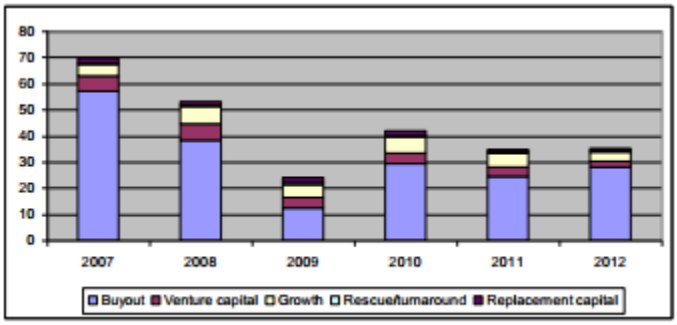
All industries are characterized by industry statistics. These statistics, present an accretion of figures based on the country of the PE firm's office in control of the investments. With regard to Europe and the U.S, the statistics are associated with investments made by private equity firms in Europe irrespective of the portfolio company's location. The industry statistics are thus associated dependent on the location, the aggregations of the market involve figures with reference to specific portfolio company location. According to EVCA (2013, the European private equity firms invested over €270bn into about 22,000 countries in Europe being a statistic that showed a significant amount of proceeds that were being invested in the PE industry. Besides, EVCA (2013) reported that the momentum of private fundraising activities increased compared to earlier years dating back from 2008 with an overall buyouts averagely representing

71% of all private equity funds that had been invested the same period as shown in the graphs presented in figure 4 and 5 below.



Source: EVCA/PEREP_Analytics

Fig 4: Amount of funds raised7 by private equity buyout funds in Europe in the period 2007-2012 (€ bn) (EVCA, 2013)



Source: EVCA/PEREP_Analytics

Fig. 5: Overview of private equity investments by stage focus in the period 2007-2012 in Europe (€ bn) (EVCA, 2013)

Based on the report by the EVCA (2013), it is a fact that buyouts was predominant in Europe between 2007 and 2012, an indication that leverage buyout and consequently private equity was on the rise. Subsequently, the data confirms the argument that investment in the PE industry has significantly increased over time in Europe (Caselli & Negri, 2018). This is so because, the global pattern was observed in the U.S and most developing countries since

leverage buyouts attracted positive returns with infinitesimal equity and large amounts of accrued debts that were used in financing various deals.

Although the economic crisis in the U.S in 2008 may have influenced the buyout and private equity in general gained stability, slight growth was recorded. According to Milken Institute Global Conference (2013), there was a significant reduction in returns in 2008 onwards to 2011 following the global capital reduction.

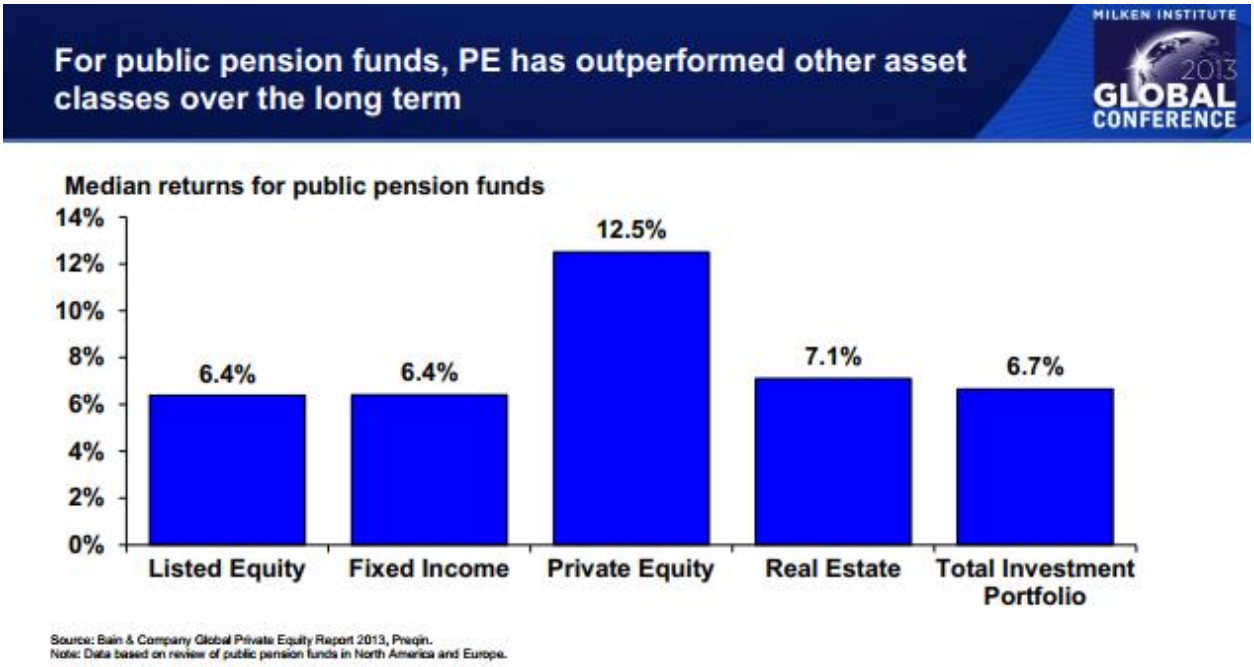


Fig 6a: Median for public pension funds (Milken Institute Global Conference, 2013)

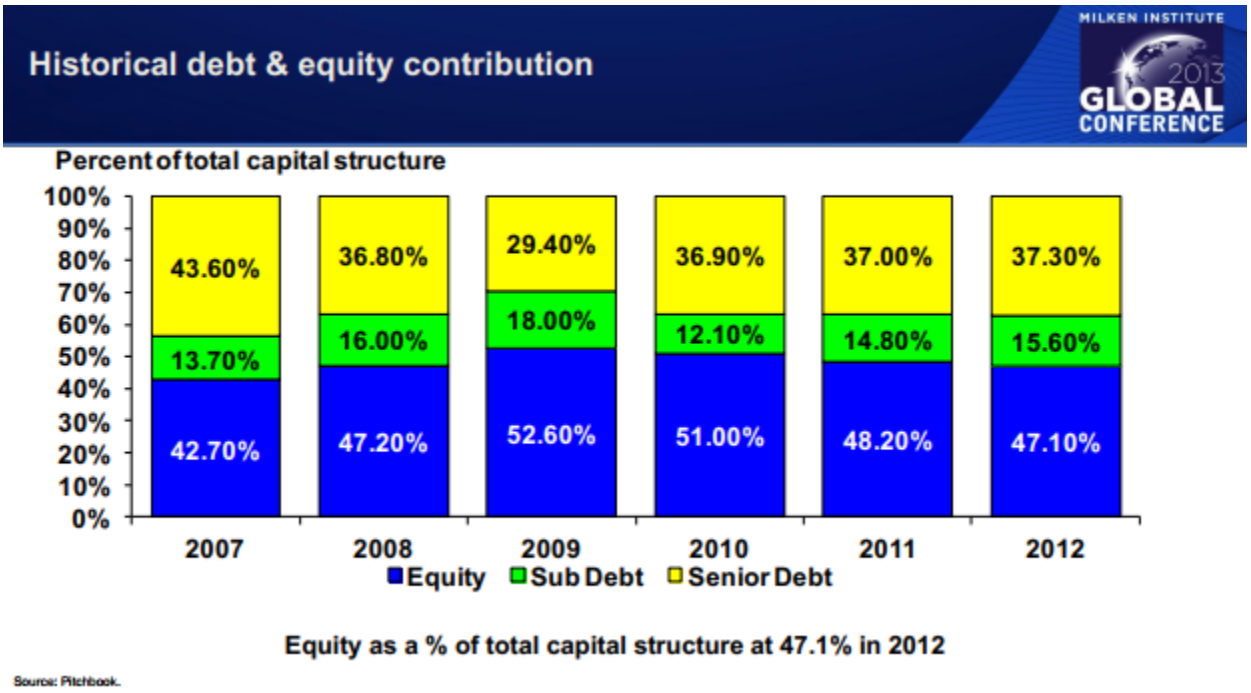


Fig. 6b: Debt and Equity (Milken Institute Global Conference (2013)

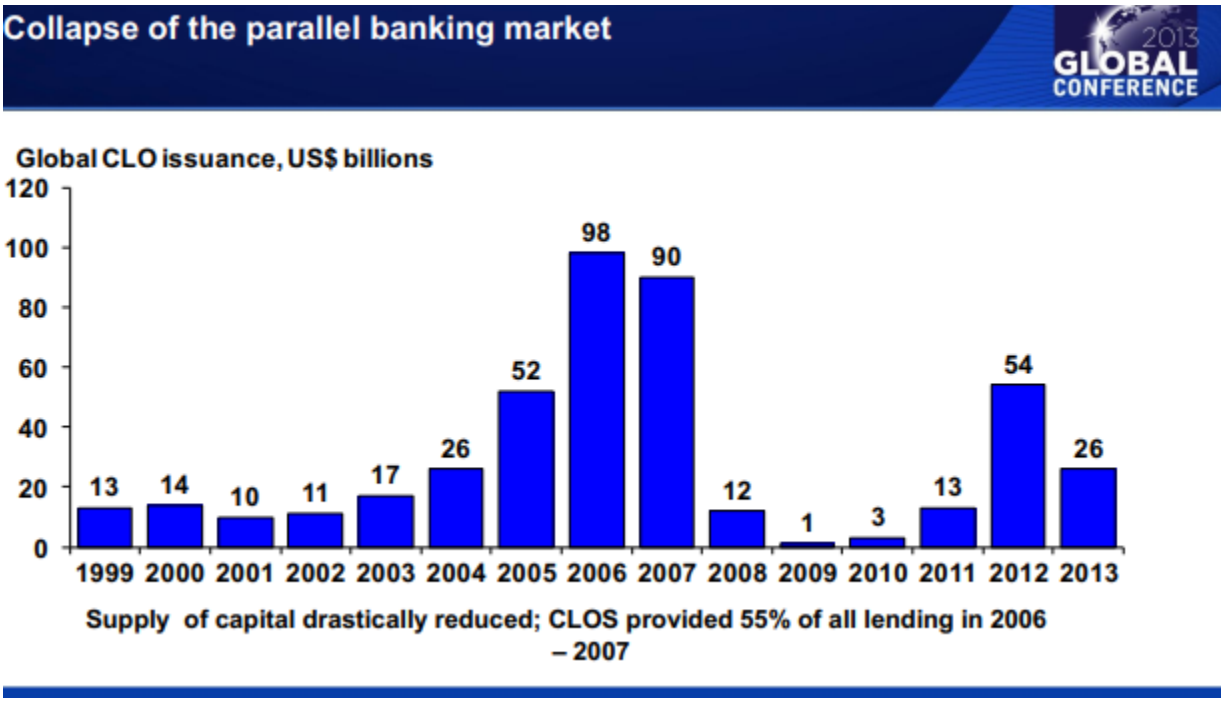
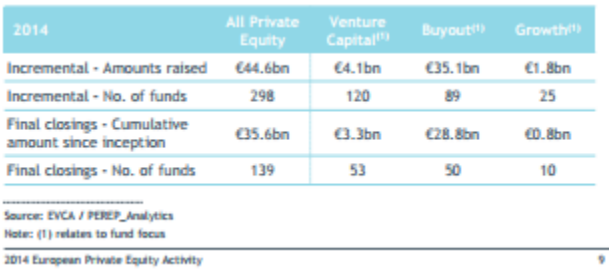


Fig 7: Collapse of the parallel banking market in the U.S (Milken Institute Global Conference, 2013)

The level of investment in the private equity industry is generally higher in European countries than in the U.S. According to EVCA (2014), the cumulative fundraising in Europe hit €44.6bn, in 2014, a figure that resents the second highest European level of investment and buyouts. The EVCA (2014) further showed a decrease in fundraising in 2014 with an 18% difference compared to previous 2013 as shown in fig. 8 and fig. 9 below.



2014	All Private Equity	Venture Capital[1]	Buyout[1]	Growth[1]
Incremental - Amounts raised	€44.6bn	€4.1bn	€35.1bn	€1.8bn
Incremental - No. of funds	298	120	89	25
Final closings - Cumulative amount since inception	€35.6bn	€3.3bn	€28.8bn	€0.8bn
Final closings - No. of funds	139	53	50	10

Source: EVCA / PEREP_Analytics
Note: (1) relates to fund focus

2014 European Private Equity Activity 9

Fig 8: Investment trend in Europe

From EVCA (2014)

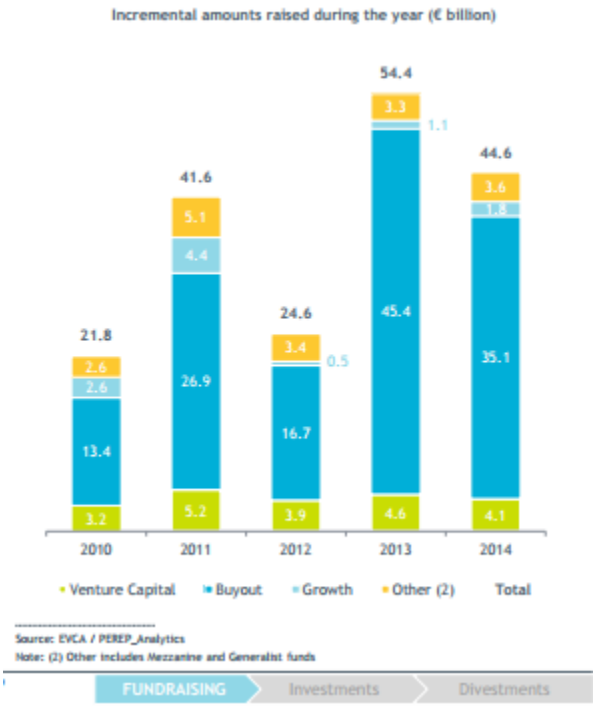


Fig. 9: PE incremental raised in 2014 in Europe (ECVA (2014)

The data shows the proportions of funding aspects. Based on the data, it could be observed the number of funds acquiring capital increased by 12% to 298 attaining the highest rate since 2011 with the pension funds providing greater than one third of funds that the institutional investors raised (EVCA, 2014). EVCA further demonstrates that funds of funds had a contribution of 12%, insurance companies at 10%, and government agencies by (11%) while the investors outside Europe in 2014 accounted for about 40% of the annual Europe private equity fundraising according to the EVCA (2014) report. The report also shows that the venture capital reached 9% of the total annual fundraising.

In general, EVCA (2014) reports that a total of €4.1bn was raised in the private equity industry with a general decrease of 12% in comparison to the 2013 value. In contrast, the U.S figures are relatively lower. Furthermore, investors from North American institutions possessed a proximately 13% with a buyout fundraising declining to €35bn from €45.4bn in 2013 with a total institutional contribution of 33%, an increase in the U.S private investment funding by about 70% to €1.8bn from 1bn, one of the highest levels in the industry since 2011 (EVCA, 2014). Additionally, being a component of the global economic success in years before 2008, the Southeastern European and the CEE regions mainly benefited from boosted FDI activities that encompassed private equity that originated largely from the EU.

Due to the strategic location of some nations, low-labor cost, palpable destructions, large scale privatization, lack of market saturations in some sectors, strategic investors, favorable tax policies, investment funds as well as those from private equity especially from the U.S and Western Europe got in the mix and considerably hiked GDP growth rates in most countries developing countries. In addition, sharing the PE investment as a percentage of its gross

domestic product is a key measure of private quality market development. Due to the fact that many developing European nations stay underpenetrated with regard to private equity investments based on the gross domestic product, there is a prospect that the percentage share would increase in future in the U.S and European developing nations. Hence, it is significant to comprehend the use of the raised private equity funds as well as the investment returns.

Descriptive Statistics

For purposes of understanding data, an analysis of the descriptive statistics would involve the discussion on three observed return series; Merrill Lynch Domestic Master-a bond index, Case-Shiller-10 City Prices-a selected real estate index, and S&P 500 market index-a private equity fund. The use of the return series offers a better view of the private equity returns, with a view of making comparisons between them. The observed statistics included quarterly data ranging from 1986-2013.

Fig. 10 - Descriptive statistics

	US PE Fund Index	S&P 500	Case-Shiller 10-City	Merrill Lynch Domestic Master
Mean	2.79	2.01	0.93	0.04
Standard deviation	4.89	8.37	2.58	2.16
Maximum	-14.60	-23.23	-6.97	-5.60
Minimum	17.24	20.87	6.22	6.01
Sharpe ratio	0.57	0.41	0.19	0.01

Fig 10. Descriptive Statistics (Deloitte, 2013)

Fig. 11 - Sub-period statistical data

Mean quarterly returns				
	PE	S&P 500	Case-Shiller	Merrill Lynch
1986-1994	1.66	*2.58*	0.52	-0.17
1997-2003	1.88	0.92	*2.63*	*0.24*
2006-2013	*4.05*	1.33	0.14	0.06
Standard deviation				
1986-1994	*2.33*	*7.42*	1.66	2.66
1997-2003	7.00	10.37	*1.24*	*1.81*
2003-2013	5.28	8.43	3.50	*1.81*

Fig 11: Sub-period Statistical Data (Deloitte, 2013)

Based on the findings from fig. 10, it can be observed that the optimum levels among the sub-periods for the specific indices showed a certain trend in private equity index. The standard deviations are although relatively higher, fig. 11 shows a more volatile return series in comparison with the indices. The private equity funds from the period witnessed the highest mean quarterly returns relative to the bond index, housing index, and market index, as indicated in fig.10.

Overall, the present proportionality between the PE performance and future simplicity of raising funds is fuelling the private equity competition for funds and investment prospects. Besides, Deloitte (2013) contends that the U.S's geopolitical unpredictability alongside the constant emerging markets like China and India are causing private funds to globally shift their attention. Furthermore, private equity funds would put pressure on enhancing operational efficiencies of the PE firms, for purposes of squeezing out greater returns from the prevailing firms aspiring to invest. Besides, Deloitte (2013) further contends that two key areas of interest are conjectured to be technological improvements and third-party administration like the back-

office tasks, processes, outsourcing, and processes as well as tax databases and data management. This is in line with fig. 12 that depicts the coefficient probabilities with all three factors being equivalent to zero

Fig. 12 - Correlation coefficients between asset classes

	US PE Fund Index	S&P 500 Index	Case-Shiller 10-City Index	Merrill Lynch Domestic Master Index
US PE Fund	100%	**3.94%**	**17.7%**	**-12.3%**
S&P 500		100%	3.86%	-18.3%
Case-Shiller			100%	-0.23%
Merrill Lynch				100%

Fig. 13 - Efficient frontiers

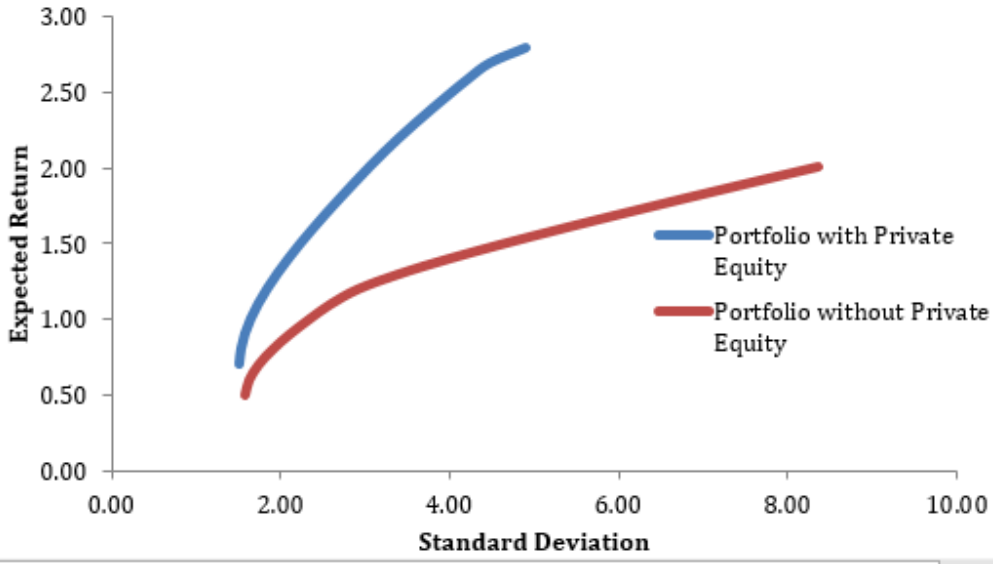


Fig 11: Coefficient Correlation and Efficient Fontier (Deloitte, 2013)

Consequently, the descriptive analysis demonstrated that PE funds have the potential to outdo the market, and represent effective broadening of possibilities to investors due to the minimal associations with other assets. As such, the PE's future fund prospects are characterized

by a greater fund availability yet complemented by a harsh competition for profitability through market exploration, structural adaptation, and enhancement of efficiencies in operations.

Private Equity Investment Selection

Private equity investment selection involves one of the most crucial aspects of business in terms of the private equity investment decision making and many other processes. According to Kovac, Burns, & McLinn (2018), the PE investment selection takes into consideration some higher uncertainties and complex business developments that are made to improve some of the aspects related to the same. This includes the most typical processes, which also involve the completion of the new private equity investments and other business opportunities. Generally, this has different specifics in terms of structuring the steps and measures into the development of business decisions and the way they vary in a wide range (Jegadeesh, Kräussl, and Pollet, 2015). These decision making processes vary in terms of the PE firm and the way they differ mostly in these opportunities. This matters in terms of the specifics of the company that is targeted and the various business transactions and the processes that these companies have to make in the process of private equity investment selection (Bernstein, Lerner, Sorensen, & Strömberg, 2016). In the private equity investment-selection process, some of the initial investments that are done to evaluate the specific investments mostly take a quick procedure. This may however differ since the whole process may also take quite some time to be completed.

Sourcing in the private equity investment-selection process takes place in the process of assessment and discovery of the various opportunities that are done in the start. During this process, the development of this stage involves the location of every potential target so that they can also look into the viability of every investment they are proposing so that they can also be able to calculate the potential returns that are available and the ones that are unavailable (Braun,

Jenkinson, and Stoff, 2017). The next step that follows is that every detail of information is gathered so that the company can conduct their due diligence. The company then follows up to create as well as developing the various models they have in their financial strategies (Harris, Jenkinson, and Kaplan, 2014). Before the final approval and the execution of the transactions is done, the evaluation of every pros and cons is done to make sure that the opportunity found is clean and swiftly handled.

Sourcing in the private equity investment selection is quite gruel and difficult more so when it comes to the investment opportunities section. Though it seems difficult, the sourcing process is duly a must have and is such a skill that is essential since it is through this aspect of skill that the best workers possess in order to have a successful career more so in the PE industry (Castellaneta & Gottschalg, 2016). Nonetheless, certain approaches need to be followed in the selection of private equity. The private equity investment-selection deals can be sourced through several channels.

However, these channels depend on the PE Company's preference and decisions. The channels include internal analysis, detailed research, and networking. Besides, other processes and channels suitable for the process include making suitable conversations with other industry consultants and company experts, meeting with other companies with the same choices and decisions, industry conferences, and company screens done through some databases for a specific criterion (Bernstein et al., 2016). The process of private equity investment selection involves potential investment decision making through which the associates ensure that they have the right investment opportunity in which the company's investments strategy fits more so when it comes to their potential value strategy of creating investment (Fang, Ivashina, and Lerner, 2015). The markets for the private equity (PE) firms therefore are created into the gap

that is seen in information imbalances. This gap is seen in the differences existing in the investors and the potential investment. The private equity investment selection is congruent to the market, entrepreneurship criteria, product in the market and the financial sector of the business.

State of Private Equity in the U.S

Firms are setting new records every day in the U.S private equity industry. This is because there is a current frenzy, which makes private investment challenging due to the rise in valuations of investment hence causing firms in the U.S to pile up additional capital. There is a rise in the trend in which private equity firms are acquiring more companies in the U.S more so through buyout funds-owned companies rather than through direct funds. In the past, private equity firms in the US mainly sought to buy companies through their own funds. This was disadvantageous especially when these firms were competing for assets against other companies. This is because organizations that do business in the same industry with corporations that acquire targets derive more cost synergies from buyout deals than fund deals (Greene et al., 2017). As a result, most private equity firms in the U.S have turned their organizations into target acquisition platforms. By so doing, once they acquire companies, they use them to acquire other more companies in the same sector. This enables their scale of their holding and their market pricing power to increase.

Based on reports made by analysts, it is clear that more than seventy per cent of all buyouts have been added to the portfolio of private equity companies. This is an increase from the previous records that had been taken before 2018. This has resulted in a rise in the price deals, the record amounts of the fundraising private equity and a significant rise in the regulations of leverage curtailing (Bloom, Sadun, and Van Reenen, 2015). This has resulted in

many U.S private equity firms seeking a competitive advantage, especially when bidding against competing buyout companies and firms for assets. Accoding to Amine (2018), such kinds of buyout trends and strategies among private equity firms in the U.S have been on the rise more so because competition of private assets in the market has intensified. Although financial crises hampered their rise, stability is being gained.

In addition, the increase in the strategies has resulted in debt pay downs as well as multiple expansions, which were not the case in previous years. In the U.S private equity industry today, private equity firms are in a position to make predictions in regard to the acquisition of additional assists and companies. Earlier in the year, it was found that deal-making in the private equity industry was so slow in the US but the competition that has further grown has increased the trend of this phenomenon.

Consequently, the US private equity industry has remained robust more so because more funds are after capital commitments from private equity funds in the market. Deployment of capital in the US private equity sector has continued to grow at a moderate pace as a result of a number of investment valuation concerns that are holding back the firms in the market (Greene et al., 2017). However, most managers of these firms are responding to the change by deploying slightly more capital than before to facilitate leverage. It has also been noted recently that most private equity funds in the US that have been holding closings especially prior to the financial crisis of 2008, have reached the peak of their terms (Bloom, Sadun, and Van Reenen, 2015). In years leading to financial depression, held fewer funds resulting in unrealized assets and unrealized value in the US private equity industry. As these funds approached the end of term after the financial crisis, their sponsors focused more on exists from the private equity portfolios of the companies while other sought to recapitalize in new companies. Buyout customers, on the

other hand, were advised to part with cash out option or other limited partners that were in need of liquidity.

Thus, it is clear from the analysis that Private equity encompasses different investment types. It involves unregistered securities and includes development and venture capital, distressed investing, mezzanine capital and LBOs. Investments on private equity are distributed through specialized intermediaries that are often called limited partnerships. The first aspect in private equity is performance persistence, which is also affected by the prevailing market conditions of the successive funds. Fundraising occurs in about six months, which is dependent on the circumstances of the market and different factors including reputation and past performance of private equity. The private equity organization emphasizes on investing in companies, which have a high potential for growth. Operating performance in private equity buyouts has also been analyzed from three different viewpoints. These are in the forms of working capital management, employee management, and profitability. It is an agreed perception that partnerships have established a reputation for the ability to generate returns early, and this presents the possibility of being lucrative later.

Throughout recent years, the economy of many countries, among them the US has been supported by the constant flow of investment that fund companies and organizations to deliver quality products and services. This trend like many others has been on a constant evolution, originating from a simple concept. Private equity refers to a form of investment that comes from a private firm. This type of funding is more of a pool of investment, whereby the private firm amasses the money endowed by many investors to make a deal in a proposal regarding an economic venture that will benefit them. What’s more, private equity funds are different from other kinds of funding because they are more inclined on the venture opportunities that run on

long-term. In the United States, private funds have become a common aspect of the economy and this can be observed through the current major trends, the level of activity when it comes to private equity, the funding sources, and structuring of private equity, the fund duration, together with the licensing and regulation placed on the private equity funds.

Currently, private equity funds in the United States has continued to shape the economy and it has remained robust. Among most reasons, private equity funds have been on a positive growth rate because of the high rates of return. According to Drean (2018), the amount of money accumulated for private equity funds amounted to approximately six hundred and twenty-one billion US dollars in the year 2017. In the previous years, amounts have already surpassed five hundred billion US dollars. Through such figures, it is a clear indication that private equity funds are on the growth more than ever and investors are contributing more because there is a constant supply of ideas to improve the current economy. Nonetheless, private equity funds did not initiate with such enthusiasm for the reason that some individuals had concerns regarding the valuation of venture opportunities. Despite that, Drean (2018) insists that private equity has already begun adopting technology in their operations, which will then streamline their transactions by improving the sharing of information and tracking the main activities.

Moving on, the level of private equity in the United States can be exemplified in terms of fundraising, investments, the transactions as well as the exit strategy. When it comes to fundraising, private equity has been on a fast growing pace because investors have realized pooling money together is both financially affordable to them and guarantees that the money will be spent accordingly. As a result, fundraising has become an essential component of private equity funds. Rowe and Kliger (2018) argue that investment opportunities have declined over the recent years in the United States, however, there is a potential for improvement based on the new

cutting-edge technology being developed. This will ensure that the level of transactions does not drop to a low figure since investors will need to invest their money on something. As mentioned earlier, PE funds have been on the increase, thus implying that the number of exits has drastically reduced due to the increase in secondary buyouts for the investors.

In the United States, there are various primary sources for private equity funds. At the onset, private equity funds are open only to clients who have qualified or to the investors who have been accredited. In line with Schell (2018), these are the primary sources for the private equity funds and they comprise of the high net worth and income individuals, endowments coming from foundations and universities, companies of insurance, and pension funds. High net worth and income individuals have invested in many ventures that bring their net value to millions and billions of US dollars, which make it possible for them to fund private equity. Endowments from universities and foundations play a role in funding private equity because they need the investments to generate profit for them (Bertoni, Ferrer, & Martí, 2013). Insurance companies, in addition, also form a part of the primary source of private equity funds given how they make profits in return. Pension funds also attract economic value when interlinked with private equity. Consequently, these primary sources for funding private equity ensure that there is a constant supply of money to feed the growing market.

Fund structuring of most private equity funds is almost similar in most firms in the United States. The main source of funds in these organizations is allowing high net worth individuals and institutions to invest in their firms by acquiring ownership in their companies and removing them from the public stock exchange. There are different private equity firm and each has a unique fund structure. However, almost all firms use some common procedures of the fund structure. These are the classes of fund structures, the places in which the firm is planning to

invest and the management fees. Similar to any business' objective, private equity gives a lot of emphasis on the return on investment. Many available investment opportunities in the private equity environment are treated as limited partnerships. According to Levin (2015), there are two classifications of partnerships in private equity firms, the general partnership and limited partnerships. The general partnerships receive a management fee and a carry, which is normally 20% of the gross profits with 2% of the firm's money, is used to pay salaries in private equity firms (Hope, Thomas, & Vyas, 2013). Such fee often proves significant for companies.

Private equity firms are mainly after attaining a significant amount of interest by acquiring ownership of as many private investments as possible and installing a better management in them. The traditional fund duration for private equity investment in the United States is usually ten years that is divided into five different stages (Lopez-de-Silanes, Phalippou, & Gottschalg, 2015). The five stages include the formation of the contract and the way it should be organized for convenience, the period when the fund is to be raised, in most cases it is normally 2 years. After that, the period of sourcing for the deal and actual investing, it is now time to manage the portfolios and lastly, the trade time. The deals offered by the private equity firms usually have a specific period. This is because of the general partner's desire to raise a new fund as well as by the structure of the incentives. Cumming (2013) explains that sometimes it can be unfortunate to find that the timeframe provided by the private equity structure is affected by harsh market conditions. In such a situation, the time might be limited because the investment is not yielding.

The private equity fund firms in the United States have to register their businesses with the US security and Exchange Commission. This was passed after the private fund investment advisor registration Act 2010 (Hornuf & Schwienbacher, 2017) any individual or organization

that is involved in securities must register as an investment under the US investment act 1940. There are two exceptions. If a company has securities that are owned by people, who qualify to be buyers during the time it was formed. If the company possesses security that belongs to less than a hundred people. There is no limited time as to when an individual can invest. The nature of private equity brings the investment period to about five or six years (Gilligan, & Wright, 2014). When purchasing buyouts a financial adviser acts as the intermediary at the auctioning on behalf of a company. Different companies project their bids and the highest bidder is awarded the buyout. During such acquisitions, documents such as merger agreements, equity purchase agreement and asset purchase agreement are issued.

Finally, private funding has increased in the US market over the years and is presently the main investment. Presently, private equity funds are among the leading commodities of trade in terms of the rate of return on income. A large part of the economy of the US is driven by private equity fund. Private equity has a perfect strategy of raising funds including the idea of pooling together funds through fundraising. The private equity fund structure is done by encouraging the investment of wealthy individuals. The industry has an investment duration of ten years. Finally, every individual or firm that wants to deal in securities has to register under the US investment Act 1940.

Significance of Research and Summary

Private equity firms have been existence for decades. The growth and expansion of private equity differs across the globe although there is a gradual stability. High returns private equity funds and high capital investments have been key in the growth of the industry. While the global financial crisis hindered growth of the industry, much efforts have been made, which enhance the acquisition of more companies. Private equity generally seems to have a bright

future with many firms engaging in investments and fund generations. Understanding the concepts of this industry would help create better understanding on the operations and performance of private equity firms with the aim of improving their industry growth and expansion. Private equity has changed from being a small asset class to becoming a main player in the world economy. Regardless of being the invention of the United States of America, the model of private equity has found its way to Europe, leading to its expansion.

Nonetheless, much remains to be done concerning private equity investment and its future growth. A substantial interest remains in comprehending in greater depth the nature of involvement and engagement of private equity firms with portfolio companies so at to provide a more robust evidence on how these relate to value creation in the industry. Besides, improved deal-level datasets made through the assistance of help of the primary equity industry are clearly needed for the creation of a better industry with high financial and operative performance as well as greater return on interest. Consequently, devising creative ways of understanding both short-run and long run investment effects of the private equity industry in relation to other firms in the economy remains an important area to explore.

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