Venture capital and private equity finance as key determinants of economic development

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For entrepreneurs, start-ups and fast growing ventures, the provision of sufficient funds to foster growth is one of the most important if not the key factor of success. While venture capital (VC) is one of the most relevant sources of funding for new ventures (e.g., Li and Zahra 2012), private equity (PE) funds represent a natural financing source for firms pursuing capital-intensive and risky investment strategies.

Venture capital enables young founders to transfer the financial risk in the case of a failure of the business to the venture capital firm. In exchange, the founders give up a part of their equity so that they lose some of the possible returns on a potential exit of their venture. In addition, representatives of the VC firm get comprehensive control rights as members of the board. Therefore, getting venture capital does not always pay off for the entrepreneur (Rosenbusch et al. 2012). However, venture capital enables founders to establish young ventures, as without it many would not be able to raise enough capital. In contrast, PE funds typically buy the firm seeking for additional capital, e.g., by a leveraged buyout. Specifically, this investment form, resulting in highly levered firms, has been the topic of a long-lasting and heated discussion. Critics believe that PE puts a heavy burden on firms limiting their financial flexibility and lowering their long-term prospects (e.g. Ernst et al. 2013), whereas other studies showed that firms financed by PE funds increased their performance due to an enhanced financial scope (e.g. Cumming et al. 2007).

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Obviously, investors in VC and PE funds expect adequate returns to get compensated for the risk taken by their fund investment. While PE funds generate on average high returns (e.g. Gompers et al. 2015), the situation is different for VC funds which offer on average an unfavorable risk-return relation for their investors (Kelly 2011). One reason might be the diverse picture of fund performances. In this respect, the management and its competencies hold a key position.

Undoubtedly, VC and PE funds play a major role for a sustainable and strong development of today's economies. However, the role of these investors is perceived differently by the general public. Many studies show the positive impact of VC on national economies (e.g. Mason 2009), while the economic effect of PE funds remains unclear (e.g. Davis et al. 2008). The contributions of this special issue aim to shed light on this and related issues.

The increase of money which has been invested in PE and VC funds over the last two decades finds its equivalent in sustained growth of corresponding research on venture capital and private equity financing. In her paper "Venture capital and private equity financing: an overview of recent literature and an agenda for future research", T. Tykvová surveys the growing body of most recent literature on VC and PE. Therefore, she collected and analyzed the impressive number of 314 papers, which were published from 2011 until mid of 2016 in top ranked international finance and business/management journals. By choosing appropriate categories, the author presents them in a comprehensible way. In addition, she points to areas that deserve deeper investigation. Most of the surveyed articles are related either to PE or VC, with the latter accounting for the majority. Only a small part (17 articles or about 5 percent) deals with both forms, accordingly low is the number of corresponding previous surveys. Only two recent papers review the literature on both the VC and the PE industry. Moreover, they are focused only on certain aspects. Metrick and Yasuda (2011) concentrate mainly on studies that deal with returns and contracts, whereas the survey of Kaplan and Sensoy (2015) is exclusively referring to VC and PE fund performance. In contrast, the survey of Tykvová covers all topics of both the VC and the PE industry that have been recently published in leading international journals. Hereby, the reader gets also information on the frequency of different research areas in all studies on PE and VC. In addition, it should be emphasized that many of the analyzed papers have not been included in previous surveys.

Tykvová gives an overview of differences of VC and PE, like the different age of the portfolio companies and the use of leverage, as well as on common characteristics such as the typical VC and PE cycle with the specific roles of limited partners (LPs), VC or PE firms and funds and the portfolio companies (PCs). VC and PE firms take a very active role in the management of the PCs which unlike the investments of most other types of funds are illiquid private companies.

The author identifies so-called 'hot' topics, those that have received the greatest interest of researchers in recent years and that have not gained so much attention in prior studies (e.g., aspects of heterogeneity within the VC and PE industries; the process of selecting and matching PCs; PC performance and the value-adding impact of the fund management or the performance of VC and PE funds and its proper measurement).

T. Tykvová shows that recent research includes a couple of new topics that reflect the developments within the VC or PE industries. For example, she emphasizes an expansion in terms of regional coverage, reflecting an increased interest in regions outside the US, especially Europe, as well as in cross-border VC and PE investments. The author points to emerging research in new areas, such as new sources of entrepreneurial finance, and discusses research gaps. Finally, she suggests an agenda for future research. One of her overall five recommendations for future research is more evidence from outside the US, because distinct differences between the characteristics of the US economy and those of other regions may influence the way in which the VC and PE industry operates. All the more, the editors are pleased to introduce in the following new research that deals with both, VC and PE activities from outside the US and some of the ‘hot’ and future research topics, which were addressed by Tykvová.

The starting point of the article “Private equity group reputation and financing structures in German leveraged buyouts” (LBOs) by R. Braun, A.-K. Achleitner, E. Lutz, and F. Tappeiner is the well-known fact that reputation is a valuable asset among the resources available to financial intermediaries. According to empirical evidence from the US, the reputation of private equity groups is highly relevant to the financing structures of LBOs. US buyouts sponsored by reputable PE groups are found to be financed with more leverage, less traditional bank debt, longer maturities and lower interest rates. Due to peculiarities of the German LBO market, these results cannot necessarily be generalized to apply equally to the German context. In particular, in Germany, most buyouts are private-to-private transactions and banks still hold a dominant position as debt providers. Moreover, there is less institutional demand pressure due to the less heterogeneous group of institutional investors involved in syndicated loans. The objective of this article is hence to examine the implications of these German market particularities and their impact on the general relevance of PE sponsor reputation in German LBOs, especially with respect to capital structure, interest costs and terms of lender control in LBO loan contracts in Germany. The authors show that while private equity sponsor reputation is related to the amount and structure of debt used as well as to the amount of lender control imposed, it does not have an impact on interest costs of German leveraged loans.

In the paper “Does culture affect the performance of private equity buyouts?” by B. Hammer, H. Hinrichs, and B. Schwetzler, the relationship between national culture and private equity performance, as measured by operating performance of portfolio firms and exit outcomes, is examined. This connection should be important for at least three reasons. First, operating performance of portfolio companies and exit decisions are material drivers of PE value creation. Second, varying cultural backgrounds are likely to affect financial decision-making in acquisition processes and, consequently, the performance of buyouts. Third, PE firms should also be frequently exposed to distinct cultural backgrounds. A typical feature that PE firms have in common is the high-powered incentive to generate significant returns within a short period of time. As a consequence, several studies describe PE firms as having a single-minded performance focus that is quite different from the mindset and practices in non-PE firms. Given the institutional context of PE firms, a cultural dimension that might be of particular interest to PE managers is the degree to which a society

values performance improvements. The GLOBE data set, which is available for 62 countries and was developed through the questioning of 17,300 middle managers in 951 organizations during the 1990s, provides such a dimension. Specifically, the authors make use of the GLOBE's performance orientation (PO) measure, which reflects the extent to which a community encourages and rewards innovation, high standards, excellence, and performance improvements. The authors apply this measure to test how different levels of a country's PO affect subsequent buyout performance of portfolio firms from this country. Consistent with the "spillover hypothesis", they show that higher levels of PO are detrimental to efficiency improvements and increase the probability for unsuccessful exits, as there is *ceteris paribus* less room for improvements for portfolio firms with the help of PE firms. These findings hold after addressing endogeneity concerns, confounding and measurement error.

S. Schmidt, D. Bendig, and M. Brettel raise the question of how to build an equity story. In their paper the authors use the concept of effectuation for a better understanding of the outcomes of the investor activity of business angels and provide empirical evidence on business angels' value-added to their investee businesses. The effectuation theory of entrepreneurship which was developed by S. Sarasvathy (2001) is generally defined as a form of problem solving which assumes the future is largely unpredictable, but that it can be controlled through entrepreneurial action. This is in opposite to causality, which assumes that the future is theoretically predictable based on prior events. So when it comes to entrepreneurship, the future is neither found nor predicted, but made by what the entrepreneur controls.

The authors gathered primary data amongst German speaking business angels, resulting in a sample of 73 complete responses, each representing an individual investor-venture setting. Although the size of the sample is small, the collected data fit well into the picture of previous angel investor research. It is their main finding using regression analysis that angel investors who emphasize the effectual decision making principle of means orientation lead to a significant increase in their investee business' valuation. For the further analyzed effectual dimensions affordable loss, partnerships, and leveraging contingencies empirical evidence could not be proved. Amongst the control variables, as it was expected, only the new economy dummy and investor involvement show a positive and significant effect on valuation increase in the baseline model.

Furthermore, the results empirically confirm the positive influence of the "hands-on" attitude of business angels which is well known from literature and practice, but the study is among the first to provide empirical insights into the role and attitude of business angels in the crucial phase of early post-investment. Besides the academic contribution, the findings are also relevant for practice, e.g. for business angels and entrepreneurs. Following the study's outcomes, on the one hand, a stronger focus on available means rather than on goals in business angels' decision-making will have a positive effect on their investee business' valuation. On the other hand, entrepreneurs approaching potential investors should specifically look for angels that provide ideas on how to make best use of available means.

"On private equity exits of family firms in the German Mittelstand" is another paper in our special issue which is co-authored by M. Brettel. Together with F. Kreer, R. Mauer and St. Strese he presents their research on succession in German

family firms. With their study, Kreer et al. contribute to the literature on non-family firm succession routes by enhancing the current understanding of one alternative option to family succession: the private equity succession route – a topic of increasing importance especially in the so-called German *Mittelstand*. Current empirical studies show that the percentage of firms without a family successor varies between one-third in West Germany and two-thirds in East Germany. Due to the fact that the willingness of potential family successors for taking over is shrinking, private equity exits become more and more relevant. Therefore, the study is of common interest to understand the specific perceptions of family firms' owner-managers about the PE succession route much better.

Specifically, the authors try to explain which beliefs primarily constitute family firm owner-managers' attitude towards private equity as a non-family succession route entailing family exit from the company. Therefore, they use a two-step approach of qualitative and quantitative methods to meet the requirements for a solid empirical study. The study starts with a qualitative gathering of the attitudinal beliefs of family firms' owner-managers toward pursuing the PE succession route. The authors group the beliefs into the following four comprehensive classes and develop a classification scheme: The perceptions of (1) firm continuance, (2) opportunities for a positive development of the firm, (3) loss of firm ethos, and (4) commercial firm risks. In a second step these classes were tested quantitatively with a sample of 195 family firm owner-managers among German SMEs, most of them with an annual revenue between five and 50 million Euros.

The results partially confirm the qualitative findings. Two out of four hypotheses are supported, as perceived firm development opportunities increase and perceived commercial firm risks decrease the intention to pursue the PE succession route. This explains owner-managers' intention to pursue a private equity succession, mediated through attitude. There was no support for the hypotheses on firm continuance and loss of firm ethos. Furthermore, the paper gives deeper insights into the important decision-making process of family firm owner-managers by identifying attitude to be a central cornerstone in the chosen context-specific intention model. Finally, the authors shed light on the attitudinal beliefs of family firm owner-managers by focusing on what role specific salient behavioral beliefs play in the formation of their attitude regarding the PE succession route.

Corporate venture capital comprises minority equity investments from incumbent enterprises in private startups and plays a major role in venture capital deals. Due to their special features, corporate venture capitalists (CVCs) differ in their motivation regarding the target of strategic goals, such as gaining a window on technology, and financial returns. In contrast to previous research that generally studies the inter-group comparison between the valuations of corporate and independent venture capitalists, in their article "A world of difference? The impact of corporate venture capitalists' investment motivation on startup valuation", P. Röhm, A. Köhn, A. Kuckertz, and H.S. Dehnen deliberately shift the focus to an intra-group perspective to effectively scrutinize how CVCs' startup valuations differ according to their publicly stated investment motives. To discern a corporate investor's levels of strategic and financial motivation, the authors analyze the public statements from the websites of 52 CVCs with the help of a computer-aided text analysis. An exploratory

cluster analysis results in four types of CVCs: CVCs with a (i) strategic, a (ii) financial, an (iii) analytic, and an (iv) unfocused motivation. In order to confirm the identified clusters within the paper's theory-testing section, hierarchical linear modeling is applied for 147 startup valuations between January 2009 and January 2016 that characterized the first round of CVC involvement. The main findings are as follows: CVCs with a strategic investment motivation assign lower startup valuations than CVCs with an analytic motivation, suggesting that entrepreneurs trade off the former CVCs' value-adding contributions against a valuation discount; second, CVCs with an unfocused investment motivation pay significantly higher purchase prices, thus supporting the hypothesis that they have a so-called liability of vacillation; and third, the valuations of CVCs with a financial investment motive are not significantly different from those of their analytic peers.

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