European University Institute

ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

FLORENCE SCHOOL OF BANKING & FINANCE

Private Equity & Markets in the COVID context

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Online Debate Highlights

by Nikita Divissenko, European University Institute

Background

Private capital is back in the game. Still a niche a few years ago, private markets in general and private equity in particular – are increasingly becoming key solutions to financing SMEs across almost all sectors. In spite of COVID, Private Equity's committed but unallocated capital – so-called 'dry powder' – remains high in 2021 and there is mention in the marketplace of a 'new decade for private markets' (McKinsey, 2020). Yet geographical differences persist: PE remains much more developed in the United States than in Europe.

Against this background, the following questions suited as a starting point for this online debate:

- What is the current market sentiment in private equity in Europe?
- How solid are the funding models of private equity firms and to what extent do they rely on private credit, preferred equity and net asset value (NAV) financing in COVID times?
- Would a too swift ramp up of private equity in Europe bear financial stability implications?
- Is the current European regulatory and supervisory framework for PE fit for purpose?

The panel featured:

Helmut Kraemer-Eis
European Investment Fund

Sophie Manigart
Vlerick Business School

and has been chaired and moderated by

Thorsten Beck
The Business School (formerly Cass) and
Florence School of Banking and Finance, European University Institute

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You can watch the recording of the Online Debate on the FBF website and YouTube Channel.

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Key take-aways:

The panellists discussed preliminary data of the effects of COVID on private equity in Europe:

1.

Despite the return of the activity levels in the European private equity markets to the pre-financial crisis levels by 2019, Europe is still lagging behind its peers with a lot of 'untapped potential for venture capital in Europe' (*Kraemer-Eis*).

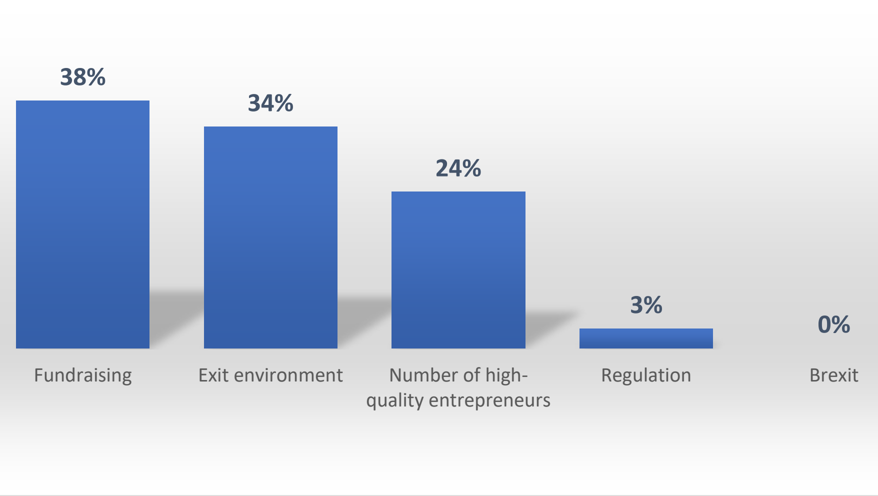
2.

The available data allows for some but rather limited comparison of the COVID-19 crisis with the Great Financial Crisis (GFC). The COVID-19 pandemic has led to a number of supply and demand shocks, unseen in recent economic history. This means that the key features of the COVID-19 crisis do match those of the GFC. Overall, the impact of COVID on the market appears to be less severe than the impact of the GFC.

3.

Fundraising remains the major challenge in venture capital and private equity Mid-Market business in the current crisis. Meanwhile, the biggest challenge for portfolio companies prompted by COVID-19 pandemic has been customer acquisition and retention alongside disruption of business activity or changes to how the business operates due to COVID-19-related restrictions. The responses from the audience resonated with these findings.

What is the biggest challenge for Venture Capital fund managers in the current COVID-19 environment?



Poll results from the participants
Number of respondents: 29

4.

Since the onset of COVID-19, venture capital investment criteria have been showing 'a clear trend towards safety' (*Kraemer-Eis*) with growing considerations for ESG despite the crisis. Generally, it has been noted that the 'long-term optimism prevails' (*Kraemer-Eis*) in the markets.

5.

Global private equity buyout activity volumes remain high despite a slight decrease in 2020. However, this is primarily due to the large buyouts as the overall number of buyouts has been going down. What characterises the European private equity market transactions is the fast growing average EBITDA purchase price multiple for leveraged buyout transactions, 'which is worrying' (*Manigart*) as a signal of increasing overall indebtedness.

The panellists discussed broader effects of private equity in Europe and globally:

6.
The importance of the wider picture of the private equity and markets has been outlined in the view of an often negative perception of private equity impacts on corporate indebtedness, operational performance and employment. However, the outcomes of a meta-analysis presented by prof. Manigart showed 'significant positive impact' of private equity on operational performance of portfolio firms and 'no effects of statistical significance' on employment.

7.
More detailed findings of academic studies of private equity impacts based on meta-analysis have allowed to have a closer look at the effects on operational performance. The studies suggest making a distinction between effects on efficiency and effects on growth, and show empirical evidence of significant growth as a change in operating performance after private equity buyout.

8.
'Legal environment is very important to what happens to private equity investment' (*Manigart*), as the studies show positive correlation between employment outcomes after private equity buyouts in jurisdictions with high employment protection. In jurisdictions with low employment protection numbers of employees tend to go down. Similar influence of the legal environment has been found with respect to investor protection rules, where average relative change in operating performance after private equity buyout has been higher in countries with high investor protection standards (U.K. & U.S.) as compared to countries with lower investor protection (e.g., Italy, Germany, Sweden and others).

9.
The panellists underlined of the key challenges for the European level initiatives to enhance private equity. Based on empirical evidence from the market, the inherent 'heterogeneity' (*Kraemer-Eis*) of investment activities across countries alongside 'cultural differences' (*Manigart*), such as between collectivist and more individualistic cultures, pose difficulties to further development.

The key risks and policy challenges that have been emphasised:

10.
Thorsten Beck inquired whether the impact of low interest rates that present a concern in banking sector do not affect private equity and venture capital markets. According to Helmut Kraemer-Eis, the effects in Europe are rather indirect, and are manifested through the challenges of fundraising as investors search yield. Sophie Manigart, in turn, underlined the relation between low interest rates and increase in the level of indebtedness of target companies, as low interest rates affect the cost of other types of funding.

11.
A number of questions raised in the audience concerned the impact of private equity investment on the eligibility of heavily indebted target companies for government support programmes in COVID crisis, and the need for changes in the policy. Sophie Manigart underlined that the evidence of negative impact of raising debt levels on businesses' eligibility for state aid measures (such as credit guarantees) is lacking. Helmut Kraemer-Eis, in turn, emphasised the need to further enhance CMU to provide incentives to non-bank finance and reduce dependency on the European banking sector.