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# The Uncertain Global Environment

The statement on the front of this issue of *The Journal of Private Equity* is drawn from the *84th Annual Report* of the Bank for International Settlements (BIS).[1] The BIS report recognizes that the global economy has shown signs of improvement since the global financial crisis of 2007–2008, but this improvement is not occurring in all countries and there are issues concerning its sustainability. The BIS points out that financial cycles culminating in banking crises tend to last more than twice as long as business cycles (15–20 years versus less than 8 years), which may help explain the very shy recovery seen in private equity and venture capital activity.

Some of the major global uncertainties identified by the BIS include a need for policy framework improvements to respond to boom-and-bust cycles, a "disconnect between global equity market recovery and narrowing credit spreads and underlying economic developments" (including an increasing dependence on debt as the main driver of growth), persistent below-normal real growth rates with high unemployment levels relative to pre-crisis levels, supply-side distortions, little improvement in productivity, an unhealthy financial sector, and limited policy tools. The United States, United Kingdom, and Germany have experienced mild recoveries but other advanced economies have not. Even emerging market economies that recovered quickly after the global financial crisis are now facing growth problems; and international trade growth remains way below historic levels. Very accommodative monetary policies have not restored growth as expected, while low price increases and even disinflation have stymied increased corporate investment.

Accommodative monetary policy has increased global liquidity while keeping interest rates low, and helping banks to improve their capital levels. However, there is continuing concern over bank balance sheet exposure to over-indebted borrowers (corporate and government) that remain vulnerable to any "tapering" of central bank stimulating monetary policies, as recently witnessed in several emerging markets. Furthermore, low interest rates may not much help overbuilt sectors of the economy. The rapid growth in asset management companies since the financial crisis has made them a major new source of credit for firms and households. Overall corporate investment remains weak, however, as firms focus on repurchasing shares, mergers and acquisitions, and holding cash—none of which supports new investment, reduces unemployment, or expands productivity. Meanwhile, fiscal policy remains under stain because "public sector debt for G7 countries has risen by 40 percentage points to 120% of GDP in the post-crisis period." Thus, macroeconomic policy options will be limited should the present growth pattern be adversely impacted by sudden growth uncertainties.

Increased globalization and the interconnectedness of economies, especially through international capital flows, has resulted in the transfer of expansive monetary policies in advanced economies (AEs) to emerging market economies (EMEs). Non-financial companies in EMEs have borrowed heavily in foreign currencies through their affiliates and have often used this debt to acquire foreign companies in advanced and especially emerging markets. This ownership change tends not to create new jobs and may have little growth impact. As EME share of global GDP is near half, any shock will likely have an impact on AE economies through sudden capital flows, exchange rate changes, and/or debt servicing problems.

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In this issue, we begin with two articles focusing on funding private equity. Shidan Derakhshani, in "Branding Equity Capital," outlines the reasons branding capital is becoming increasingly important, reviews activities by private equity and venture capital firms and others in this area, suggests practical steps to identify a capital offering's unique selling propositions in order to develop and enhance its brand, and presents the concept of capital due diligence. The second article, by Yasin Ebrahim, "'What I Wish I Knew'—Hiring My First Placement Agent," examines the increasing role placement agents will play in contributing toward the current and future fundraising success of private equity general partners.

The next article, by Stuart Taylor, "How Investors Can Utilize Performance Track Records to Make Investment Decisions," looks at the relationship between the performance of predecessor and successor funds and assesses whether fund performance at four or six years can be used to predict the eventual performance of a fund.

In "The Coefficient of Determination for Listed Private Equity Funds," Manu Sharma, Gunwant Singh, Puneet Gupta, and Esha Prashar examine the performance of 13 private equity (PE) firms listed in the U.S. and having operations in North America against the performance of a diversified investment portfolio. Out of the 13 PE funds, 7 showed no significant relationship with market variables, and for 6 firms, the best predictor relationship was a single market variable.

The next three articles examine private equity activities in Europe, India, and Brazil. In "Taxonomic Analysis of the European Private Equity Market," Zbigniew Drewniak takes a look at the European private equity market. In this article, the data describing the European private equity market are provided from the scope of investment process stages: fundraising, investment, and divestment. The analysis finds that three countries are leading the European private equity market: United Kingdom, Germany, and France.

A. Thillairajan and Srikant Menon, in "Private Equity Investment in Infrastructure: Evidence from India," present an analysis of private equity funding in infrastructure based on data from 335 infrastructure projects with PE investment and 370 projects with no PE investment. They find that:

- the average investment by foreign PE investors was higher than that of domestic;
- the average investment size made by a mix of domestic and foreign investors was significantly higher than the average of either a domestic or foreign investor group;
- those states that had relatively higher values for PPP (an index indicating higher levels of infrastructure activity) and the property right index and lower corruption levels attracted PE investment in more projects; and
- PE investors are prepared to invest in riskier environments than are other investors.

Andrea M.A.F. Minardi, Ricardo Vinicius Kanitz, and Rafael Honório Bassani investigate 46 PE funds in "Private Equity and Venture Capital Industry Performance in Brazil: 1990–2013." The average internal rate of return (IRR) of Brazilian funds is higher than the average of U.S. funds with vintages between 1998 and 2008. They find evidence that performance in Brazil has a higher cyclicality than in the U.S., although this finding may be due to the small sample size rather than the emerging market effect.

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The next two articles focus on analyzing recent venture capital market strategies. Joseph R. Bell, in "Angel Investor Sophistication: Increasing Application of Pre-Revenue Venture Valuation Methodologies," traces how the angel investor has become more sophisticated. Angel investors have adopted some of the strategies and valuation methodologies employed by the venture capital community. Research suggests today's angel is focused on return on investment, investment timelines, dilution, and other assessment factors that were historically reserved for the venture capital community.

Nicholas Racculia, in "VC Specialization Improves IPO Performance," shows that specialization enhances the performance of funded initial public offerings. Also, initial public offering survival rates and performance are higher when backed by single-industry venture capitalists. This presents useful investment analysis for portfolio managers adding venture capital to their investment portfolio.

## ENDNOTE

[1]The 2013/2014 BIS annual report is available online at http://www.bis.org/publ/arpdf/ar2014e.htm.

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