

# EXPERTISE RISK SUCCESS

Investing in Private Equity Funds – Market on the Move  
An Empirical European Survey · August 2002



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Published by:

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This study is available in English  
and German.

Nominal charge: EUR 350.-

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Munich, August 2002

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## 1. Study Background

### Alternative investment opportunities becoming increasingly important

Now more than ever, investors are doing all they can to increase their wealth by investing where they receive high returns. In asset management, leading global investment companies are busy investing both their customers' and their own funds in the billions. Large banks' private banking groups also currently manage several hundred billion Euro for about 100,000 wealthy private customers. Moreover, pension funds, insurance companies, industrial companies and foundations are constantly engaged in building up and expanding their capital. Traditional forms of investment or asset classes such as shares, loans, and financial market products account for the largest sums by far. In the meantime, however, investors have become more aware of alternative investment possibilities. Alternative investments expand the spectrum of investment possibilities and make room for diversifying the investment strategy. These mainly include hedge funds, managed futures, and private equity.

### Private equity asset-class represents niche for experts

Private equity, as pre-IPO and private investment capital, is a form of financing for companies in the early and later phases of their development. Venture capital as full risk-bearing equity for young, innovative high-tech companies in the early phase of their development therefore represents a part of the private equity market. The private equity asset class is characterized by complexity and a lack of transparency. It is a niche market for qualified, experienced experts in the sector. For the most part, private equity investments develop largely independently of developments in share markets. Financial experts use the term correlation in this respect. Investments in the private equity asset class can, for example, be very successful while investments in shares make losses during the same period. A further characteristic of the private equity market is the relatively non-liquid nature of the investment. The private equity investor has to think in terms of planning periods of up to ten years.

### Complex market that lacks transparency

The market for private equity is now well documented on the level of venture capital firms participating in the market. However, the main players, investors in private equity and venture capital funds managed by private companies, still maintain a pretty low-key presence. Investors initiate funds and acquire additional external investors for these. These funds invest both directly in companies and also in other funds. At the same time, banks, insurance companies, and industrial companies also have their own venture capital firms in the market. In addition to these, there are numerous fund-of-funds specialists (umbrella funds) that raise funds from institutional and private investors and then invest these in carefully selected fund constructions. The aim is to achieve returns at least five percent higher than those of share investments.

### Limited awareness of private equity

As part of our study, we contacted institutions with which we had had no previous contact. We were surprised to find out how little managers knew about private equity, even at large institutions. This meant, for example, that we had to contact eighty pension funds throughout Europe to be able to conduct fifty-two discussions and ultimately have twenty-

one useful interviews. Our experience in Great Britain, The Netherlands, and Switzerland was relatively positive. However, we were amazed at the limited awareness of asset managers at large institutions in Germany, Austria, and France with respect to the private equity asset class.

Potential investors in private equity and venture capital funds have to be given a clearer picture of the mechanisms, opportunities, and risks of the business. There is a huge deficit here in the private equity sector. The sector has not yet enlightened its target group sufficiently about its business of company participations – a complex business compared to share or real-estate funds.

**Deficits in marketing**

In our study, we take a close look at the various investor groups in private equity and VC funds, analyze their motivations for participating in this asset class, and reach conclusions about their future investment behavior.

What goals do investors pursue with their engagements? How do they choose their targets among the large number of funds participating in the market? What requirements do they make on funds and what characterized the selection process? What returns do investors aim to achieve with their private equity engagements? What regions, sectors or financing phases will attract them in the future? What makes private equity so attractive compared to fixed-interest investments? Is there a trend towards outsourcing PE activities to fund-of-funds specialists? These and other questions will be examined in our study, for which we conducted 118 interviews with representatives of leading institutions.

**Analysis of background to private equity investments**

This report documents the results of our analyses, makes the sector more transparent, profiles investor groups and their goals, and describes interaction between the various players. Based on our discussion of market influencing factors, our study gives insights into the further development of the market as a whole and forecasts business development in individual market segments.

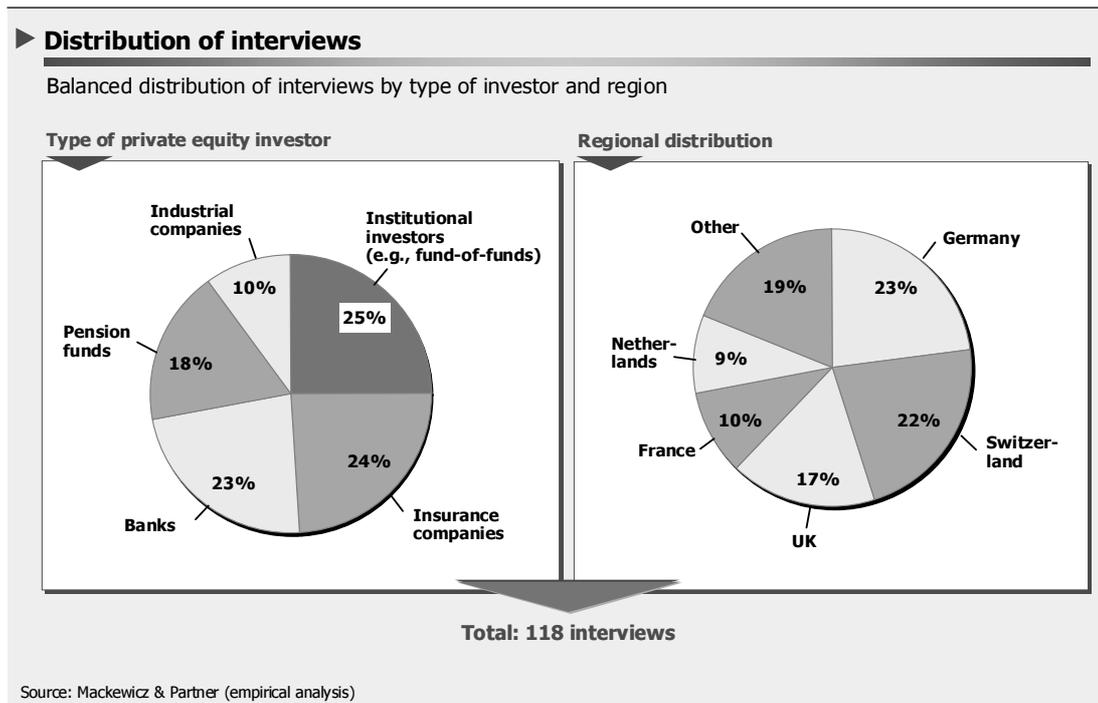
At this point, we would like to take the opportunity to thank the interview partners who contributed their time and knowledge during our indepth and constructive discussions. Their highly committed support played a key role in making this study a success.

**Thanks to our interview partners**

## 2. Conducting the Study

### 118 interviews with fund managers in Europe

Over 200 discussions with institutions that are potential candidates for private equity investments form the core of this study. In particular, we conducted 118 interviews with fund managers with private equity investment experience from first and second management levels of leading European investor groups. As part of this effort, we conducted fifty-two interviews with pension funds, for example, but determined that only twenty-one of these had sufficient experience with private equity investments to enable us to integrate interview content in our overall evaluation. In concrete terms, the awareness and level of recognition of private equity at these institutions is very limited. The names of the institutions where we conducted our interviews are listed in the appendix. Some interview partners were willing to provide us with information but absolutely did not want the name of their institution mentioned. The reason they gave us was that they did not want to be confronted with queries from fund managers in search of capital.



The institutions where we conducted interviews manage capital sums of just under EUR 5,000 billion overall, with the private equity asset class accounting for EUR 58 billion (1.2 percent).

### Interview partners represent PE investments of EUR 58 billion

The survey largely consisted of personal discussions in keeping with suitable random samples without set quotas. The interviews were conducted during the period April to July 2002.

The questionnaire was designed in several steps. Following database analyses and first discussions with sector experts, we began by outlining

the main issues of the study. This provided the basis for designing the questionnaire. The questionnaire was then tested in a series of pre-tests with funds investors both in Germany and abroad and modified accordingly.

About three-quarters of individual questions are closed questions, and about a quarter open questions. Open questions do not provide any answer categories and require interview partners to formulate their own answers. This type of questioning can help bring subconscious knowledge to the surface. To the extent possible, open questions were formulated actively, i.e. interview partners were not asked whether they had any improvement suggestions, but asked to formulate concrete improvement suggestions. In the closed questions, answer categories are provided or formulated as scale questions (e.g., what requirements does a fund construction have to fulfill for you to decide to invest? Please give your answer on a scale of 1 = very important to 5 = unimportant). In order to be able to evaluate the scale questions, interview partners were also asked to provide a reason for their answers. The interviews were conducted exclusively by members of Mackewicz & Partner trained in the appropriate methods, and who have at least five years experience in the private equity business. The statistical, computer-aided analysis of interviews was carried out by an experienced research analyst.

**Interviews  
conducted by  
private equity  
experts**