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Editor's Letter

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With continuing turmoil in our economy, the world of private equity funds continues to face serious challenges. These pools of capital rely on several systems in a vibrant economy for their smooth operation, from robust and growing demand for products and services, to abundant and cheap capital from financial institutions, to a wide range of exit options from IPO to strategic sale. Each one of these pillars of private equity is under stress in today's tough markets, yet the business of private equity goes on. What are others doing? What will change as a result of these times?

Our issue this quarter focuses on the near-term future of private equity buy-out funds, with views from four unique angles of how firms are reacting to today's difficulties. We then look at one sector that may prosper in these tough times, for-profit higher education, then two international topics, and end with a technical piece on valuing IPOs which we publish with the knowledge that someday, the public offering window will reopen.

There have always been two broad ways to make money in the private equity buy-out business: One is through the usual sorts of financial engineering such as dramatically increased leverage along with improved corporate governance; the other is via active ownership and intervention in operations and strategy of the acquired companies. In our lead piece, Klier, Welge, and Harrigan use an exploratory research design among 20 private equity firms to measure which approach works best over 5- and 10-year horizons. Which approach delivers the highest returns? Their findings may point the way for private equity firms to rethink their own approach.

The effects of being in the right place at the right time are legendary. Cornelius, Juttmann, and de Veer take this thought and put it into action for the private equity world by looking at various industry sectors and comparing that to performance. The outcome is predictable yet important for your fund. If you are a limited partner and co-invest in deals, then understanding your role becomes even more important.

Once we pick the right industry to enter, at the right time in the cycle, we have to decide how to organize our fund. Pappas, Allen, Umscheid, and Schalock investigate the extent to which private equity firms are restructuring themselves. Do you think the organizational structure of your firm has an effect on returns? These authors review their findings on this intriguing question.

And what if it all goes bad and you, as an investor in a private equity fund, simply need to cash out? How do you do that with these famously profitable but illiquid investments? Quietly, a secondary market has always existed, but Peterman and Lai take us deep into this newly evolving exchange to make sure we understand how the game is evolving. The upsides here are big on both sides of the trade, so this may be a growth area. Sellers, as original investors, get a cash-out short of the projected end of the fund, while buyers, as new investors, get a chance to access selective funds, often at discount prices, with partially identified portfolios well into the investment process. This is an important area to understand.

Want a recession-proof idea that may stand up no matter how harsh the economic climate? Fried and Hill take us inside this profitable niche and explain how it works, what to expect in the future, the big challenges awaiting for-profits, and potential responses to look for from non-profits as they lose share.

Our final three articles update topics we often follow, those of international investing, public investment in private equity, and private placement valuations. We begin with authors Scheela and Isidro taking us inside the world of business angel investing in the Philippines. How does this type of "personal" deal investing work in a system with a lack of fully developed business institutions? Would it surprise you to learn that business angels work together and co-invest? How would you predict returns in a place like this, as positive or negative?

Public investments in private equity (PIPEs) have been well chronicled in these pages and elsewhere, but Haggard, Zhang, and Ma take us on a worldwide tour to look at similarities and differences. Yes, the firms that are accepting investments are small and evidencing high growth. But these companies vary as we travel from Hong Kong, Australia, Canada and the U.K. The similarities and differences help us view how this field is changing.

Our final piece, from Brooks and Ferreira, is a study of private equity placements, pre- and post-announcement, tracking stock market and operating performance. They attempt to answer an important question: How do public investors fare as opposed to the private equity investors who also invest in these deals? Which group makes better investment decisions? Take a look at the results for an explanation of who wins and why.

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