Contents

Foreword to the Second Edition xi
Acknowledgements xiii
About the Author xv

Introduction 1
0.1 A Moving Target 1
0.2 A Consubstantial Lack of Information 2
0.3 Benign Neglect, Malign Consequences 5
0.4 Knowing the Devil to Circumvent it 6

PART I  WHAT IS PRIVATE EQUITY? 9
1 Private Equity as an Economic Driver: An Historical Perspective 11
   1.1 Pooling Interests to Identify and Exploit Sources of Wealth 12
      1.1.1 Identify, Control and Exploit Resources 13
      1.1.2 Leverage Public Policies and a Favourable Business Environment 15
   1.2 Championing Entrepreneurship 17
      1.2.1 No Private Equity without Entrepreneurs 17
      1.2.2 Convert Ventures into Business Successes 20
      1.2.3 Entrepreneurship and Private Equity Form a Specific Ecosystem 22
   1.3 Conclusion: An Attempt at Definition 24
      1.3.1 A Negotiated Investment in Equity or Quasi-Equity 24
      1.3.2 A Fixed Maximum Term 25
      1.3.3 Implying Specific Risks 25
      1.3.4 With High Expected Returns 25
      1.3.5 Undertaken on Behalf of Qualified Investors 25
      1.3.6 To Support Entrepreneurs 25

2 Modern Private Equity – A French Invention? 33
   2.1 USA: The Foundry of Modern Private Equity 34
      2.1.1 The Strict Separation of Public Policies and Public Financing 34
Contents

2.1.2 The Separation of Public Endeavours and Private Efforts; the Subsequent Support of the Former for the Latter 35
2.1.3 Governmental Input: SBA, DARPA and ERISA 35
2.1.4 Universities, Defence and Disruptive Innovation 36
2.1.5 Challenges 37

2.2 Europe: Adapting a Successful Model or Creating its Own? 39
2.2.1 Governmental Input: Legal Changes, Tax Rebates, Infrastructures and Pan-EU Market 40
2.2.2 National Champions, Information Technologies and Incremental Innovation 43
2.2.3 Challenges 47

2.3 Conclusion: Emerging Markets, Building Castles on Sand? 57

PART II THE PRIVATE EQUITY ECOSYSTEM 71

3 Private Equity: A Business System Perspective 73
3.1 We Are All Investors in Private Equity 73
3.1.1 Sources of Capital 73
3.1.2 Private Equity Investment Rationale 79

3.2 Organisation and Governance of Private Equity Funds 91
3.2.1 Private Equity Fund Managers are Financial Intermediaries 91
3.2.2 Incentives and Fees 93
3.2.3 Conflicts of Interest 95
3.2.4 Power, Checks and Balances 98

3.3 Measuring Performance, Managing Risks and Optimising Returns 99
3.3.1 Measuring Performance in an Uncertain Context 99
3.3.2 Managing Risks and Optimising Returns 103

3.4 Pitfalls and Challenges 110

3.5 Conclusion 113

4 The Universe of Investment 117
4.1 Venture Capital: Financing Company Creation 122
4.1.1 Venture Capital Investment Targets 122
4.1.2 Actors and Structures 130
4.1.3 Operational Activities 142
4.1.4 Challenges 144
4.1.5 Limits 152

4.2 Growth Capital: Financing Companies’ Expansion 152
4.2.1 Growth Capital Investment Targets 152
4.2.2 Actors and Structures 152
4.2.3 Operational Activities 154
4.2.4 Challenges 154
4.2.5 Limits 155

4.3 Leveraged Buy-Out: Financing Companies’ Transmissions 155
4.3.1 LBO Investment Targets 156
4.3.2 Actors 158
4.3.3 Operational Activities 160
4.3.4 Challenges and Limits 165

4.4 Other Interventions in Private Equity 177
4.4.1 Funds of Funds 178
4.4.2 Targeting the Stock Exchange 183
4.4.3 Special Situations: Turn-Around Capital and Distressed Debt 186
4.4.4 Quasi-Equity Instruments (Mezzanine) and Second Lien Debt 198
4.4.5 Merchant Banking, Investment Banking and Private Equity House Intervention 212
4.4.6 Secondary Market 214
4.4.7 Real Estate, Infrastructure and Exotic Assets 218

4.5 Conclusion 221
4.5.1 Private Equity is a Financing Solution Designed for a Specific Need 221
4.5.2 Venture and Growth Capital 221
4.5.3 Leveraged Buy-Out 221

5 The Process of Investment: A Matter of Trust and Mutual Interest 225
5.1 Step 1: Preliminary Analysis 225
5.2 Step 2: Valuation 226
5.3 Step 3: Negotiating 227
5.4 Step 4: Structuring 228
5.5 Step 5: Complementary Due Diligence 229
5.6 Step 6: Transaction 229
5.7 Step 7: Monitoring and Exit 230
5.8 Conclusion 230

PART III PRIVATE EQUITY IN TEENAGE TIME: TREND SETTING, FADS AND RESPONSIBILITIES 233

6 Private Equity Evolution: Trends or Buzzes? 235
6.1 Is Private Equity Going Mainstream? 235
6.2 Is Private Equity (Still) Creating Value? 239
6.3 Private Equity: Between Bubbles and Crashes 242
6.4 Conclusion 247
6.4.1 There is No Such Thing as ‘Capital Overhang’ 247
6.4.2 Elements of Analysis 248
6.4.3 From ‘Capital Overhang’ to ‘Dry Powder’ 250

7 Private Equity and Ethics: A Culture Clash 255
7.1 Greed 255
7.2 Destruction 261
7.3 Philanthropy 266
7.4 Transparency 268
7.5 Self-Regulation or Imposed Regulation? 269
7.6 Conclusion 271
## Contents

### 8 General Conclusion – Private Equity Today and Tomorrow 275

8.1 Fewer General Partners, but not Necessarily Better Ones 275
8.2 Core Target: Manage the Volatility of Performance 276
8.3 The Only Valid Leitmotiv: Long-Term Thinking 278
8.4 The Impact of Fair Market Value 280
8.5 A Long-Term Trend: The Attractiveness of Private Equity 281
8.6 Private Equity: Future Victim of its Own Success? 290
8.7 The Impact of a Better Knowledge of Private Equity 294
8.7.1 Understanding the Risk and Managing the J-Curve 294
8.7.2 Innovating through Structuring 296
8.7.3 The Temptation of Co-Investments 297
8.7.4 Change or Die: The Pressure on General Partners 298
8.7.5 Regulation: Damocles’ Sword Looming over Private Equity 299

#### Template 1 (Fund) 303
Architecture of the Private Placement Memorandum of a Private Equity Fund 303

#### Template 2 (Fund) 305
Structure of a Limited Partnership Agreement 305

#### Template 3 (Fund) 309
Due Diligence Checklist 309

#### Template 4 (Fund) 313
Quarterly Report Template 313

#### Template 5 (Company) 317
Non-Disclosure Agreement 317

#### Template 6 (Company) 321
Business Plan 321

#### Template 7 (Company) 327
Term-Sheet 327

#### Business Case: Kroton Educacional SA – A Private Equity Operation Can Hide Another One 333

#### Exhibits 349

#### Glossary 361

#### Bibliography 375

#### Index 383