THE JOURNAL OF PRIVATE EQUITY

VOLUME 18, NUMBER 1 WINTER 2014

F. JOHN MATHIS Editor

HARRY KATZ Content Production Director
DEBORAH BROUWER Production/Design

CATHY SCOTT Content Director

SHARON CHIEN Marketing Manager

DAVID MARKS Account Manager
DENISE ALIVIZATOS Account Manager

WILLIAM LAW Regional Sales Manager

DEWEY PALMIERI Reprints Manager

VINCENT YESENOSKY Head of U.S. Fulfillment
CHERLY BONNY Customer Service Manager

BEN CASTLE Finance Manager
SEAN CASEMENT Business Manager

DAVE BLIDE Associate Publisher
BHUVNA DOSHI Digital Advertising Operations

DAVID ANTIN CEO
ALLISON ADAMS Group Publisher

Worldwide economic uncertainties continue to dampen global venture capital and private equity activity. Increased evidence of the "coupling" of Emerging Market economic recovery to Advanced Country performance focuses attention on the U.S. economy, which leads debt-strapped Europe and indecisive Japan. But U.S. real GDP growth is running in the 2%–2.5% range, roughly one percentage point below its normal recovery growth rate.

U.S. politics, with its lack of economic leadership, seem to be stymied, and clarity in economic policy hinged on the presidential election. Increased regulation of financial services has nearly paralyzed the flow of funds to corporations, which continue to rely on internal cash generation to support growth investment, or on lending surplus funds to other corporations whose investment promises a higher return. As higher tax revenues ease U.S. Treasury debt financing and the Federal Reserve halts quantitative easing, what are the implications for inflation? Price increases on basic consumer goods, particularly food and health-care costs, are constraining the average consumer's standard of living.Even though productivity is beginning to go up, wage levels remain sticky, a situation which is not helped by still relatively large numbers of unemployed or underemployed. Government appears to be confused, and while legislators remain lost in political wrangles, they are distracted from taking action on key issues necessary for sustained U.S. economic growth. Failure to change government regulations protecting large corporations has weakened competitiveness of small and medium-size companies, which has aggravated the widening compensation gap between the rich and the middle class.

With U.S. economic growth leading the Advanced Economies recovery, most PE activity will likely remain centered on middle-market companies in the United States. Under slower U.S. growth, the average investment period of PE firms will likely continue to lengthen closer to 10 years, better enabling them to achieve their target IRR return. Some downward pressure on PE fees may continue as a result of longer holding periods. With bank lending to corporations constrained, debt percentages for buyouts may continue to rise above the present level of 70%. Corporate acquisitions and secondary buyout activity remain the major exit strategies. Global secondary funds are expected to continue performing well, as they are able to purchase assets at discounts to NAV. However, with some narrowing in the discount, primary PE and VC asset classes may become more attractive relative to secondaries. VC markets are expected to continue buoyant, led by more advances in technology and related commercialization opportunities, and by comparatively favorable returns.

The current issue of *The Journal of Private Equity* illustrates some of the changes that are underway as a result of the aforementioned factors. We begin with several articles focused on performance and fundraising. In "The Impact on Management Experience on the Performance of Start-Ups within Accelerators" Sean Wise and Dave Valliere investigate the effect of accelerator management teams' experience on the performance of accelerators. The survival and growth of tenant firms is assessed by means of the hazard rates for successful exits (acquisitions) and unsuccessful exits (firm failures). Evidence suggests that increased knowledge of accelerator managers reduces the risk of firm failures.

Steven Dolvin highlights the fraudulent activity of some investment banks convicted of illegal activity in "Can Venture Capitalists Tame the Wolves? *An Analysis of Fraudulent Underwriters, IPO Characteristics, and VC Certification*." During the 1990s, at least 34 initial public offering (IPO) underwriters were subject to SEC enforcement. The characteristics of IPOs underwritten by these investment banks are examined, particularly as they compare to other IPOs. A significant difference is found in IPOs underwritten by sanctioned investment banks.

Dhafer Salih Alqahtani takes us to the Middle East in "Demystifying the Challenges Facing Fundraising for Private Equity in the GCC Region," where he examines the lengthy and irritating process of fundraising from Limited Partners and indicates that it is getting worse. The result is that General Partners are being forced to find a better alignment of LP interest, governance, compliance, transparency, and disclosure with the GP's business model needs.

In the next article, by Mark Nuijten, we continue (from previous JPE issues this year) the discussion of the dramatic changes impacting the pharmaceutical industry. "The Potential Impact of Current and Future Pharmaceutical Policy Changes on Cash Flows for Innovative Medicines" explores the financial consequences of complying with requirements of reimbursement authorities and pharmaceutical policy reforms. The financial value of a pharmaceutical company is heavily influenced by regulatory decisions, often taken at, or near, product launch. Nuijten discusses scenarios such as central evaluation of cost-effectiveness, conditional reimbursement, risk-sharing schemes, pay-for-performance models, value-based assessment, and decentralization. Requirements to submit economic data to inform the pricing and reimbursement process, and new business models such as value-based pricing and risk-sharing agreements have financial consequences for the pharmaceutical industry, altering their net present value of future cash flows from new drugs.

Next, Soumaya Ben Khelifa and Dorra Mezzez Hmaied examine the characteristics and performance of European Hedge Funds that invest exclusively in Europe. In "European Hedge Funds Industry: *An Overview*" their analysis of a sample of 1,905 hedge funds reveals that 85.4% of management companies are based in Europe, with a particular dominance in the United Kingdom. Most of these funds follow a Long/Short Equities strategy, 52% use leverage, and they are becoming strong competitors for U.S. hedge funds.

The next article by Manu Sharma, Esha Prashar, and Gunwant Singh Saini "Relational Analysis of Global Private Equity and GDP of Eight Major Economies" examines the relationship between the percentage changes in quarterly GDPs of eight nations including; Canada, the European Union, France, Italy, Germany, Japan, the United Kingdom, and the United States, to that of the quarterly returns of Global Growth Equity indexes. The purpose is to determine the significance of venture capital activity.

The final two articles in this issue present historical perspectives on private equity performance and investment practices. Raviraj Gohil undertakes "The Performance of Private Equity Funds in India," using a dataset of Indian private equity from 2007 to 2012. Three issues are analyzed: First, the performance of private equity funds of exited investments in India; second, a comparison of Indian private equity industry returns with public market returns; and third, Indian private equity "performance persistence."

Rajibul Hasan gives a global perspective of the private equity industry in "Private Equity Practices: *A Comprehensive Study*." Hasan discusses industry economics, overall performance of local and global private equity markets, the future of private equity and career prospects in the industry.

F. John Mathis
Editor