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
      Measuring the Returns to Private Equity 17
      The Measurement of Risk 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
      Factors that Led to the Growth of Private Equity Industry 36
      What Went Wrong? 37
   Nontraditional Fund-Raising Methods 38
      (Ir)rationality behind Private Equity IPOs 38
      Then Why Are These Companies Going Public? 39
   Private Equity IPOs: Performance and Implications for the Future 39
      Short-Term Performance 40
      Long-Run Performance and Implications for Future IPOs 41
### Contents

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
  - **Investment Styles** 55
  - **Financing Styles** 56
    - **Categorization of Listed Private Equity** 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
  - **Risk Sharing** 75
  - **Risk Reduction** 76
  - **Access to Deal Flow** 77

Partner Selection 78
Structuring and Managing the Syndicate 81
  - **Equity Ownership Structure** 81
  - **The Investment Agreement** 81
  - **Contractual Enforcement** 82
  - **Monitoring of Investees** 83
  - **Decision Making** 84

Syndication and Performance 84
The Future of Syndication Research 85
  - **Emerging Themes in PE** 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

Empirical Tests 99
  Data Source 100
  Summary Statistics 101
  Regression Analysis 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
    Antidilution Protection 115
    Redemption Rights 116
    Investor Registration Rights 116
    Investor Board Representation 116
    Trading/Hedging Restrictions 116
    Company-Forced Conversion 117
    Investor Call Option, Investor Right of First Refusal, and
      Company Put Option 117
  Firms Issuing PIPEs 118
    Why Firms Choose PIPEs 118
    Cost of PIPEs 119
    Stock Performance at Closing and in the Long Run 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
    The Canadian Stock Market 130
    Regulation of Private Placements in Canada 131
  Private Placements and the Issuers 132
    Data 132
    Which Firms Issue Private Placements? 134
    Industry Clustering 135
    Financing Strategies and Clustering of Issuers 136
    Operating Performance 137
    Preissue Performance 138
    The Postplacement Performance 139
<table>
<thead>
<tr>
<th>Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Returns Surrounding Private Placements</td>
</tr>
<tr>
<td>The Estimation of Abnormal Returns</td>
</tr>
<tr>
<td>The Preissue Return of the Public Investors</td>
</tr>
<tr>
<td>The Postissue Return of the Public Investors</td>
</tr>
<tr>
<td>Analysis of Differences in Long-Run Performance</td>
</tr>
<tr>
<td>Discussion</td>
</tr>
<tr>
<td>Discounts</td>
</tr>
<tr>
<td>Previous Evidence and Explanations</td>
</tr>
<tr>
<td>Measure and Stylized Facts</td>
</tr>
<tr>
<td>Discount and Long-Run Performance</td>
</tr>
<tr>
<td>Conclusion</td>
</tr>
<tr>
<td>Notes</td>
</tr>
<tr>
<td>References</td>
</tr>
<tr>
<td>About the Authors</td>
</tr>
</tbody>
</table>

9 Hedge Funds' Activism: A New Trend of Convergence toward Private Equity in Public Firms? |

<table>
<thead>
<tr>
<th>Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hedge Funds and Private Equity: Market Data and Trends toward Convergence</td>
</tr>
<tr>
<td>Private Equity and Hedge Funds: Competitors or Allies?</td>
</tr>
<tr>
<td>Hedge Funds' Approach to Activism</td>
</tr>
<tr>
<td>Features of Targeted Companies</td>
</tr>
<tr>
<td>How Hedge Funds Engage a Fight against Incumbent Management</td>
</tr>
<tr>
<td>Stake Owned, Wolf Packs, Empty Voting, and Hidden Ownership</td>
</tr>
<tr>
<td>Clinical Study of Carl Icahn versus Time Warner, Inc.</td>
</tr>
<tr>
<td>The Parties Involved</td>
</tr>
<tr>
<td>Why Did the Activists Intervene?</td>
</tr>
<tr>
<td>What Happened: The Path Followed</td>
</tr>
<tr>
<td>The Event Study Analysis</td>
</tr>
<tr>
<td>Conclusion</td>
</tr>
<tr>
<td>Notes</td>
</tr>
<tr>
<td>References</td>
</tr>
<tr>
<td>Reference Web Sites</td>
</tr>
<tr>
<td>About the Authors</td>
</tr>
</tbody>
</table>

PART III Financial and Real Returns to Private Equity |

10 Projection of Private Equity Fund Performance: A Simulation Approach |

<table>
<thead>
<tr>
<th>Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
</tr>
<tr>
<td>Related Literature</td>
</tr>
</tbody>
</table>
A Simulation Approach for Venture Capital Performance Projection and Risk Management 201
  Description of the General Approach 201
  Data Description 204
  Econometric Analysis and Modeling 213
  Monte Carlo Simulation 218
Simulation Results for Two Fictitious Venture Capital Funds 221
  Structure of the Fictitious Venture Capital Funds 221
  Simulation Results 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
  Sample and Data 232
  Variables 233
  Descriptive Statistics 234
  Differences by Subsamples 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
  Publicly Traded Vehicles 258
  Round Valuation Data 258
  Investment Data 259
  Fund Data 260
  Sample Biases 260
Methodology 266
  Publicly Traded Vehicles 266
  Round Valuation Data 266
  Investment and Fund Data 269
Results 270
  Publicly Traded Vehicles 270
  Round Data 270
  Investment Data 271
  Fund Data 272
13 Private Equity Fund Selection: How to Find True Top-Quartile Performers

Introduction 283
Hypothesis Development 284
The Research Approach 285
Measurement and Operationalization 285
Performance Track Record 286
Deal Flow 286
GP Experience 286
Differences between the Focal and Prior Funds 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 MeasureTM 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

Introduction 301
Evidence of the Real Effects of Private Equity 301
Research Agenda 307
References 308
About the Author 309
Acknowledgment 310
# Contents

## 15 Employment, Wage, and Productivity Effects of Private Equity Transactions

- The Universe of Private Equity Transactions
- Task of the Chapter
  - Pitfalls for the Unwary
- Employment and Productivity Identities
- Employment, Wage, and Productivity Effects
  - U.S. Empirical Studies
  - U.K. Empirical Studies
- Conclusion
  - Notes
  - References
  - About the Author

## PART IV International Perspectives on Private Equity and Regulation

## 16 Valuation and (Financial) Disclosure in the Private Equity Industry: Institutional Set-Up, Incentives, and Empirical Analysis

- Introduction
- Institutional Setup
  - Valuation and Disclosure Rules for Privately Held (Portfolio) Firms
  - Valuation and Disclosure Guidelines for Private Equity Funds
  - A Brief Evaluation of Valuation Guidelines
- Main Problems and Conflicts of Interest
- Incentives for Voluntary Disclosure versus Mandatory Disclosure
- Disclosure of Firm-Specific Information
- Determinants of Potential Reporting Biases of Private Equity Funds
- Financial Standards, Disclosure, and Regulation
- Disclosure and Reporting Patterns of Venture-Backed Portfolio Firms
  - Reporting Biases of Private Equity Funds Valuation
- Conclusion
  - Notes
  - References
  - About the Authors

## 17 Private Equity Regulation: A Comparative Analysis

- Introduction
- The Growth of Private Equity
  - The Performance of Private Equity
  - The Supply-and-Demand Side of Private Equity
Dealing with Agency Problems: Contractual Arrangements 368
  The Relationship between Investors and Fund Managers:
    The Limited Partnership Structure 369
  The Relationship between Investors and Fund Managers:
    Restrictive Covenants 373
  The Relationship between the Fund and Its Portfolio Companies 376
Regulation of Private Equity Funds 379
  Self-Regulation 379
  Coregulation 382
  The Regulatory Response 384
  Legal Tools 386
  Regulatory Responses to Hedge Fund and Private Equity
    in Canada, the European Union, Germany, the Netherlands,
    and the United Kingdom 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
      Most Important International Investor Countries 399
      Most Important International Target Countries 402
      Regional Clustering of the International PE Investment Market 406
      International Syndication of Buyouts 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
    Perceptions of Particular Allocation Criteria in Emerging Markets 429
    Investors’ Preferences Regarding Different Emerging Regions 431
  Conclusion 432
Note 434
References 434
About the Author 436
CONTENTS

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
      The Literature 450
      Performance Measures 451
      Evidence from Europe 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
      Critical Features 468
   The LBO Legal Environment: Past, Present, and Future Trends 469
      The Past Debate 469
      The Inconsistent Case-Law and the Supreme Court Prohibition 470
      The Investors’ Reaction and the Subsequent Turning Point 471
      Regulatory Restrictions of LBOs prior to 2004: A Closer Look 472
      The European Context 474
      The 2004 Reform: Conditions for the LBO Legitimacy and Unsolved Issues 475
      New Criminal Prosecutions in Case of Financial Assistance 478
      Consequences in Case of Bankruptcy 479
   The Economic Impact of the 2004 Reform 480
      Data and Methodology 480
      Sample Characteristics and Representativeness 481
      Impact on Investor Behavior: A Descriptive Analysis 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
      Article 2357: Share Buyback Restrictions 496
      Article 2358: Financial Assistance Prohibition 497
   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
      An International Comparison of the Relative Importance
      of Venture Capital 515
   Sources of Venture Capital Funds in Germany 518
   Venture Capital Investments 521
   Specialization and Ownership Structure of Venture Capital
   Firms in Germany 527
   Financial Contract Design by Venture Capital Firms in Germany 528
   Exit Alternatives and Exit Strategies of Venture Capital
   Firms in Germany 530
   Going Public as an Exit Route for Venture Capital and the
   Performance of Venture-Backed IPOs in Germany 534
      Going Public as an Exit Route for Venture Capital 535
   Performance of Venture-Backed Initial Public Offerings in Germany 536
   Empirical Evidence on the Long-Run Performance and Exit
   Behavior of Venture-Backed IPOs in Germany 537
   Other Venture Capital–Related Issues 545
   Conclusion 548
   References 549
   About the Authors 553

23 Private Equity in Denmark: Capital Structure
   and Taxes 555
   Introduction 555
      History of Buyouts in Denmark 556
   Consequences for Capital Structure of Portfolio Companies 558
      Leverage and Takeovers 558
   Capital Structure of Private Equity Funds 559
      An Empirical Investigation 560
   Some Case Studies 563
   Financial Performance of Investments 564
   Summing Up 564
   Implications for Tax Payments 565
      Taxes and Takeovers 565
         A Simple Example of a Private Equity Takeover 566
      The Example with Numbers: Implications for Corporate
         Tax Payments 567
      Wider Tax Implications of PE Takeovers 571
         A Hypothetical Case 572
      More Complications 573
      Summing Up 575
   Conclusion 575
   Notes 576
   References 576
   About the Authors 577
## CONTENTS

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

| Index   |                                                                     | 603  |