AN OVERVIEW OF THE EUROPEAN PRIVATE EQUITY INDUSTRY

Popescu Tudor
Associate Lecturer
Babes-Bolyai University,
Faculty of European Studies,
Cluj-Napoca, Romania
E-mail: tudor8019@yahoo.com

Abstract: Private equity is an alternative form of financing companies, besides classical methods (bank loan or bonds), which is done in exchange of a part of the share capital of the company. This funding is realized by investors interested in the company that also offer portfolio companies expertise in order to increase their value. Private equity is viewed as the most expensive form of financing because is done against a stake in the company's share capital and gains from selling the shares at a higher price than the buying price. The operations can be divided into two main categories, regarding the owned stake in the company. There are venture capital investments, that are made in the early stages of company development, the involvement of investors is mainly consulting and the percentage of owned share capital is under 50%. The other category is buyout investments, that are made in more mature companies, the percentage owned is more than 50% and the involvement of investors goes to complete restructuring of the company. The article is structured in four parts. The first part is the introduction and presents the private equity activity. The second part is a brief presentation of the present state of the industry at a global level. The third part presents the European private equity market, with a focus on European fundraising, investments and divestments. The data is gathered from European Private Equity and Venture Capital Association (www.evca.eu) and represents the evolution of the market in the last five years, between 2007 and 2011. The last part represents the conclusions of the research. We present the state of the industry globally, with US representing more than half of total activity, followed by Europe and Asia-Pacific. The European market is dominated by the United Kingdom, with more than 40% of total activity, followed by France and Germany. The funds are raised primarily from pension funds and banks and are invested in different sectors, depending on the type of operations: venture capital or buyout. We also find that the preferred exit routes for investments are trade sale and secondary sale.

Keywords: private equity; venture capital; buyout; funds raised; investments; divestments; exit

JEL classification: G32, O16, O52

1. Introduction

Private equity funding is an alternative form of funding companies, besides classical methods of funding (bank loan or bonds), which is done in exchange of a part of the share capital of the company. This funding is realized by investors interested in the company. The revenue of these investors is represented by the dividends which they cash in and the sums of money that they receive by selling the packages they own at higher prices than the acquisition price. This gap between the two values (the acquisition and the sell price) is due to the active involvement of the investors in the company's activity, resulting in the increased value of the firm and implicitly in the increased price of the shares. The role of private equity activity is to increase the performance of the company, because "any economic entity must increase its performance in order to survive" (Pintea, 2011:13).

Another essential feature of the private equity activity is that besides the funding activity, the private equity investors also offer expertise to the companies in their portfolio. Thus, they get involved in the activity of the company to contribute to the development and the increase of its value.

Figure 1. Private equity activity
Source: own work

The definition of the private equity activity has changed in time, including today any investment in share capital of companies, listed or not, accompanied by the active involvement of investors in their activity, through a well developed strategy, with the express purpose of helping to increase the value of the respective companies and to generate profits by selling the shares at a higher price than the acquisition one.
Being an alternative form of funding, this method is usually used by companies which cannot apply for classical forms of funding. Also, it is considered to be the most expensive form of funding, because you have to sell a part of the business.
The private equity activity can be divided into two categories, depending on different criteria: venture capital and buyout. In the next table we will present the main features of the two forms of funding:

Table 1. The main features of the venture capital and buyout operations

Characteristics	**Venture capital**	**Buyout**
Percentage of the share capital owned	Minor (under 50%)	Almost always control, over 50% (minor holdings in the case of "development capital" or "expansion capital")
Dimensions of the firms in which is invested	Relatively small companies, in course of development	Big, mature companies
Level of involvement	Passive (consulting, know-how, business relationships)	Active (involvement in the activity of the company, going all the way to restructuring)
The stage in the life of a company in which the investment is being made	Early (start-up, establishment, early-stage, development, late-stage, expansion)	Advanced (mature or in decline)
Sectors in which to invest	Emerging sectors, with a high innovating capacity	Traditional, mature, settled sectors, with a well known business model
Using loaned money	Almost never	Almost always
Necessity of profit for the company in the portfolio	Not essential in the beginning	Essential, for paying the debt
Funding rounds	Continuous funding through rounds of financing	Single funding
Risk and reward profile	High (due to the uncertainty about the future of the company)	High, but lower than in the case of the VC (high, due to the necessity of reimbursing the acquired credit for the acquisition of the company, and lower due to the higher certainty about the future of the company)
Types of people involved	Former managers, business owners	CFO's, Accountants
Reward of the investment depends on	Flair of the investor, sense of business (art)	Preparing an accurate financial plan (science)

Source: own work

The two types of operations, even though they posses different features, they have the same objective, namely earning profits, and follow the same pattern, buying a stake in the company, raising the value of the package and selling it at a higher price.

2. The Global Private Equity Market

Private equity assets under management around the world probably exceeded $2.0 trillion at the end of March 2012, and funds available for investment totaled $949bn (about 47% of overall assets under management) (www.wikipedia.org).
Some $246bn of private equity was invested globally in 2011, down 6% on the previous year and around two-thirds below the peak activity in 2006 and 2007.
Global exit activity totaled $252bn in 2011, practically unchanged from the previous year, but well up on 2008 and 2009 as private equity firms sought to take advantage of improved market conditions at the start of the year to realize investments.
The fund raising environment remained stable for the third year running in 2011 with $270bn in new funds raised, slightly down on the previous year's total.
The United States plays the biggest part in private equity activity worldwide, with more than 50% of the operations.

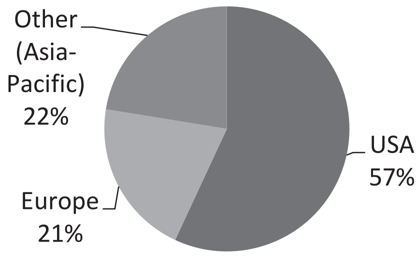

Chart 1. Regions share in the private equity operations (2011)
Source: www.evca.eu

3. European Private Equity

In 2011 European fundraising increased by 80% to 40 bn. EUR compared to the previous year, matching 2001 level. Venture Capital contributed to this trend with its 50% increase compared to 2010. The buyout & growth segment almost grew by 100% compared to 2010 and attributed for 30 bn. EUR. More than half of the buyout amount raised came from pension funds, banks and fund of funds.
Investments remained stable at 46 bn. EUR showing a 6% increase from 2010. This figure resembles the investment level of 2005. Buyout & Growth accounted for 91% of the total amount invested.
In 2011 more than 4,800 companies received investments in Europe out of which SMEs accounted for 85% with an average investment per company of 3m EUR. More than 60% of these investments were attribute to Venture Capital.
The three most targeted sectors by number of companies in 2011 were Life sciences, Computer & consumer electronics and Communications together accounting for 50% of the total. The stage focus split reveals a sector specificity in case of Venture Capital (Life sciences, Computer & consumer electronics and Communications) and a more homogeneous distribution for Buyout & Growth.
In 2011 30 bn. EUR were divested showing a 50% increase compared to the previous year and almost reaching the 2006 peak. This increase was triggered by the Buyout & Growth segment which accounted for 92% of the total amount. More than 2,000 companies were divested of which Venture Capital and Buyout & Growth had about an equal share.

The most preferred exit routs were Trade sale and Secondary sale, together representing more than 60% of the market in terms of amount divested.
The total funds raised, the investments and divestments through 2007-2013 are presented in the following chart:

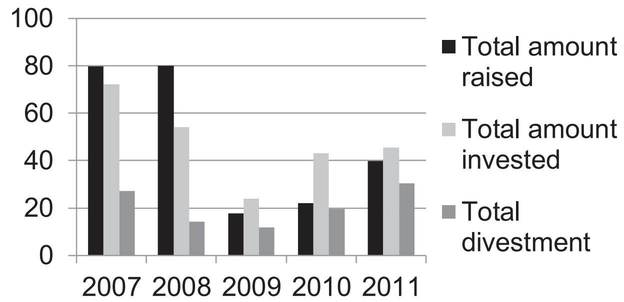

Chart 2. Amounts raised, invested, divested 2007-2011 (total bn. EUR)
Source: www.evca.eu

As for the European countries, their share in 2011 regarding the amounts raised, invested and divested is as follows:

Table 2. Participation of European countries in private equity (%)

Funds raised		Investments		Divestments	
United Kingdom	41.40 %	United Kingdom	41.95 %	United Kingdom	40.78 %
France	15.22 %	France	19.87 %	France	18.49 %
Sweden	14.14 %	Germany	9.45%	Germany	15.33 %
Germany	7.83%	Spain	4.84%	Sweden	7.71%
Netherlands	5.52%	Sweden	4.65%	Netherlands	4.04%
Norway	3.46%	Netherlands	4.40%	Spain	2.84%
Italy	2.11%	Italy	2.55%	Italy	2.55%
Other countries	10.31 %	Other countries	12.00 %	Other countries	8.00%

Source: www.evca.eu

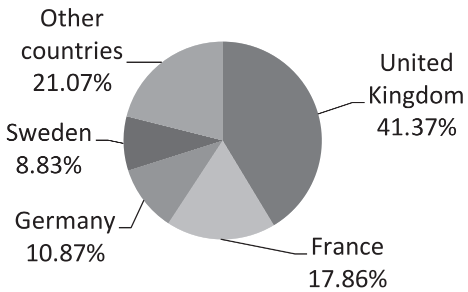

Chart 3. European countries share in private equity
Source: Own work

United Kingdom is by far the most active player in the European private equity industry, with more than 40% of total activity, followed by France and Germany, with 17.86% and 10.87% respectively.
Because of its high risk – reward profile, the share in GDP of private equity activity is low, the European average being under 0.5%.

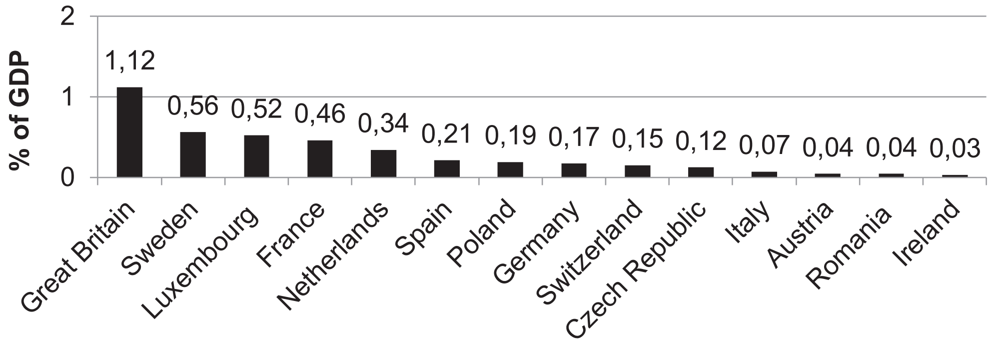

Chart 4. Private equity as percent of GDP for European countries (2011 - %)
Source: www.evca.eu

3.1. Fundraising

Total funds raised in 2011 were 40 bn. EUR. As a source of funding private equity operations, the most important contributors in the last 5 years were the pension funds, the banks and the funds of funds.

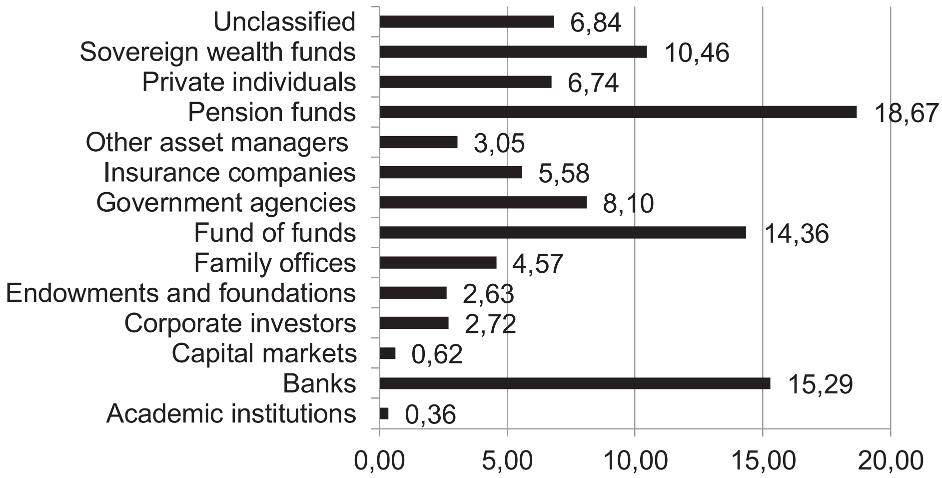

Chart 5. Sources of funding private equity operations 2007-2011 (%)
Source: www.evca.eu

The geographic sources of funds between 2007-2011 are presented below:

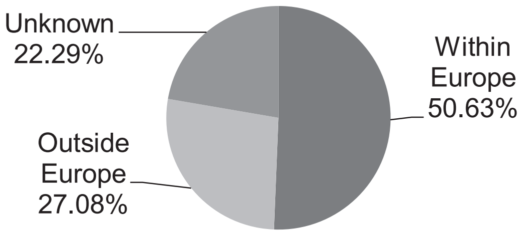

Chart 6. Sources of funds 2007-2011 (%)
Source: www.evca.eu

As we can see, almost half of the money for private equity investments in the last five years came from outside Europe.

3.2. Investments
Investments made in 2011 totaled 46 bn. EUR and more than 4,800 companies received financing. The geographic distribution of investments between 2007-2011 is presented below:

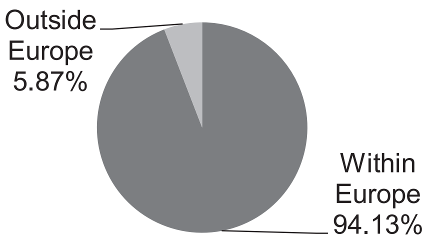

Chart 7. Distribution of investments 2007-2011 (%)
Source: www.evca.eu

We can see that more than 90% of the investments were made within Europe. Venture capital investments are made in innovative sectors (such as life sciences – medicine, pharmacy, etc. or electronics and informatics), while buyout investments are made in mature domains, with a well known business model (such as consumer goods or industrial production).

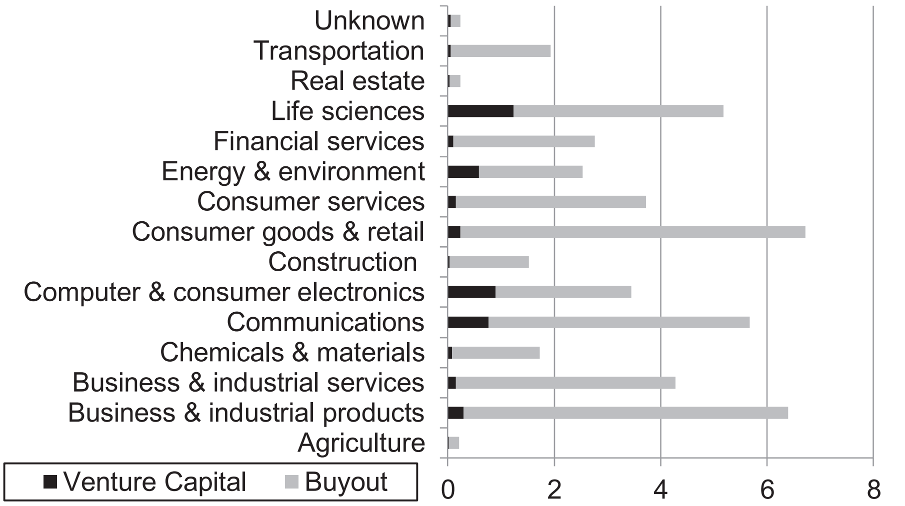

Chart 8. Private equity sector focus of investments 2007-2011 (average bn. EUR)
Source: www.evca.eu

3.3. Divestments

In 2011, a total of 30 bn. EUR was divested from more than 2,000 companies. The exit by route between 2007-2011 is presented in chart 9:

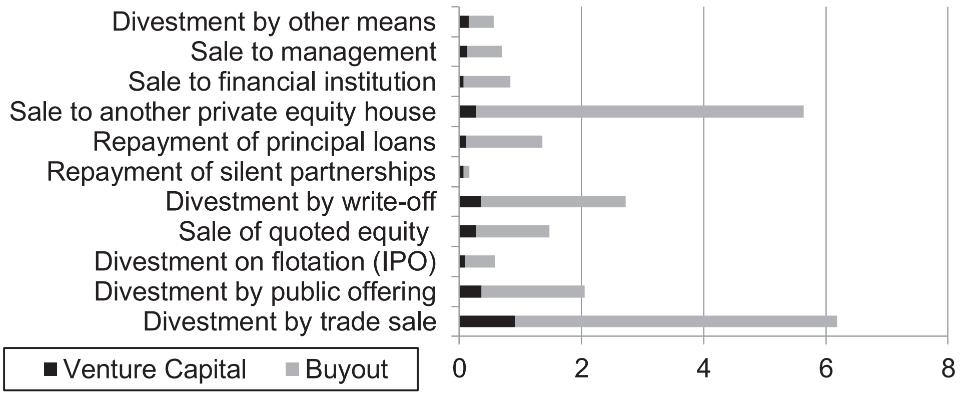

Chart 9. Exit route 2007-2011 (average bn. EUR)
Source: www.evca.eu

The preferred exit route by private equity investors are trade sale and secondary sale. The sector focus of divestments between 2007-2011 is as follows:

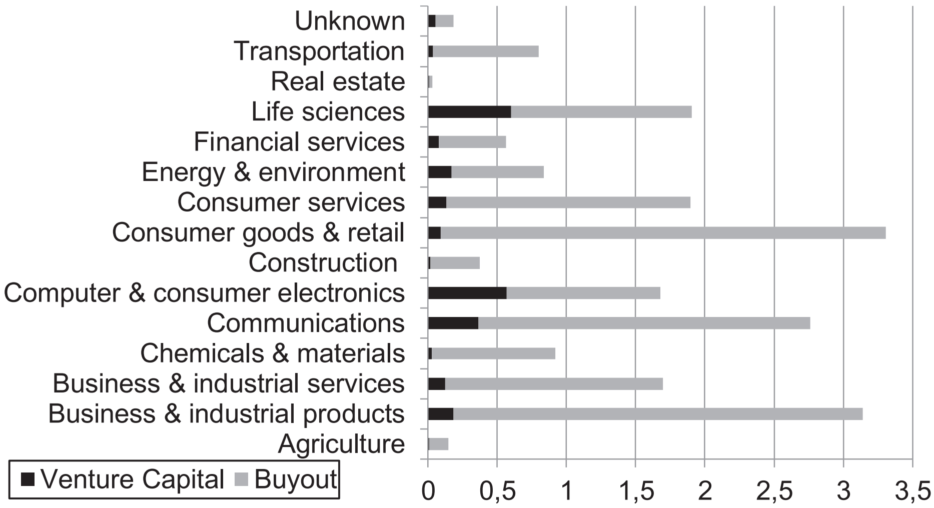

Chart 10. Sector focus o divestments 2007-2011 (average bn. EUR)
Source: www.evca.eu

The major divestments were made in the same sectors as most investments were made, that is innovative sectors for venture capital and mature industries for buyout.

4. Conclusions

Private equity is an alternative form of financing, besides classic forms of financing (bank or bond loans). Private equity investments are made were classic forms are not applicable, and are realised against a stake in the company's share capital. Besides financing, private equity investors offer expertise to the portfolio companies, in order to increase their value, and therefore gain profits from selling them at a higher price. The operations can be divided in two main categories – venture capital and buyout – based on the stake in the company (minor or control), the degree of involvement, etc., but they all have the same purpose, that is profit form buying low and selling high.
Globally, the United States are the most active in private equity operations, with more than half of overall activity, followed by Europe with 21% and Asia-Pacific with 22%. In Europe, the United Kingdom is the most active, with more 40% followed by France and Germany. Because of its very risky nature, the share in GDP of private equity is low, the European average being under 0.5%.
The most important contributors to private equity are the pension funds, the banks and the funds of funds. Almost half of the money for private equity investments comes from outside Europe but more than 90% of the investments are realized within Europe. The investments are specific to the type of private equity operation: venture capital investments are made in innovative sectors, while buyout investments are made in more mature industries. The preferred exit route by private equity investors are trade sale and secondary sale and the major divestments were made in the same sectors as most investments were made.

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