FACTORS INFLUENCING EXIT DECISIONS AMONG SOUTH AFRICAN PRIVATE EQUITY INVESTORS

by

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DECLARATION OF ORIGINALITY

By submitting this thesis electronically, I declare that the entirety of the work contained therein is my own, original work, that I am the authorship owner thereof (unless to the extent explicitly otherwise stated) and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

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ABSTRACT

Private equity plays an important role in financial markets and is a source of capital for many growing businesses. The private equity industry has seen significant growth both locally and internationally. The private equity investment process has a number of stages, with the 'exit' stage being the final stage. Although this stage is crucial for creating maximum value for investors, it is under-researched, especially in an emerging market context. Given of the practical significance of the research and the gap in academic literature, the researcher set out to investigate the factors that may have an influence on the exit decisions of South African private equity investors who invest in Africa, including South Africa.

From the literature review it emerged that a number of factors were predicted to have an impact on the exit decisions of private equity investors in terms of the choice of exit timing, exit route or both. A conceptual framework was developed around these factors, and was tested empirically.

A mixed-method research methodology was adopted in this study, making use of both qualitative and quantitative data collection and analysis methods. A survey questionnaire was developed and emailed to experts in the private equity industry to gather primary quantitative data. Due to an unsatisfactory response rate, qualitative data were also gathered by conducting in-depth semi-structured interviews with a sample of private equity industry. The quantitative data gathered were analysed using descriptive statistics. The rich qualitative data were analysed by means of in-depth thematic analysis.

Firstly, it was found that the exit process is complex and is affected by a number of diverse factors. However, it was determined that the main factor influencing exit decisions is achieving the maximum exit price. A further finding was that South African private equity investors favoured trade sales, secondary sales and management buyouts as exit routes. The final main finding was that the timing of exits was crucial for creating maximum value for investors. Based on the results of the study, it is recommended that private equity fund managers carefully plan their exits, as to achieve the maximum exit price. It is also recommended that private equity investors become aware of the developmental impact that private equity can have, and adjust their investment objectives accordingly.

Key words: Exit timing; exit route; Africa; private equity; exit price

OPSOMMING

Privaat ekwiteit speel ’n belangrike rol in finansiële markte en is ’n kapitaalbron vir heelwat groeiende besighede. Die privaat ekwiteitsbedryf het sowel plaaslik as internasionaal aansienlike groei beleef. Die proses van privaat ekwiteitsbelegging behels ’n paar stadiums, waarvan die beëindigingstadium die finale stadium uitmaak. Alhoewel hierdie stadium deurslaggewend is by die skepping van maksimum waarde vir beleggers, is dit onvoldoende nagevors, veral in die konteks van ’n opkomende mark. Gegewe die gaping in die akademiese literatuur was die navorser se vertrekpunt om die faktore te ondersoek wat moontlik die beëindigingsbesluite beïnvloed van Suid-Afrikaanse privaat ekwiteitsbeleggers wat in Afrika en Suid-Afrika belê.

Uit die literatuuroorsig het dit geblyk dat daar ’n aantal faktore is wat na verwagting ’n impak op die beëindigingsbesluite van privaat ekwiteitsbeleggers het vir sover dit die keuse van tydsberekening van beëindiging, beëindigingsroete, of albei betref. ’n Konseptuele raamwerk is om hierdie faktore ontwikkel en dit is empiries getoets.

’n Gemengde navorsingsmetodologie is vir hierdie studie gekies, wat sowel kwalitatiewe as kwantitatiewe dataversameling en -ontledingsmetodes gebruik. ’n Opnamevraelys is ontwikkel en aan kundiges in die privaat ekwiteitsbedryf ge-epos ten einde primêre kwantitatiewe data te versamel. As gevolg van ’n onbevredigende reaksiekoers is daar ook kwalitatiewe data versamel deur die voer van diepgaande, semigestruktureerde onderhoude met ’n steekproef uit die privaat ekwiteitsbedryf. Die kwantitatiewe data wat versamel is, is aan die hand van beskrywende statistieke ontleed. Die kwalitatiewe ryk data is deur middel van ’n diepgaande tematiese ontleding gedoen.

Eerstens is daar bevind dat die beëindigingsproses kompleks is en deur ’n hele aantal uiteenlopende faktore beïnvloed word. Daar is egter vasgestel dat die hooffaktor wat beëindigingsbesluite beïnvloed met die behaling van die maksimum beëindigingsprys te doen het. ’n Verdere bevinding was dat wanneer dit by beëindigingsroetes kom, Suid-Afrikaanse privaat ekwiteitsbeleggers voorkeur aan handelsverkope, sekondêre verkope en bestuursuitkope gee. ‘n Finale en belangrike bevinding was dat die tydsberekening van beëindigings deurslaggewend is by die skepping van maksimum waarde vir beleggers. Gebaseer op die resultate van die studie word daar aanbeveel dat privaat

ekwiteitsfondsbestuurders hulle beëindigings omsigtig beplan ten einde die maksimum beëindigingsprys te behaal. Verder word daar aanbeveel dat privaat ekwiteitsbeleggers bewus raak van die ontwikkelingsimpak wat privaat ekwiteit kan hê en hulle beleggingsdoelwitte dienooreenkomstig aanpas.

Sleutelwoorde: Tydsberekening van beëindiging; beëindigingsroete; Afrika; privaat ekwiteit; beëindigingsprys

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LIST OF ABBREVIATIONS

ARD	American Research and Development Corporation
B-BBEE	Broad-Based Black Economic Empowerment
BRICS	Brazil, Russia, India, China, South Africa
DFI	Development Financial Institution
ERISA	Employee Retirement Income Security Act
EVCA	European Venture Capital Association
IPO	Initial Public Offering
IRR	Internal Rate of Return
M&A	Merger-and-acquisition
SAVCA	South African Venture Capital Association
SBIC	Small Business Investment Company

CHAPTER ONE
INTRODUCTION TO THE STUDY

1.1 INTRODUCTION

"It's clear to me that when you do private equity well, you're making companies more efficient and helping them grow and become more profitable. That success means that investors benefit, which contributes to the economic wealth of society" – David Rubenstein

This quote by renowned private equity investor David Rubenstein illustrates the importance of private equity and the need for a deeper understanding of the phenomenon. Private equity is not only one of the most vital sources of finance available to companies, it is also a very important tool for business development and economic growth (Povaly, 2006:1). In this chapter, the concept of private equity will first be defined, with attention given to its unique and differentiating attributes. Further, a brief overview of the private equity investment process will be provided. Thereafter, the problem statement and research objectives of the study will be discussed. A layout of the research design and methodology used in this study will also be presented, followed by the contribution of the study, and a list of key concepts. The chapter concludes with a brief outline of the structure of the thesis.

1.2 INTRODUCTION TO PRIVATE EQUITY

In this section, private equity will be defined and an overview of its unique characteristics will be provided. The private equity investment process will also be briefly discussed.

1.2.1 Defining private equity

Various definitions of private equity exist, but according to most definitions, private equity constitutes investments in companies that are not publicly traded, in other words, investments in companies that are not listed on a stock exchange (British Venture Capital Association,

2010:6; Thornton, 2007:9; Meggison, 2004). Pictet (2014:5) further asserts that apart from investment in private companies, private equity also applies to buyouts of public companies, resulting in these companies becoming private companies.

According to The Private Equiteer (2011:4), an important consideration in private equity is to increase the value of the firm in which the investment is made (called the portfolio company), resulting in private equity being defined as "the ownership by a value-adding investor of equity securities of a business not publically traded". Fenn, Liang and Prowse (1997:4) add that private equity managers actively try to add value to the firms in which they invest. They state that this could be achieved by taking large ownership stakes and being active in the management of the portfolio company to increase its value.

There are different levels of involvement that the private equity investor can have in the portfolio company. The level of involvement is determined by the amount of work the private equity investor is willing to do, and the level of involvement the investor desires in the daily operations of the portfolio company (Kocis, Bachman, Long & Nickels, 2009:9). The four levels of investor involvement are shown in Table 1.1.

Table 1.1 Levels of investor involvement in portfolio companies

Level of involvement	Characteristics
Hands-on, "hands-dirty" ownership	This form of ownership is characterised by the investor being highly involved in the daily operations of the portfolio company. The investor spends a substantial amount of time, effort and money on the operations of the portfolio company.
Hands-on ownership	Hands-on ownership differs slightly from hands-on, "hands-dirty" ownership in that the investor is more removed from the daily operations of the portfolio company. The investor is, however, still involved to the extent that he/she provides capital and advice to the management of the portfolio company in an attempt to add value.
Hands-off ownership	This level of ownership is characterised by a decrease of responsibility on the part of the investor as a result of being even further removed from the daily operations of the portfolio company. This decrease of responsibility is due to investments in the portfolio company usually being made by co-investment, or by investment in a private equity fund.
Arm's distance ownership	This ownership level has the least amount of responsibility, involvement, and control on the part of the investor. This form of ownership is generally achieved by investing in a private equity fund-of-funds.

High — Level of investor involvement — Low

Sources: Kocis *et al.* (2009:9); Sapienza, Amason & Manigart (1994:3)

Private equity is referred to by some as risk capital that is used as a form of finance in different situations that range from financing young start-up firms to financing the buyout of large mature companies (Gilligan & Wright, 2008:1). It is important to distinguish between venture capital and private equity as these two terms are often used interchangeably in both academic literature and in practice. Although both terms involve different forms of finance, venture capital refers to investments in high-growth start-up firms, and increasingly to situations where firms are undergoing radical restructuring (Wright & Robbie, 1998:522), whereas private equity mostly refers to investments in more mature companies (Fenn *et al.*, 1997:1).

Another important difference between private equity and venture capital is related to the return expectations and requirements of investors, which in turn, affect the execution of deals (The Private Equiteer, 2011:44). While venture capitalists favour high-risk investments promising high returns (with high expected failure rates), private equity investors generally focus on lower-risk investments that deliver predictable returns. The difference is, therefore, that venture capital deals are not always expected to succeed, in contrast to private equity, where it is imperative for virtually all deals to yield good risk-adjusted returns.

The Private Equiteer (2011:40) reports that while venture capital strictly qualifies as private equity, private equity in the broad sense should rather be used to describe a business model of investment. This business model should be characterised by the business being privately owned, the investor taking an active part in the management of the portfolio company, and the investor applying a pool of funds across a number of businesses. Further, the investments should mostly be structured as equity, and the investment should be made in established businesses with a proven track record and sustainable positive cash flows.

There are a number of reasons why private equity as an asset class should be considered by investors. Some of these reasons are listed in Table 1.2.

Table 1.2 Factors contributing to the attractiveness of private equity as asset class

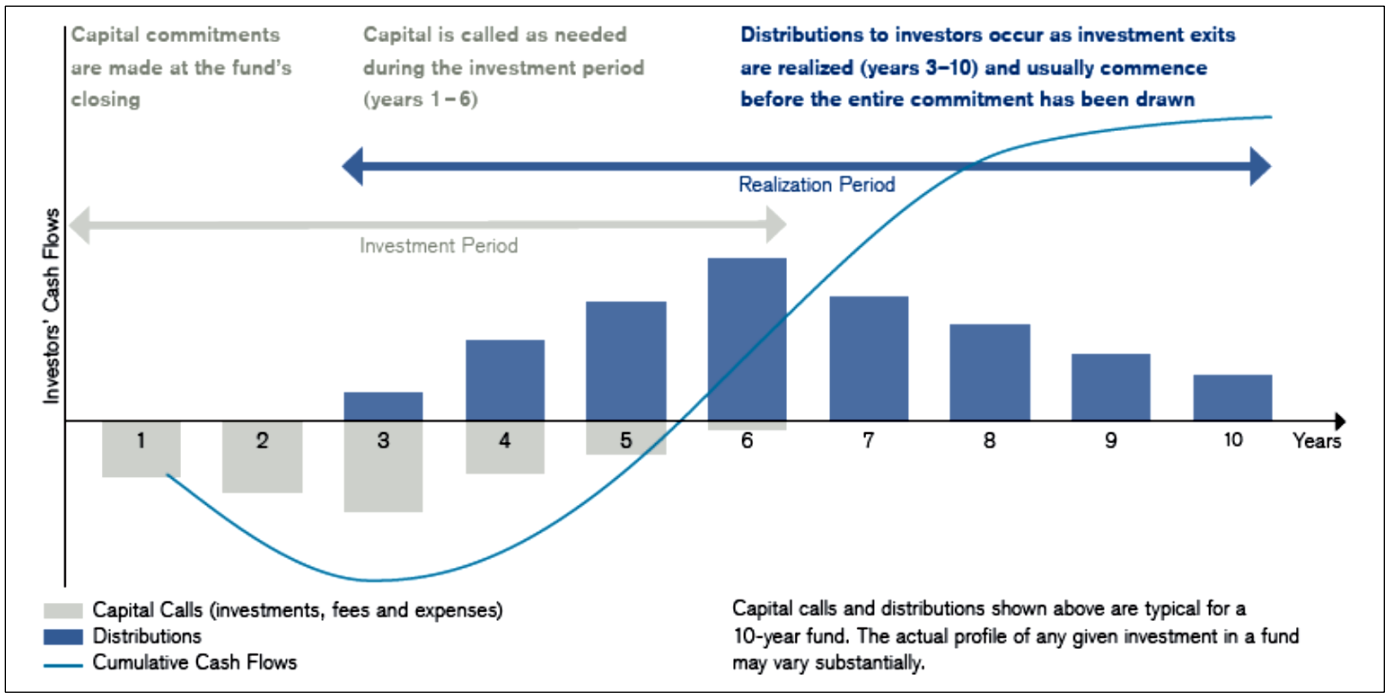
Factor	Factor description
Predictable returns	• Private equity offers attractive risk/return characteristics • Private equity returns have often exceeded returns of public equity markets
Value creation over the long term	• Value is created by active involvement of private equity investment firms because of attractive incentives for managers and the aggressive use of debt • Private equity provides stable long-term capital that allows for a long-term value-creating management style
Portfolio diversification	• Portfolio diversification is possible owing to the low correlation of returns with public equity and bond market instruments
Market resilience	• Private equity is attractive in suppressed market conditions, as investors can benefit from low valuations of target companies that are a result of the poor market conditions
Flexible ownership	• Investors hold on to companies for as long as they can add value, with the ability to dispose of the investee company/companies when this is no longer the case

Source: Pictet (2014:9); Barber & Goold (2007:10)

As can be seen in Table 1.2, private equity is set apart from most other asset classes due to its long-term investment horizon. Private equity funds usually have a life span of between seven and ten years (even more in some cases), and are further characterised by the relative illiquidity of the investments. Capital is pooled in a fund managed by a private equity fund manager and then invested on behalf of the investors who supplied the capital (Kocis *et al.*, 2009:xviii; Kaplan & Stromberg, 2008:3; Fenn *et al.*, 1997:7).

Private equity is also unique among asset classes as a result of the distribution of returns. The distribution of returns is demonstrated by what is known as the 'J-Curve' of private equity returns (also referred to as the cash flow profile).

Figure 1.1 The J-Curve of portfolio returns and cash flows



Source: Credit-Suisse (2011:4)

The long-term investment horizon of private equity is illustrated in Figure 1.1. At the start of the life of a private equity fund, investors commit to provide a certain amount of capital to the private equity fund. This capital is called over a period of time, as needed (usually during the first six years of the life of the fund). During this period, only minor distributions are made to investors, while the fund manager waits to exit from the investments once the investments have reached maturity. As the investments mature, these positions are exited and returns are distributed to investors (Credit-Suisse, 2011:4).

Private equity is similar to other asset classes in that investment in a private equity fund constitutes an investment in a stream of cash flows. For example, publicly traded bonds and shares also qualify as investments in cash flows. However, it is fundamentally different from the cash flows originating from a private equity investment: while the cash flows from a bond investment are certain and stable, the cash flows from private equity are uncertain and often irregular (as is often also the case with publicly traded shares). Large negative cash flows are experienced initially as the general partner draws down committed funds to start making investments in portfolio companies. Only at the end of the investment horizon do the cash flows become positive again, with these cash flows then being distributed to investors at the end of

the life of the fund (Fraser-Sampson, 2007:25). This irregular stream of cash flows is represented by the 'J-Curve', as depicted in Figure 1.1.

Kocis *et al.* (2009:103) and Diller, Herger and Wulff (2009:19) discuss the J-Curve in terms of the internal rate of return (IRR) of the investment. It is mentioned that in the initial period (usually the start-up phase), the IRR of the fund will be negative, as capital is used to fund the portfolio companies, but also to cover fees and management expenses. As time passes, value is built in the portfolio companies, thereby gradually increasing the IRR towards the end of the life of the fund.

1.2.2 Unique characteristics of private equity investments

As mentioned before, the unique attributes of private equity investments include their relative illiquidity compared to other asset classes (such as listed shares and bonds), and the low correlation to public equity markets (SAVCA, 2014b).

Povaly (2006:1) mentions another special characteristic of private equity investments, namely that these investments have a limited lifespan, in contrast to public equity investments which, in theory, have an indefinite lifetime. Private equity investments generally have a lifespan of between seven and ten years, after which the investment is wound up by means of one or more exit strategies (Povaly, 2006:12; EVCA, 2014:6). Exit strategies are a combination of exit timing and exit route decisions. Exit timing refers to when the investor decides to exit, while exit route refers to the type of transaction that is used to complete an exit. Exit timing and exit routes are discussed in detail in Chapter Three Sections 3.3.2 and 3.3.3.

Private equity investments are also unique because of the high degree of control and alignment of interests that is achieved between investors, shareholders and employees (Pries & Berla, 2012:1). The largest shareholders in private equity investments are private equity investment firms that are mostly structured as limited partnerships. As a result of their large shareholding in private equity investments, limited partnerships exercise a substantial degree of control and are principally responsible for the alignment of interests between the parties mentioned above (Fenn *et al.*, 1997:2). Limited partnerships have emerged as the dominant corporate form in private equity investment due to their ability to overcome the high degree of information

asymmetries that are characteristic of private equity investments (Gompers & Lerner, 2001:159). The importance and role of limited partnerships are explained in more detail in Chapter Two Section 2.5.1.

1.2.3 The private equity investment process

Gompers and Lerner (2004) and Wright and Robbie (1998:537) divide the venture capital and private equity investment process into six stages, namely:

- **Stage 1: Fundraising**. During this stage, private equity investors seek to attract funds from different institutional investors and wealthy individuals. Funds are raised from these investors, as private equity investment firms rarely provide the bulk of funds needed for an investment on their own.
- **Stage 2: Investing**. Potential investments (i.e. portfolio companies) are reviewed and assessed. After the assessments are complete, shares in the target companies are bought.
- **Stage 3: Monitoring**. The equity stake in the acquired firm is monitored on a regular basis. Representatives of the private equity investment firm are granted seats on the board of the acquired firm to control the performance of the investment.
- **Stage 4: Adding value**. Representatives of the private equity investment firm influence decision-making and provide assistance to the board of the acquired firm.
- **Stage 5: Exiting**. This stage of the private equity investment process entails the divestment of assets in the private equity portfolio.
- **Stage 6: Re-investing**. After divestments have been made, funds are freed up to be re-invested in new portfolio companies.

It was shown in Table 1.1 that there are different levels of investor involvement in the management of portfolio companies. These levels of involvement are particularly important in stages three and four. The exit stage is just as important, if not more so, than the previous four stages of the private equity investment process (Neus & Walz, 2005; Lerner & Hardymon, 2002). Often, the focus falls on the earlier stages of the investment process, with the exit stage being neglected, both in practice and in academic research (Felix, Pires & Gulamhussen, 2008:1).

Various strategies are available for private equity investors to exit their investments. MacIntosh (1997:17) lists five main exit strategies. The first is to make use of an initial public offering (IPO) which entails part of the portfolio firm's shares being offered for sale to the public. Another strategy is an acquisition sale - a process whereby all shares held by the private equity investor is purchased by a third party, who is usually a strategic acquirer. Secondary sales are also used as an exit strategy and involve only a part of the shares being held by the private equity or venture capital firm being sold to a third party, who is usually also a strategic acquirer. Buybacks and write-offs are the last of the five main exit strategies. Buybacks entail the repurchase of the shares held by the investors by the founders of the firm, while write-offs involve investors walking away from under-performing investments, often incurring a loss in the process.

The exit strategies that are used tend to differ between developed and emerging markets. The most commonly used exit strategy in the United States is that of an IPO (Felix *et al.*, 2008:1). IPOs are also used extensively in Europe, but to a lesser extent than in the United States. Private equity exits are more frequently conducted by means of sales to other companies (usually competitors) in the European market (Felix *et al.*, 2008:1). This is due to European capital markets being relatively less liquid than those in the United States (Povaly, 2006:5; Schwienbacher, 2002:4).

Given the difference of market characteristics between developed and emerging markets, IPOs are very rarely used in emerging markets (Wilton, 2012:57). This is mainly because of the illiquidity and relatively small size of stock exchanges in emerging markets, and the fact that financial markets tend to be less sophisticated in emerging markets (United Nations, 2014:2). Acquisition and secondary sales are most often used in these markets (Bliss, 2012:10).

The different exit routes and exit timing decisions are discussed in more detail in Chapter Three. The discussion of exit decisions is important, as the exit stage of the private equity investment process is the main focus of this study.

1.3 PROBLEM STATEMENT

Much research has been done on private equity, especially in the United States and Europe (Bliss, 2012; Felix *et al*., 2008; Povaly, 2006). Research on private equity in emerging markets has also increased in recent years (Bliss, 2012; Pries & Berla, 2009; Meggison, 2004). However, the exit stage of the private equity investment process has received much less attention from researchers, as proven by the extensive research done by Povaly (2006).

The rapid growth and development of the private equity industry and its increasing prominence as a source of corporate funding confirm the importance of further research into the topic (Wood & Wright, 2009:361). Private equity investment in emerging markets is also an interesting field of research considering the amplified standing of emerging markets in the global private equity context (Quinlan, 2012:17).

Given that emerging markets, especially those in Africa, pose such challenges to private equity investors (United Nations, 2014:2), it is imperative to be aware of the factors that may influence these investors' decisions during the investment process. The researcher of the present study therefore set out to investigate the factors influencing South African private equity investors' exit decisions of African investments, including those made in South Africa.

As mentioned in the opening quote of this chapter, private equity (and in the case of this study, the exit stage in particular), can contribute substantially to the economic wealth of society. This contribution extends beyond the value created for investors. Private equity has the ability to benefit a number of other stakeholders as well, such as communities, by means of job creation and the transfer of skills.

1.4 RESEARCH OBJECTIVES

According to Zikmund and Babin (2010:66), research objectives are formulated after exploratory research has been conducted to define the primary research problem. The main goal of research objectives is to address the purpose of the research project and to set out

exactly what is being planned by the researcher (Cooper & Schindler, 2014:596). Whereas a study generally only has one primary objective, it can have several secondary objectives (Zikmund & Babin, 2010:66).

The primary objective of the study was to investigate the factors influencing the exit decisions of a sample of South African private equity investors investing in Africa, including South Africa.

The secondary objectives that were addressed include the following:

- to outline the development of private equity both internationally and in Africa;
- to describe the size and nature of the South African private equity industry;
- to explain the private equity investment process, with particular reference to the exit stage; and
- to provide recommendations to private equity investors interested in Africa and South Africa on what factors they should consider when planning an exit.

Based on these research objectives, the following research questions were formulated:

- How is the private equity industry structured?
- Which factors influence exit strategies formulated by local private equity investors who invest in Africa?
- Which exit routes are most often used by South African private equity investors who invest in Africa, including South Africa? Why is this particular exit route favoured?
- What effect does Broad-Based Black Economic Empowerment (B-BBEE) legislation have on the exit decisions of South African private equity investors?
- How important is the timing of an exit?
- To what extent are private equity investors in South Africa interested in making investments in Africa, including South Africa?
- Has there been growth in the size and number of investments made in Africa, including South Africa, by local private equity investors?

1.5 RESEARCH DESIGN AND METHODOLOGY

Zikmund and Babin (2010:66) claim that a research design is a master plan that provides a framework for the study, and specifies the procedures and methods that will be used to collect and analyse the information needed to give effect to the research objectives.

Two main research methodologies, or paradigms, are available to researchers in the social sciences. These include the positivistic and phenomenological methodologies. According to the positivistic research methodology, reality consists of what is available to people's senses, and that any investigation of reality should thus be done by means of observation and empirical study (Gray, 2014:25; Saunders, Lewis & Thornhill, 2009:113). The phenomenological methodology assumes that the understanding of reality is based on people's experiences of that reality.

The positivistic methodology focuses on facts and locating causality between certain variables, whereas the phenomenological methodology is concerned with the understanding of what is happening in a specific situation, and developing theories and models based on that

understanding (Gray, 2014:25; Saunders *et al*., 2009:116). Research methods that are typically used in the positivistic research paradigm include quantitative methods. Positivistic researchers generally use large samples, with concepts being operationalised in a way that they can be measured (Gray, 2014:25). When the phenomenological research paradigm is applied, multiple observational methods are used to obtain different views of a phenomenon. Generally speaking, phenomenological research methods use small sample sizes with in-depth observations being made over a relatively long time frame. These methods are usually qualitative in nature (Gray, 2014:25).

This study employed a combination of these methodologies, through the process of triangulation. A positivistic methodology was first applied to gather primary quantitative data. Thereafter, a phenomenological research paradigm was used to gather primary qualitative data to increase the depth of the study, whilst at the same time strengthening the study's validity (Scandura & Williams, 2000:1249).

Careful attention was given in this study to ensure validity, reliability and trustworthiness. The research design and methodology employed as well as the study's reliability and validity are discussed in more detail in Chapter Four.

1.5.1 Secondary data collection and analysis

Secondary research refers to the collection of secondary data from existing sources, which include books, academic journals, media articles, and online sources (Greener, 2008:73). Secondary data have the advantage of being less expensive, faster and more easily available than primary data. Conducting secondary research is also necessary as part of planning a study (Zikmund & Babin, 2010:162).

In the present study, the relevant literature about private equity was obtained from secondary data sources. In reviewing the extant literature, particular attention was paid to the exit stage of the private equity investment process and private equity in the South African context.

1.5.2 Primary data collection and analysis

If secondary research is not sufficient to answer the research question, primary research must be conducted. Povaly (2006) found that surveys and personal interviews were the most appropriate methods to collect data in the private equity industry in Europe. To collect the data, decisions must be made regarding the population, sampling technique, sample size, the sample frame, and research instruments. These elements of the data collection process will be discussed next. It should be noted that data were collected in two phases in this study. First a survey was conducted, followed by in-depth semi-structured interviews with a sample of experts in the private equity industry.

(a) Population

Greener (2008:48) defines a population as "the full universe of people or things from which a sample is selected". Given that this study dealt with the exit decisions made by South African private equity investors, the population for the survey consisted of 95 South African private equity firms that were full members of the South African Venture Capital Association (SAVCA), and a further 41 associate members of SAVCA, as at 31 December 2014 (SAVCA, 2014a). The units of analysis for the proposed study were thus the decision-makers and experts in these private equity and venture capital firms.

All the decision-makers who completed the survey and who indicated their interest to participate in the in-depth interviews effectively formed the population for the qualitative phase of the research. Thirteen (13) responses were received which constituted the population for the semi-structured interviews.

(b) Sample frame

A sample frame is a list of all population units from which a sample can be drawn (Greener, 2008:49). It is also referred to as a working population (Zikmund & Babin, 2010:391). The present study used a list of private equity firms and other related institutions that were full and

associate members of SAVCA (2014a) as its sample frame. This list provided the contact information and physical addresses of the managers of 95 South African private equity and venture capital firms, as well as the information of 41 associate members. Therefore, the sample frame consisted of 136 firms in the private equity industry.

All 136 firms in the sample frame were contacted and requested to participate in the study. Where managers provided informed consent, an online survey questionnaire was sent to them for distribution to decision-makers and experts in their respective organisations. For the purpose of this study, decision-makers and experts referred to fund managers and portfolio managers, as well as other specialists in the private equity industry.

(c) Sampling technique and sample

Zikmund and Babin (2010:68) define a sample as a subset of elements from a larger population. They describe the act of sampling as a procedure that involves drawing conclusions about the characteristics of a population by measuring or investigating a part of that population.

Sampling can be broadly divided into two main techniques. The first is probability sampling, in which every element of the target population has a known and non-zero probability of being selected (Greener, 2008:18). Non-probability sampling is the second broad sampling technique, and entails the selection of units of the population based on convenience or personal judgment. In this case, the probability of selection for each member of the population is unknown (Zikmund & Babin, 2010:395; Kothari, 2004:59). A detailed discussion of sampling techniques is provided in Chapter Four Section 4.5.1.

This study employed two non-probability sampling techniques. The sample for the survey was selected by means of convenience sampling, due to the contact details of South African private equity firms being easily available from SAVCA. After the results of the survey were analysed, judgment sampling was used to choose potential interviewees based on specific characteristics that emerged from the survey data. The interviewees were individuals who were considered as experts, based on their education and industry experience. A sample of eight experts was used, as a sample of this size is deemed sufficient for a phenomenological study (Gray, 2014:25).

Furthermore, eight interviews were considered to be appropriate due to the fact that data saturation occurred (Saunders *et al.*, 2009:235).

(d) Research instruments

The researcher designed a survey questionnaire and semi-structured interview guide to facilitate the data collection. The survey questionnaire that was distributed was based on the questionnaire developed by Povaly (2006). However, it was adapted to address the specific research problem of the present study.

The survey questionnaire consisted of three sections. Section A focused on the gathering of demographic data of the respondents. In Section B, closed-ended questions were asked about the factors that could have an effect on the exit timing. Section C contained questions about the factors that could have an impact on the exit route decisions. The responses were measured using a Likert scale. Sections B and C also included an open-ended question where respondents could add further aspects that they deemed relevant. A more detailed discussion of the design of the questionnaire is presented in Chapter Four Section 4.5.2(b).

The objective of the survey questionnaire was to investigate the factors that could have an impact on the exit decisions made by South African private equity investors investing in Africa. The factors relevant to this study were identified from prior research conducted by Povaly (2006) and other influential researchers in the private equity field. The exit decisions made by private equity investors were divided into two categories. The first category focused on decisions made regarding the exit timing, while the second category dealt with decisions regarding the type of exit route. Exit timing refers to the moment when private equity investors choose to liquidate their investment, whereas exit route refers to one (or a combination of) divestment strategies, which include initial public offerings, acquisition sales, secondary sales, buybacks, and write-offs (MacIntosh, 1997:17).

The variety of factors that may influence exit behaviour (i.e. exit timing and exit route combined and individually) are listed in Table 1.3.

Table 1.3: Factors that affect exit timing and exit route

Factors influencing exit timing	Factors influencing choice of exit route
• Marginal value-adding and monitoring cost • Monitoring requirements for the portfolio company • Performance requirements for the overall fund • Performance requirements for the individual investments • Investment duration limits	• The industry-specific merger-and-acquisition market environment • The size of the portfolio company • Certainty of execution • Transaction cost • Agency theory
Factors influencing both exit timing and exit route	
• The state of the capital market environment[(a)] • Portfolio company performance • Fundraising requirements • Capacity of private equity professionals • Capacity of portfolio company executive management • B-BBEE legislation • Asymmetric information and certification • Grandstanding	

[(a)] The first factor (the state of the capital market environment) is assessed at the time when divestment is considered

Source: Adapted from Povaly (2006)

An additional factor addressing the impact of B-BEEE legislation in South Africa on exit timing and exit route was also included in the questionnaire given the absence of this factor in Povaly's (2006) European study. B-BBEE is an empowerment initiative unique to South Africa, and has had (and is expected to have) important implications for the venture capital and private equity industries. B-BBEE has a particular impact concerning the choice of which companies to invest in, as well as the structuring of such investments (Lingelbach, Murray & Gilbert, 2009:23). B-BBEE legislation and the effect it may have on investments in South Africa is discussed in more detail in Chapter Two Section 2.4.2 and Chapter Three Section 3.3.6(f).

The survey questionnaire was sent electronically to the contact persons listed on SAVCA's (2014a) member list, along with a written request that the questionnaire be distributed to and answered by the decision-makers in the firms. Two rounds of reminders were done

telephonically and by email to increase the response rate. A copy of the survey questionnaire is included as Appendix A.

After the responses in the survey questionnaire were analysed, the interview process started with the potential interviewees who were chosen based on their responses to the survey questions. All respondents who participated in the survey were first asked if they were willing to participate in personal interviews. Those individuals who agreed were asked to provide their names and contact details. The subsequent interviews with them were conducted both personally and telephonically.

The interview guide that was used during the semi-structured interviews consisted of two sections. As with the survey questionnaire, Section A of the interview guide contained questions relating to the demographic information of the respondents. Section B consisted of 22 open-ended questions that were designed to identify factors that could influence the exit decisions of investors. These questions were based on the data that were gathered from the survey questionnaire, to further explore these results and to ensure the validity and reliability of the study. A copy of the interview guide can be found in Appendix B.

(e) Data analysis

The quantitative data that were gathered with the online survey were analysed using descriptive statistical analysis, and calculating the mean and mode. As part of the original research design, it was proposed that inferential statistical analysis should also be conducted. However, inferential analysis could not be done due to the low response rate achieved from the survey questionnaire.

As mentioned earlier, eight interviews were conducted after the results of the survey were analysed. Once the semi-structured interviews were completed, the data had to be processed. The data processing stage of the research process involved converting the data into a form that would address the study's research objectives. This stage consisted of editing and coding the collected data and identifying common themes that emerged from the interviewees' responses (Zikmund & Babin, 2010:70).

The process that was followed to analyse the quantitative and qualitative data is discussed in more detail in Chapter Four Section 4.7.

(f) Ethical considerations

Several ethical considerations were relevant to the study. The first ethical principle that was addressed was whether or not the respondents and interviewees would need to provide informed consent. Informed consent refers to a research participant's understanding of what the researcher expects the participant to do, and to give his or her consent to be part of the research project (Zikmund & Babin, 2010:90). The current study required research participants to provide informed consent.

Respondents were not anonymous, but their identities were kept confidential. The data that were collected from the survey were kept confidential and were protected from unauthorised access. All potential respondents had the right to refuse participation in the study. Respondents were also free to answer only parts of the survey, as well as answering only those interview questions that they felt comfortable to answer.

Prior to the collection of the primary data, ethical clearance was obtained from the Ethics Screening Committee of the Department of Business Management of Stellenbosch University.

1.6 CONTRIBUTION OF THE STUDY

The exit stage is one of the most important stages in the private equity investment process due to its role in value creation process (Neus & Walz, 2005; Lerner & Hardymon, 2002). Gompers, Kaplan and Mukharlyamov (2016:4), however, state that the exit stage is often not a top priority for private equity investors during the process, with the planning and facilitating of high value exits being listed as only the third most important consideration when attempting to create value. According to these authors, exit planning is often overlooked in practice. The exit stage has also received little attention in academic research compared to the other stages in the private equity investment process (Cumming, 2010:396; Povaly, 2006:1). Given the lack of attention

that the exit stage receives in both practice and academic research, it is important that it be studied further.

Although a number of studies have been conducted on private equity in South Africa, most of these studies have focused on the development and the current state of the private equity market in the country (Lingelbach, 2012; Portmann & Mlambo, 2012; Lingelbach *et al.*, 2009). As far as could be established, no South African studies could be found that specifically focused on the exit stage of the private equity investment process. This study therefore aimed to address this research gap, by developing and empirical analysing a conceptual framework, illustrating the factors influencing the exit timing and exit route decisions of South African private equity investors investing in South Africa and on the African continent.

One rationale for the study is the fact that unique results are expected in the African and South African context due to a variety of factors, particularly a difference in the structure of financial markets in Africa and South Africa, and those in more developed nations. These differences in market structure are addressed in more detail in Chapter Two Section 2.3.4.

Further, due to the largely qualitative nature of this study, it is expected that rich data will be gathered from private equity professionals, as to the factors that influence their exit decisions. A number of possible factors have been identified in the extant literature, and have been presented in Table 1.3. Other factors that have been identified from the data gathered during the interview process and from the first-hand accounts of private equity professionals include conditions in the merger-and-acquisition, public equity, and debt markets, the importance of exit price, portfolio company size, factors that may shorten or extend the holding period of portfolio companies, certainty of deal execution, performance of individual investments and the overall fund, Africa-specific factors, as well as value creation within the portfolio companies. These themes and factors are discussed in greater detail in Chapter Five Section 5.4.

Addressing the research gap was only one of the envisioned contributions of the study. As mentioned, the rich qualitative data provides insights into the thinking of private equity professionals regarding exit decisions. The study may also assist private equity investors who invest in Africa (including South Africa) by creating awareness of factors that affect exit decisions. The results of this research may also be of value to entrepreneurs who use private

equity or venture capital to fund their operations, as correct exit planning leads to value creation and ultimately economic growth. Further, the results of the study will be of value to industry associations such as SAVCA, in that it provides a clearer picture of the thinking of private equity professionals regarding their exit decisions.

1.7 KEY CONCEPTS AND DEFINITIONS

Developed markets: Markets with highly developed economies and financial systems, as well as advanced regulatory and legal systems (Bliss, 2012:1).

Emerging markets: Markets that are showing rapid growth and development in their financial and legal systems (Bliss, 2012:1).

Exit route: The divestment channel chosen by the private equity investor, such as IPOs, acquisition sales, secondary sales, buyouts, and write-offs (Povaly, 2006:1).

Exit strategy: The timing and exit route chosen by the private equity investor. The exit strategy also deals with the structuring and financing of divestments (Felix *et al*,. 2008:2).

Exit timing: Exit timing relates to when the private equity investors decide to exit (Felix *et al*., 2008:2).

Portfolio company: A company in which a private equity firm has invested and that forms part of the private equity firm's investment portfolio.

Private equity: Medium to long-term investments in companies that are not listed on a stock exchange (EVCA, 2015).

Private equity firm: A firm usually structured as a limited partnership that invests in unlisted companies (Povaly, 2006:1).

Venture capital: Venture capital is a form of private equity that is focused on investment in start-up companies (EVCA, 2015).

1.8 STRUCTURE OF THE THESIS

This study is divided into six chapters. The following section provides a brief overview of the key topics that are discussed in each chapter.

Chapter One: Introduction to the study

This chapter provides a background to the study. The research problem is introduced, as well as the related research objectives and questions. The research design, methodology and methods that were used in the study are also briefly described. The chapter thus provides a broad outline of the study.

Chapter Two: The development of the private equity industry

In this chapter, the development of the private equity industry is discussed, focusing firstly on the development of the industry in the United States and Europe, and thereafter on the industry's development in Africa and South Africa. The private equity market structure is also explained in detail.

Chapter Three: The private equity investment process, with a focus on the exit stage

A detailed discussion of the private equity investment process and its different stages are presented in this chapter. Particular attention is given to the exit stage of the process, along with the relevant factors and variables that may affect the exit process decisions.

Chapter Four: Research design and methodology

In this chapter the research design of the study is delineated. The data that were gathered and the sources of the data are described. The different analysis techniques that were used to address the primary research question are also discussed.

Chapter Five: Empirical results

The results chapter contains an in-depth report of the empirical analysis of the gathered data. The results are discussed in detail and compared to those reported in the literature review.

Chapter Six: Summary, conclusions and recommendations

This final chapter comprises a summary of the study. It includes the study's conclusions, contributions and managerial implications. Based on the results, pertinent suggestions for future research are also offered.

CHAPTER TWO

THE DEVELOPMENT OF THE PRIVATE EQUITY INDUSTRY

2.1 INTRODUCTION

In this chapter, the development of the private equity industry will be discussed, along with the private equity market structure. The chapter will firstly focus on the development of the industry in the United States and Europe. Thereafter, the focus will shift to the development, current state and future prospects of the private equity industry in Africa. The African private equity market will also be compared to private equity markets in other emerging markets. The development, current state and future prospects of the South African private equity market will also be examined.

Based on the development of the industry, the private equity market structure will then be presented. Particular attention will be given to the role of different stakeholders in the market and in the private equity investment process.

2.2 DEVELOPMENT OF THE PRIVATE EQUITY MARKET IN THE UNITED STATES

2.2.1 Early development of the private equity industry

Pictet (2014:5) states that private companies have been bought and sold since the Industrial Revolution (which started in the 18th century). The author also mentions that although this is the case, the first true private equity buyout is generally accepted to have occurred in 1901, when the Carnegie Steel Company was purchased from Henry Phipps and Andrew Carnegie by J.P. Morgan & Co.

The development of the modern private equity industry began in earnest in the United States in 1946 when the American Research and Development Corporation (ARD) was formed (Fenn

et al., 1997:10). The ARD (structured as a publicly traded closed-ended investment firm) was formed in response to concerns over the lack of small business development during the late 1930s and early 1940s. It was thought that new business creation could be stimulated and funded through private sector investment.

According to Bottazzi and Da Rin (2001:3), the ARD was formed by a number of prominent academics and businessmen to raise capital for new firms in the budding technology manufacturing sector. This sector showed rapid development after the Second World War, as a result of military technologies that were being redeveloped for civilian and commercial use. The funds for these firms were raised from wealthy individuals and institutional investors.

Fenn *et al.* (1997:10), however, claims that the ARD struggled to raise the required capital from institutional investors, and was forced to, at times, sell-off portfolio companies to ensure the liquidity of the firm. In the long term, the ARD not only delivered sufficient returns to investors, but also offered managerial and financial assistance to the portfolio companies in which the firm invested.

Another driver of the development of the early private equity industry in the United States, was the emergence of the Small Business Investment Companies (SBICs) in 1958 (Schertler, 2001:6). These businesses were privately owned investment companies tasked by the government with investing in risky businesses (Fenn *et al.*, 1997:12).

The Small Business Investment Companies were partly funded by the government by the Small Business Administration. However, as a result of government influence over the Small Business Administration and its policies, the SBICs generally tended to focus more on providing loans instead of equity finance. This government influence further resulted in the SBICs typically targeting more mature companies (Schertler, 2001:6; Fenn *et al.*, 1997:12).

Although the SBICs provided funding for a number of new firms, they had a few shortcomings. Gompers and Lerner (2001:147) and Fenn *et al.* (1997:13) note that the extensive regulations applied to SBICs discouraged established and experienced venture capitalists from taking part in the programme, along with the fact that the SBICs attracted mainly uninformed (and often unscrupulous) individual investors rather than the more experienced institutional investors originally envisioned by the government. A further shortcoming of the SBICs was that they were often poorly managed, with poor management partly to blame for the collapse of many of the companies belonging to the SBICs.

2.2.2 The middle period of the development of the private equity industry

Until the early 1970s, private equity investing in the United States and elsewhere was to a large extent an informal affair, and only became a structured industry in the late 1970s and early 1980s (British Venture Capital Association, 2010:7). According to Kocis *et al.* (2009:5), a number of developments in the late 1970s and through the 1980s created an environment for future industry growth. The first of these events was the implementation of new legislation in the United States, in the form of the Employee Retirement Income Security Act (ERISA). This Act allowed pension funds to invest in private equity for the first time. As a result of the large amount of funds that pension funds had available to invest, investment in private equity increased considerably, leading to substantial growth in the industry (Fenn *et al.*, 1997:16).

Fenn *et al.* (1997:14) assert that the emergence of limited partnership as a dominant corporate structure for private equity investment firms was another major driver of the development of the industry. Limited partnerships offered a number of advantages over the SBICs, including fewer investment restrictions, as well as ways to more advantageously structure compensation for the fund managers. Limited partnerships also had the advantage that they were privately held, compared to the SBICs and other early venture capital and private equity firms, that were often public companies structured as closed-ended mutual funds. The limited partnership structure furthermore had tax advantages, and attracted investors who were experienced and had a longer-term investment horizon.

However, despite the positive changes that occurred, growth in the industry was slow due to sub-optimal conditions in the public equity and bond markets during the late 1970s. The poor performance of the public equity markets during this decade had a negative impact on the exit environment, with initial public offerings (IPOs), the main exit route in the United States performing poorly (Kocis *et al.*, 2009:6; Fenn *et al.*1997:14). On the other hand, suppressed market conditions did offer some opportunities for fund managers, especially those managers aiming to take public firms private as a result of most firms' stock trading at significant discounts. This was the beginning of fund managers' focus in non-venture or later stage investing (Fenn *et al.*, 1997:15).

2.2.3 The later development of the private equity industry until today

Gompers and Lerner (2004:150) contend that although institutional investors were starting to invest in private equity in the United States by the end of the 1970s, the levels of corporate investment in private equity were low. Only in the 1990s did companies start to enter the private equity investment space through a number of buyouts that were often motivated by the rationale that the energy of young growing firms can be harnessed to invigorate larger stagnant companies. The authors further mention that the positive publicity that could be gained from being associated with a successful buyout was also a motivating factor for corporate investment in private equity.

Kocis *et al.* (2009:6) note that following the mixed performance of private equity and venture capital in the 1970s and 1980s, the 1990s saw substantial industry growth, largely as a result of the boom in the global information technology sector, especially in the United States. To illustrate the scale of this growth, Gompers and Lerner (2004:150) mention that capital commitments to private equity and venture capital grew twenty-fold between 1991 and 2000. This growth was primarily driven by an increase in private equity investment by pension funds. However, a bubble formed in the information technology industry which came to an end in the early 2000s, resulting in a sharp decrease in the levels of investment in private equity, especially venture capital (Kocis *et al.*, 2009:6; Chew & Kaplan, 2007:8).

After the decline in capital commitments because of the collapse of the information technology bubble in 2001, the industry rebounded in 2003, with substantial amounts of capital re-entering the market. This recovery was largely the result of a general improvement in the economic environment. The focus of private equity investment also shifted during this period, with much more focus on public-to-private transactions in industries other than the high-growth technology sector (Chew & Kaplan, 2007:9).

2.3 ORIGINS, DEVELOPMENT AND FUTURE PROSPECTS OF THE AFRICAN PRIVATE EQUITY INDUSTRY

In this section, the development of the African private equity industry will be discussed, along with its current state and future prospects. The African private equity industry will additionally be compared to the industries in other emerging markets.

2.3.1 Private equity in Africa

Before the development of the African private equity industry can be discussed, the history of economic development in Africa must briefly be considered, as it is closely linked to the growth of the private equity industry on the continent. According to Campbell (2012:136), real economic development in Africa began during the colonial age, when large parts of the continent were controlled by a number of European powers, including England, France, Germany, Belgium, Italy, and Portugal.

During the 1950s, substantial political change took place across Africa due to the emergence of a number of independence movements. These independence movements led to the end of colonialism, with political power being transferred to the local populations. Unfortunately, this did not always happen in a peaceful manner (Campbell, 2012:136).

Campbell (2012:136) further states that after the end of the colonial period in Africa, the continent received disproportionate amounts of aid from the former colonial powers, in part as reparations for the suffering inflicted on the local populations by the colonialists. Ogunlesi (2013:29) and Campbell (2012:136) add that this influx of aid created an environment which facilitated corruption and economic waste, which rendered the international aid extended to Africa largely ineffective.

Babarinde (2012:65) explains that as a result of the transition from colonial rule to self-governance, the African economic space was (and to a large extent still is) controlled by local governments through parastatals and the public sector. This is seen as one of the major inhibitors of the initial development of private equity in Africa.

The modern private equity industry in Africa has its origins in South Africa in the 1980s (Appia-Kubu, 2013:5). Private equity did, however, take longer to feature prominently in the rest of Africa (Africa Investor, 2012:1).

Since the 1990s, the focus of both international investors and local governments has shifted from purely providing aid to Africa's emerging economies. These investors have changed their focus from basing investment selection purely on financial motivators to creating development financial institutions (DFIs) that focus on investing in projects that are expected to provide sustainable economic growth on the continent (African Development Bank, 2012:17; International Finance Corporation, 2011:14).

The emergence of DFIs is deemed as one of the key drivers of initial private equity development and growth in Africa, by promoting private equity financing as an alternative to debt and government funding (African Venture Capital Association, 2014:7). One of the main reasons that DFIs and other investors have considered private equity as an investment avenue in Africa, is the lack of adequately developed stock exchanges and fixed income markets on the continent. Private equity is therefore seen by these investors as the most direct route for investing on the African continent (African Development Bank, 2012:12). However, despite DFIs being seen as one of the major drivers of the industry's development, the number and size of investments made by DFIs have been diminishing in recent years, creating space for private sector investors to enter the market (Babarinde, 2012:65).

2.3.2 The current state of the private equity industry in Africa

In terms of size, the African private equity industry makes up a very small portion of the international market for private equity (Babarinde, 2012:65). Despite the small size of the African private equity industry, it is showing rapid development (Ernst & Young, 2014b:3; Riscura, 2013:2). A number of factors are steering the current growth in African private equity investment. The first and foremost factor is the rapid economic growth experienced by some African economies over the past decade (United Nations, 2014:1), with more than a third of African economies growing at 6 per cent or more (Ernst & Young, 2014b:3; Lingelbach, 2012:225). According to the United Nations (2014:1), Africa as a whole has seen the highest risk-adjusted economic growth from all emerging economic regions.

Despite many positive developments on the continent, such as increased economic liberalisation and growth, a number of challenges remain. As indicated earlier, the major challenges are the underdeveloped stock exchanges and fixed income markets on the continent. These challenges create opportunities as well as obstacles for private equity investors. On the one hand, demand for private equity is created in this situation, when firms are not able to raise the needed capital on the small and illiquid public equity and fixed income markets (United Nations, 2014:2). While this situation creates demand for private equity, it also closes off a number of exit routes for investors (Ernst & Young, 2014b:16). This lack of developed financial markets has traditionally been seen as one of the major deterrents of investment in emerging markets.

As a result of the lack of adequately large and liquid stock exchanges, most exits are conducted through trade sales (Ernst & Young, 2014b:16). Initial public offerings are used less frequently, but their use is expected to grow as the local stock exchanges continue to develop (African Development Bank, 2012:9).

2.3.3 Future prospects of the private equity industry in Africa

The African private equity industry is seen as having significant potential for further development, with the continent being increasingly perceived as an attractive destination for private equity investments (Bowman Gilfillan, 2014a:10). A number of factors are seen as drivers for future growth.

Ernst and Young (2014b:5-7) suggest that some of the drivers of future industry growth include economic diversification away from resource-driven economies to ones that are more reliant on the service sector, strong consumer demand as a result of a growing middle class, as well as a substantial increase in international trade, which has increased fourfold since 2000. Another factor identified by Ernst and Young (2014b:7), is the growth of foreign direct investment on the continent, especially in sub-Saharan Africa, in recent years.

Aside from the economic factors that make the private equity industry in Africa more attractive for investors, developments in other areas are also expected to drive industry growth. Freshfields Bruckhaus Deringer (2014:1) identifies the following as key drivers of the industry's future growth: increased political stability, the global integration of African

economies, increased standards of corporate governance (largely the result of the aforementioned global economic integration), and the increase in the number of skilled investment professionals active in the African private equity market.

As mentioned earlier, the industry allocation of investments is changing and is expected to keep doing so. Traditionally, investors have focused their investments on infrastructure, natural resources, and renewable energy when investing in Africa (Ernst & Young, 2014b:10; Campbell, 2012:137). These sectors do still make up a large portion of investment on the continent. However, according to KPMG (2014:8) and Riscura (2013:11), investors are increasingly focused on a number of other industries, including pharmaceuticals, healthcare, information technology, telecommunications, financial services, consumer staples, and firms targeting consumers' discretionary funds.

Changing demographics are seen as an important driver of future industry growth. One of the main demographic changes that are occurring is the emergence of a middleclass (Campbell, 2012:137). According to Avanz Capital (2012:2) and KPMG (2014:1), other important demographic changes include: a growing formal labour force, increasing urbanisation of the population, and falling dependency ratios (implying that each income earner has fewer dependents, which increases the per capita discretionary income). KPMG (2014:1) further states that the population of the African continent is expected to exceed that of India by the year 2023, and that of China by 2025. This population growth will lead to both an increase in the labour force and the demand for a wide range of goods, which in turn, are expected to be key drivers of future economic growth on the continent.

Increased political stability and economic policy reforms on the continent are seen by many as instrumental to future economic growth, which is expected to lead to an expansion of the African private equity industry (Babarinde, 2012:59). Although there are simmering and active conflicts on the continent, the political landscape in Africa is the most stable it has been in the past fifty years (KPMG, 2014:1). This increased political stability is directly linked to the success of economic policy reforms, due to the fact that policymakers have a more stable environment in which to implement these reforms, with less chance of these reforms being overturned by new regimes (Babarinde, 2012:61).

The United Nations (2014:4) notes that along with political and economic policy reforms, regulatory and legal reforms are also occurring on the continent. It is thus imperative that these changes continue if the private equity industry in Africa is to flourish. Regulatory and legal

reforms are expected to make Africa a much more attractive investment destination, which could be greatly beneficial to the private equity industry (Babarinde, 2012:60).

Another factor that is expected to drive the growth of the African private equity industry is the increasing talent pool of skilled private equity managers (United Nations, 2014:5). Although the number of skilled managers is still small, due to the industry still being new to the continent, the number of managers is expected to grow as a result of the increase in the number of so-called 'repatriots'. These are young African private equity professionals that are being lured back to their home countries by opportunities offered by the growing African private equity industry (Africa Investor, 2012:2).

As mentioned before, the state and maturity of financial markets has traditionally been a limiting factor when private equity investments in Africa were considered. This is, however, expected to change because of the development of stock exchanges on the continent, such as the Nigerian Stock Exchange, as well as the development of emerging exchanges, like the Ugandan Securities Exchange and the Mozambique Stock Exchange (Yartey & Adjasi, 2007:6).

As economic growth on the continent is expected to continue, the nature and size of private equity deals are expected to change. Deals are expected to increase in size, which will make the continent more attractive to larger investment firms, which have in the past struggled to deploy capital on a small scale. Until the economic conditions have changed to accommodate easier deployment of capital, international investors are expected to remain focused on large deals in the oil and gas, power and utilities, infrastructure, financial services, and banking industries (Ernst & Young, 2014b:13).

2.3.4 Comparing private equity in Africa to other emerging markets

On an individual basis, private equity investments in African economies (excluding South Africa) have remained small in comparison to other larger emerging markets, especially those that are part of the BRICS group (Brazil, Russia, India, China, South Africa). Put together, however, private equity investment in Africa as a whole has been shown to be increasing, largely as a result of the above average economic growth experienced by some African

economies (which has exceeded that of Russia and Brazil over the period 2005 to 2012) (Riscura, 2013:4).

Ernst and Young (2014b:12) argue that, despite the increased share of private equity investment in Africa compared to other emerging markets, Africa (sub-Saharan Africa in particular) has lagged behind other emerging markets when it comes to private equity investment. However, sub-Saharan Africa's share of merging market private equity investment has increased from two per cent in 2010 to eight per cent in 2012.

Campbell (2012:141) paints a positive picture of the African investment environment by addressing some of the common misconceptions of the continent, such as the level of political stability, which is described as being at least on par (if not better) than other emerging markets. Furthermore, Campbell (2012:141) counteracts the perception that poor legal enforcement and corruption is rife by stating that sophisticated legal systems have been inherited from previous colonial rulers, which aids in legal enforcement. The level of corruption is also seen as being overstated, with many African nations being less corrupt than other emerging nations in Eastern Europe and Central Asia, as well as South America (Transparency International, 2014:5).

2.4 ORIGINS, DEVELOPMENT AND FUTURE PROSPECTS OF THE SOUTH AFRICAN PRIVATE EQUITY INDUSTRY

This section will focus on the development of the private equity industry in South Africa, its current state, as well as its future prospects.

2.4.1 Private equity in South Africa

The modern private equity industry in South Africa originated in the 1980s (Lingelbach *et al.*, 2004:8). Researchers such as Lingelbach (2012:227) and Lingelbach *et al.* (2004:16) contend that one of the most important factors that have influenced the development of the South African private equity industry is the country's unique economic structure. Lingelbach (2012:227) mentions a number of distinct economic characteristics of the South African economy that has had an impact on the development of the private equity industry in the

country. The first unique structural occurrence is the dominance of five major companies of the South African economy. These groups are Liberty, Sanlam, Old Mutual, Rembrandt, and Anglo-American/DeBeers.

A high degree of horizontal diversification is a key factor influencing the operations of these major companies. The horizontal diversification of these firms has also been traditionally financed using internal funds, rather than funds raised by means of debt issues, share issues, or from private equity investors. As a result, the early stage venture capital industry in South Africa has been largely substituted by corporate venturing on the part of these large companies. One of the reasons for this occurrence is the fact that South African companies could not invest abroad due to sanctions that were the result of apartheid (Lingelbach, 2012:227). Corporate venturing refers to a minority investment in one company by another. These are often non-controlling and temporary in nature, and are managed outside the normal operating structures of the company making the investment (Arnst, Postma, Sherer & Thierry, 2001:3).

Another factor influencing the development of the private equity industry in South Africa is the emergence of black-owned business groups, that have benefited from the unbundling of these large companies by the distribution of shares and other assets (Lingelbach, 2012:227).

According to Teoh, Welch and Wazzan (1999:35), many multinational firms divested from South Africa during the 1980s due to the political situation in the country. This divestment process resulted in a number of management buyouts that were funded by large domestic banks. Some examples of such buyouts include IBM and General Motors selling their South African businesses to the managers of their local subsidiaries (Lowenberg & Kaempher, 2001:1213). As a result of the involvement of these large banks in the private equity business in South Africa, the management of these institutions developed the needed skills to manage these private equity investments (De Bruin & Swanepoel, 2013:3).

The development of the South African private equity industry is closely linked to the increased importance of the financial sector in the local economy. To illustrate the increased significance, Lingelbach (2012:226) mentions that the financial sector constituted 20 per cent of the South African economy in 2009, up from 6.5 per cent in 1994. The financial sector made up 24 per cent of the economy in 2012 (Statistics South Africa, 2014). Due to the financial sector being dominated by a few large institutional investors, private equity activity in South Africa has consisted largely of raising funds for development capital and buyout transactions, rather than early stage venture capital investments.

Since the establishment of the private equity industry in South Africa, private equity managers have managed to establish track records of successfully run funds (De Bruin & Swanepoel, 2013:3). Sound track records are essential in the private equity industry, as it is a prerequisite when private equity fund managers seek to raise new funds in the future (Lingelbach, 2012:226).

2.4.2 The current state of the private equity industry in South Africa

The South African private equity industry consists primarily of captive private equity firms, namely firms that are either directly or indirectly controlled by large institutional investors. It is in contrast to the private equity industries in developed markets, where most private equity firms are independently held (Lingelbach, 2012:231). The captive private equity firms in South Africa are associated with banks such as Rand Merchant Bank, Standard Chartered, and Nedbank, and large insurers like Sanlam.

The most prominent private equity investors in South Africa are foreign-aid agencies and DFIs. The dominance of DFIs in the South African private equity industry is in line with the considerable share of private equity investment conducted by DFIs in other African economies (Lingelbach, 2012:232).

According to the South African Venture Capital Association (2014b:5), the local private equity industry is currently characterised by successful fundraising as a result of the recovering global economy. Research by the Association (2014b:5) shows that private equity investments are being made in a wide range of industries, including construction, manufacturing, software, retail products, and real estate. Although both the developed market and local institutional investors are increasingly targeting the South African private equity industry, the interest shown in the asset class by the local institutional investors remains comparatively low.

According to a report by KPMG-SAVCA (2014:4), the South African private equity industry is currently showing growth (funds under management have grown at a compound annual rate of 11.8 per cent from 1999 to 2013), with South African private equity managers having R162.2 billion under management at the end of 2013. The report by KPMG-SAVCA (2014:4) adds that a major factor characterising the South African private equity industry is the country's B-BBEE (Broad-Based Black Economic Empowerment) programme, with most recent deals

having a B-BBEE component. This is illustrated by the fact that R131.8 billion of the R162.2 billion of private equity funds are managed by either the South African government, through the Public Investment Corporation (PIC) and the Government Employees' Pension Fund (GEPF), or fund management firms that are either entirely black-owned or partly black-influenced (KPMG-SAVCA, 2014:5).

B-BBEE is defined by the Broad-Based Black Economic Empowerment Act 53 of 2003 (Republic of South Africa, 2003) as "a legislative framework for the promotion of black economic empowerment". The Act further states that B-BBEE aims to promote equality, increase broad-based and effective participation of black people in the economy, as well as to promote a higher economic growth rate, increased employment, and a more equitable income distribution. B-BBEE is an important factor that influences private equity investment in South Africa, with B-BBEE private equity deals constituting a distinct and significant transaction class (Bowman Gilfillan, 2014b:275).

Lingelbach (2012:230) notes that as a result of the B-BBEE regulations, both local and foreign funds must seek out B-BBEE-qualified investors, with the added requirement that these investors should take substantial stakes in the fund and be more than just merely front operations. Owing to the importance of B-BBEE in the industry, and as a result of most of the largest private equity firms either being white-owned or managed, it has become increasingly important for these fund managers to form close alliances with B-BBEE-qualified investors as a means of ensuring future growth.

Private equity in South Africa is important for a number of reasons. Firstly, it constitutes a significant part of the financial services sector in the country, secondly, it serves as an important contributor to economic growth in the country, and thirdly, it facilitates B-BBEE, which is helping to address historical economic and societal imbalances (KPMG-SAVCA, 2014:15).

2.4.3 Future prospects of the South African private equity industry

The South African private equity industry has shown significant growth over the past decade (De Bruin & Swanepoel, 2013:3). The prediction is that this growth will continue. However,

according to Ernst and Young (2014a:13), South Africa is expected to constitute a smaller part of private equity investment on the continent than other African countries.

Lingelbach (2012:237) takes a long-term view, and suggests that the high levels of unemployment experienced in the country could lead to increased political unrest, and perhaps even a move away from ANC dominance of the political landscape. This, in turn, could potentially lead to great political instability and deter investment in the country. This potential political situation, along with South Africa's below-par growth compared to the rest of Africa, is seen as some of the main causes for a shift away from South Africa in terms of private equity investment.

Lingelbach (2012:237) does, however, also identify some potentially positive future scenarios for the South African private equity industry, based on the expectation that the South African economy will transform into one that is more competitive in the product and services markets. This could create potential for increased private equity activity. Further potentially positive prospects include an increase in the share of private equity investment received compared to the other BRICS nations, due to the fact that the industry in South Africa is relatively sophisticated and has a much longer track record than other emerging markets. A detailed discussion of the current private equity market structure is provided in the following section.

2.5 THE PRIVATE EQUITY MARKET STRUCTURE

There are a number of stakeholders involved in private equity investments. These include investors, intermediaries, issuers, investment advisors, placement agents for partnerships, and placement agents for issuers. The three most important of these are investors, intermediaries, and issuers. These stakeholders make up the organised private equity market (Fenn *et al.*, 1997:6).

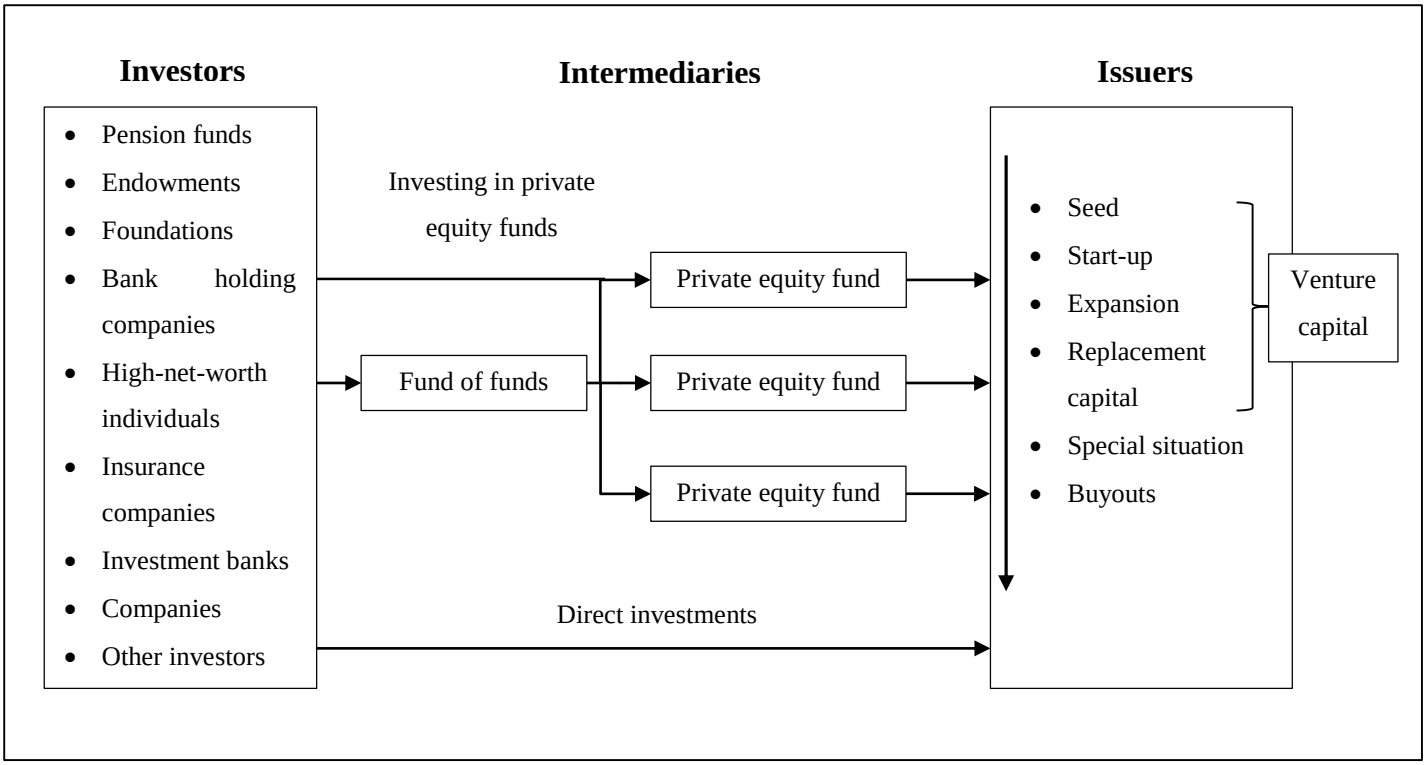
The role of each of these stakeholders will now be discussed, as well as the role of several other parties involved in the private equity investment process.

2.5.1 A general overview of the organised private equity market

Pictet (2014:5) states that the functioning of the private equity market begins with a private equity fund manager (the general partner) drawing up a limited partnership agreement with investors (the limited partners in the partnership, as well as the providers of the capital to be invested in the portfolio companies). This partnership agreement sets out the terms and conditions and the investment mandate of the fund. Thereafter, the limited partners are required to adhere to calls for capital up to their agreed commitment level. The capital raised from the limited partners is usually expected to remain in the fund for the duration of the fund's life. After the portfolio companies are sold at the end of the fund's life, the invested capital along with any profits are returned to the limited partners.

Figure 2.1 provides a diagrammatical representation of the interaction between the main stakeholders involved in the private equity market.

Figure 2.1 The organised private equity market



Source: Thornton (2007:9)

Figure 2.1 also shows the different channels and intermediaries through which capital is channelled to firms (the issuers) who require funds for different reasons at different stages in

their company life cycle. The roles of each of these market participants will be discussed in more detail in the following sections.

2.5.2 The role of investors in the private equity investment process

As can be seen from Figure 2.1, most of these investors in the private equity market are institutional investors (Kocis *et al.*, 2009:24). These institutional investors become part of private equity funds, which are predominantly structured as limited partnerships. Although most capital is committed by these institutional investors, the managers of the private equity funds also invest their own firm's money in the funds they manage (Kocis *et al.*, 2009:24; Gilligan & Wright, 2008:19).

According to Pictet (2014:9) and Fenn *et al.* (1997:8), institutional investor investment in private equity is mainly driven by financial considerations. This is a result of the perception that private equity delivers above average risk adjusted returns. The authors state that these institutional investors favour private equity for the diversification benefits offered by the asset class. Fenn *et al.* (1997:8) further mention that investors other than institutions (such as investment banks and bank holding companies) consider private equity investments, to benefit from economies of scope that can be realised between private equity investing and their other activities.

The largest proportion of funds invested in the private equity market comes from private equity funds structured as limited partnerships (Kocis *et al.*, 2009:24). Limited partnerships are discussed in more detail in the next section. The authors further mention that there are three main channels through which investors can invest in private equity. These channels can be seen in Figure 2.1.

The first channel that investors can use to invest in private equity is to commit capital to a private equity fund. In such a case, they become part of a limited partnership, with the size of their stake in the fund determined pro rata by the amount of capital they agree to supply. Often, investors with significant stakes join the advisory boards of fund managers to gain insight into the fund's operations, and to provide managerial assistance (Kocis *et al.*, 2009:25).

The second channel through which a private equity investment can be made is by committing capital to a private equity fund-of-funds (Thornton, 2008:9). Kocis *et al.* (2009:25) explains that investment in a private equity fund-of-funds provides investors with a higher degree of diversification and leverage, at the cost of adding a further layer of management fees. This added layer of management fees is seen as a big disadvantage of using a fund-of-funds as a private equity investment channel.

The final route to invest in private equity is by direct investment in a target firm (Thornton, 2008:9). The capital invested is exchanged for either equity or debt of the target firm, or in some cases, a combination of both (Kocis *et al.*, 2009:25).

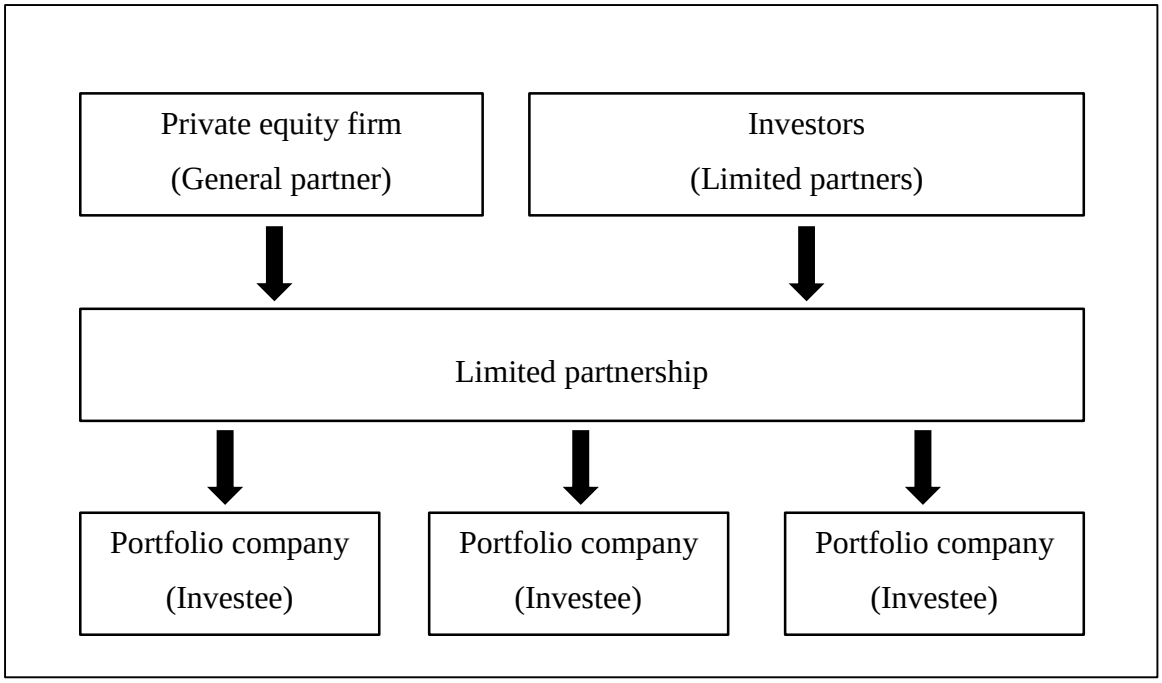
As discussed earlier, investors provide funds that are channelled through the above investment routes using intermediaries to target firms (referred to as issuers). The next section will discuss the role of the intermediaries in the private equity market.

2.5.3 The role of intermediaries in the private equity investment process

Intermediaries serve as a link between the investors who provide the capital and the firms that are targeted for investment. According to Fenn *et al.* (1997:6), the main intermediaries in the private equity market are the limited partnerships that manage the investments, as well as some SBICs that have remained in operation in the United States after the decline in the popularity of that corporate structure. A number of other intermediaries, such as agents and advisors also play an important role in the functioning of the private equity market.

The most prominent intermediary in the industry is the limited partnership. Figure 2.2 provides an overview of how a limited partnership is structured.

Figure 2.2 The structure of a private equity limited partnership



Source: The Private Equiteer (2011:22)

As can be seen in Figure 2.2, the private equity firm is referred to as the general partner in the limited partnership. The general partner is responsible for the management of the fund. The investors (usually institutions) are considered as the limited partners in this structure. The limited partners are responsible for providing the bulk of the capital that is to be invested in the portfolio companies.

Bottazzi and Da Rin (2001:6) describe private equity limited partnerships as consisting of general partners (private equity fund managers) who manage the investments and assume full liability, and limited partners (investors) who provide the capital to be invested. The authors also note that the limited partner assumes no liability other than the capital committed to the fund.

The Private Equiteer (2011:22) attributes the dominance of limited partnerships as a form of intermediary to taxation, as limited partnerships are taxed at the applicable capital gains tax rate, which is often lower than the income tax rate. However, this is not the case in South Africa, where returns from private equity are considered as income and not as capital gains, and are taxed accordingly. The South African corporate income tax rate (28%) exceeds the effective capital gains tax rate (18.65%), which is a disadvantage for South African private equity investors (South African Revenue Service, 2015;11; Sonnenbergs, 2007:1). The limited

partnership structure prevents double taxation, which means that income from private equity investments are not taxed both on a company and a personal basis.

A further reason for the popularity of the limited partnership as organisational form is that it best achieves alignment of interest between the general partners, limited partners, and the managers of the portfolio companies (Fenn *et al.*, 1997:42). Alignment between portfolio companies and the limited partnerships that invest in them is achieved by means of the power of ownership and the oversight that investors have over the portfolio companies. On the other hand, alignment between the general and limited partners is achieved through performance incentives, with the general partners being rewarded with a share of the profits generated by successful investments (Kocis *et al.*, 2009:11).

Another important group of intermediaries are the advisors. According to Fenn *et al.* (1997:60), the market for private equity investment advisory services developed in the 1980s in the United States, with these advisors usually acting on behalf of the institutional investors in their dealing with the private equity limited partnerships. A number of different professions provide advisory services to private equity market participants. These include investment bankers, accountants, lawyers, and placement agents (Gilligan & Wright, 2008:37). Placement agents are used by limited partnerships to seek out suitable investments. These agents are also used by issuers to find investors (Povaly, 2006:24).

2.5.4 The role of issuers in the private equity investment process

All issuers share the same characteristic, in that they all require private equity finance because no other sources of affordable finance are available to them at a particular point in time. Private equity is considered one of the most expensive sources of finance, which is the reason why it is used as a last resort for firms that require capital (Fenn *et al.*, 1997:5).

Lerner and Hardymon (2002:1) provide reasons for private equity being considered an expensive source of funding, stating that this is due to information gaps (or information asymmetry), and the prospects of the potential investee firms being uncertain. As a result of these uncertainties and the higher degree of risk involved, traditional providers of debt capital are reluctant to provide capital to these firms, forcing them to turn to private equity for financing.

Issuers in the private equity market are classified by the stage of the company life cycle they are in. Fenn *et al.* (1997:6) mention that issuers fall into three classes according to their stage in the company life cycle, namely new ventures, middle market private firms, and public companies. An overview of the different characteristics of issuers was given in Section 3.2.4.

2.5.5 Other stakeholders in the private equity investment process

Other stakeholders in the private equity investment process include employees of portfolio companies, as well as their customers and suppliers of these firms (Gilligan and Wright, 2008:37). These stakeholders usually do not participate in the negotiation process. However, a change in ownership may affect the employment conditions of the portfolio company's employees. Although the employees have no part in the negotiations in the case of a change of ownership, the new owners are legally obliged to inform these employees should their employment conditions change.

Investment failures are to be expected in the private equity investment industry, with these failures often due to financial underperformance or a breakdown in relations between the fund manager and the management of the portfolio company. To ensure success, investments must be prudently managed to protect and create value for all stakeholders in the process, including employees, shareholders, the community in which the firms do business, as well as the global economy (The Private Equiteer, 2011:53).

There are a number of arguments concerning the effect that private equity investment has on the stakeholders who play a role in the investment process. Jelic and Wright (2011:561) mention that it is believed that private equity-backed firms have increased employment, and have grown sales faster, than their non-private counterparts. Once divestment has taken place, these stakeholders may be negatively affected. Despite these views, the authors found that post-exit employment has been affected positively, especially in the past decade. In line with these findings, Kaplan and Stromberg (2008:14) concur that after divestment, employment did increase, albeit less than other firms in the portfolio company's industry.

From this discussion it is clear that although the stakeholders have little say in the private equity investment process, they are affected by these investments (especially due to changes in ownership). It is therefore important to consider the impact of these deals on the stakeholders to increase the chances of the investment being a success.

2.6 SUMMARY AND CONCLUSIONS

In this chapter, the development, current state and future prospects of the private equity market in the Unites States, Africa, and South Africa were discussed. Private equity in Africa was also compared to private equity in other emerging markets.

It was noted that the development of the industry started in the United States in the late 1940s. The middle period of the development featured the implementation of the important ERISA regulations and the emergence of the limited partnership as the dominant organisational form. The later development of the industry up to the current day was characterised by rapid growth, following a poor performance in the 1970s and 1980s.

The African private equity industry developed in the 1980s in South Africa. Unique economic challenges shaped the early growth of the industry. Currently, the African private equity industry makes up a small part of global private equity investments, but its share of the global market is slowly expanding as a result of positive economic and political changes taking place on the continent. The future prospects of African private equity look promising, with the expectation of increased future growth as a result of these positive economic developments. When private equity in Africa was compared to private equity in other emerging markets, it was found that it is increasing due to above average growth being experienced by many African economies.

Private equity in South Africa emerged in the 1980s. The country's unique economic structure and political history contributed to the development of the industry. Currently, the industry is showing growth with investments being made in a variety of sectors such as construction, manufacturing, software, retail, and real estate. In the future, growth in the industry is expected. However, the predictions are that South Africa will constitute a smaller part of investments in Africa, as its economy is growing at a slower rate than those of other African countries.

Finally, the private equity market structure was analysed. It was pointed out that a number of stakeholders are part of the industry. These stakeholders include investors, intermediaries, and issuers. Other players in the industry include advisors who facilitate the interaction between the previously mentioned stakeholders. The next chapter will focus on the private equity investment process, with a focus on the exit stage.

CHAPTER THREE
THE PRIVATE EQUITY INVESTMENT PROCESS, WITH A FOCUS ON THE EXIT STAGE

3.1 INTRODUCTION

The focus of this chapter is on the private equity investment process, specifically the exit stage. Firstly, a detailed discussion on the entire private equity investment process is provided, followed by the importance of the exit stage. A number of factors that influence the exit stage, especially the exit timing and the exit route used by investors when divesting, will then be outlined. The factors that affect the exit timing and exit route individually will also be explored, along with those factors that affect exit timing and exit route combined. The different exit routes used by investors will also be discussed in detail.

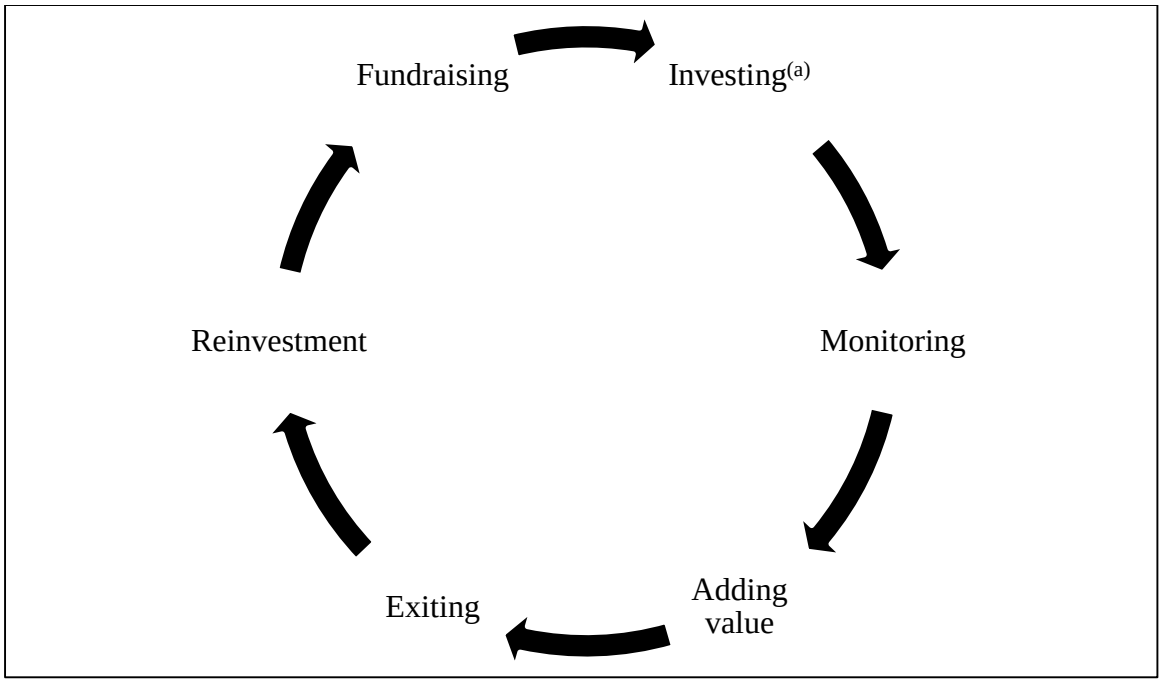
3.2 THE PRIVATE EQUITY INVESTMENT PROCESS

In this section, the process through which private equity investments are made will be investigated.

3.2.1 Overview of the private equity investment process

The private equity investment process involves a number of stages. These stages are presented in Figure 3.1.

Figure 3.1 The private equity investment process



(a) The investment stage consists of the following sub-stages: deal generation, initial and secondary screening, due diligence, deal approval and structuring

Source: Gompers & Lerner (2004); Wright & Robbie (1998:537)

As can be seen from Figure 3.1, the private equity investment process is dynamic, with all aspects of the process being inter-related (Gompers & Lerner, 2001:152). Wright and Robbie (1998:534) add that it is important to recognise the dynamic nature of the process, due to the fact that reinvestment must necessarily be included for the process to be a valid representation of private equity investment. This is so because portfolio companies are continually and concurrently being bought and sold during the investment process (Wall & Smith, 1996:5)

The private equity investment process starts with fundraising. As discussed earlier, the main corporate structure involved in private equity investing is the limited partnership. To invest, the limited partnership needs capital. Although the general partner in the limited partnership provides capital (usually to align their interests with those of the limited partners), the capital committed by the general partner usually only accounts for around one per cent of capital in the fund (Kocis *et al.*, 2009:16). This makes it necessary for the general partner to raise additional funds.

According to the British Venture Capital Association (2010:14), a good performance track record is essential when a private equity firm wants to raise capital for a private equity fund. A

private equity fund that raises capital from outside investors is known as an 'independent' fund, while a fund that raises capital from its parent company is referred to as a 'captive' fund. Increasingly, a hybrid fund sourcing method is being used both locally and abroad, with captive funds raising capital from both their parent company and outside investors (British Venture Capital Association, 2010:14).

Kocis *et al.* (2009:17) mention that fundraising depends on how well the private equity firm (the general partner) can sell the strategy and vision of the fund to potential investors. However, this stage is often one of the most difficult stages of the process, and is seen as one of the main reasons why some funds fail (The Private Equiteer, 2011:25).

The fundraising stage is complete once the amounts of capital to be committed have been agreed to, and the limited partnership has been formed between the general and limited partners (Kocis *et al.*, 2009:17). The next stage in the process involves investing the capital that has been raised in suitable portfolio companies. Wright and Robbie (1998:537) divide this stage into the following sub-stages: deal generation, initial and secondary screening, due diligence, deal approval and structuring.

During the deal-generation stage it is essential to identify and gain access to portfolio companies that present viable investment opportunities. Access to these companies is often more difficult as a result of competition between different private equity firms considering investment in the same potential portfolio companies (Wright & Robbie, 1998:536). A further challenge is to gain the attention of the owners and managers of the potential investee to initiate the investment process (The Private Equiteer, 2011:10). Kocis *et al.* (2009:30) add that investment firms are faced by a number of barriers when entering into investments. These include knowledge, language (especially relevant when doing business in areas such as Francophone Africa and other regions where English is not the primary language), and a lack of appropriate skills.

Screening must also be done to ensure that the most suitable portfolio companies are selected. Once the screening stage has been completed and potentially suitable portfolio companies have been identified, the private equity fund manager must conduct a thorough due diligence assessment on these companies. Conducting a thorough due diligence is especially important in the private equity investment process, because often very little or no public information about the issuer is available, particularly in emerging markets such as Africa (Quinlan, 2012:19; Fenn *et al.*, 1997:49).

The Private Equiteer (2011:96) lists a number of areas a fund manager should focus on when conducting a due diligence assessment of a potential investee company. These areas include: commercial, accounting, tax, legal, insurance, industry, as well as other factors that may be specific to the particular potential investee firm.

Due diligence has both qualitative and quantitative elements. The quantitative due diligence procedures are focused on gathering information regarding the past performance of the investee firm, as well as investigating the existing financial position of the potential target. The qualitative aspect of due diligence is primarily concerned with the management strategy, corporate governance, and the management and firm structure (Kocis *et al.*, 2009:36).

A deal can only be approved and structured once a thorough due diligence has been conducted, and the potential investee company has been found to meet the selection criteria of the fund manager. Fenn *et al.* (1997:50) note that deal structuring is primarily concerned with negotiating the financial and governance aspects of the deal between the fund manager and the portfolio company. The main financial aspect that is negotiated is related to the size of the stake that the fund manager acquires in the portfolio company. Two key governance issues usually receive attention. The first is centred on managerial compensation, while the second is focused on the degree of control that is exercised by the fund manager over the portfolio company. The extent of control becomes particularly important when the performance of the portfolio company turns out to be poor.

According to Wright and Robbie (1998:541), appropriate deal structuring is essential if the private equity fund manager wants to earn their target levels of return. Structuring is also essential for risk mitigation. The Private Equiteer (2011:60) states that risk mitigation often comes before value creation when deals are structured. It is further noted that the deal structure should protect the fund management firm from downside risk, and incentivise fund managers with upside potential.

After the investing stage and all its sub-stages have been completed, the performance of the investments made by the fund manager should be monitored. The general partner, who is responsible for providing managerial assistance and consulting services, in addition to governing and overseeing the portfolio, usually undertakes the monitoring function as well.

Monitoring entails optimally compensating portfolio company managers, replacing underperforming managers, and keeping up to date with the portfolio company's financial

position and performance. Good monitoring most often results from representatives of the general partner attending the board meetings of the portfolio companies (Fenn *et al.*, 1997:55). Kocis *et al.* (2009:44) argue that monitoring is both a qualitative and quantitative process used to test and improve the performance of managers. Monitoring is often more of an assessment of the human nature and personal characteristics than a purely quantitative assessment of performance. The experience gained from monitoring the performance of investments can be invaluable when future investment opportunities are being assessed.

Monitoring is also an ongoing process (Kocis *et al.*, 2009:21) and is closely related to the next stage of the private equity investment process, namely adding value. According to Fenn *et al.* (1997:55), one of the reasons most often cited by private equity partnerships for being the best organisational form to manage private equity investments is that they can add value to the investments by providing managerial assistance to the managers of the portfolio companies. During the value creation stage, the main objectives for private equity investment firms are to identify attractive investment opportunities, and to develop and successfully implement a value creation strategy (Kaplan & Stromberg, 2008:12).

Kocis *et al.* (2009:9) assert that the most important methods used for private equity investment firms to create value in portfolio companies are often through selling off non-core assets, refocusing the mission of the company, updating and freshening product lines, and optimising and streamlining operations. The authors add that the existing management is often replaced as part of the value creation process. Similar changes are applied by fund managers as part of the value creation process, namely to implement cost-cutting and productivity improvements, along with strategy changes and possible market repositioning (Kaplan & Stromberg, 2008:12).

Another channel through which value can be created is leverage (The Private Equiteer, 2011:87). Leverage in the case of private equity, refers to the borrowing that takes place as part of a transaction. Leverage drives growth and value creation by putting pressure on the portfolio company managers not to waste money and to function efficiently, due to the portfolio company being responsible for servicing its debt. If no value is created and the firm performs poorly, the portfolio company may not be able to service its debt. Another way how leverage can create value results from the tax deductibility of the interest paid on the debt. However, if too much debt is used, it may have serious negative consequences for the portfolio company, as it may be unable to service excessive levels of debt (The Private Equiteer, 2011:87; Kaplan & Stromberg, 2008:11).

The final stage of the private equity investment process is focused on divestment and exiting investments. This stage is reached at the end of the lifetime of the private equity fund, after the fund manager has had time to add value to the portfolio company and the company has reached a stage of stable growth (Ianotta, 2010:20). The exit stage involves selling portfolio companies to other companies, or taking these portfolio companies public.

3.3 THE EXIT STAGE OF THE PRIVATE EQUITY INVESTMENT PROCESS

In the following section, the importance of the exit stage will be discussed, along with the factors that affect the exit timing and exit route decisions of private equity investors.

3.3.1 The importance of the exit stage

The exit stage is crucial in the private equity investment process, due to the limited lifetime of private equity partnerships, with the partners expecting to receive payment or distributions of returns through a combination of cash or other marketable securities (Kaplan & Stromberg, 2008:9; Fenn *et al.*, 1997:48).

Apart from exits being important for the eventual distribution of capital to investors at the end of the investment's lifetime, exit planning is also essential as part of the private equity value creation process. Finding the correct advisors and partners to facilitate the exit is crucial to create maximum value throughout the exit process (Ernst & Young, 2013:2).

Despite the importance of the exit stage in the private equity investment process, it is often overlooked in practice (Povaly, 2006:8). Private equity investors and portfolio company managers instead tend to focus on near-term considerations such as the implementation of business plans, board structuring, and the negotiation of compensation schemes. Often the planning of the eventual exit from the investment is neglected because of this (often subconscious) short-term focus. Although the interests of investors and portfolio company managers are aligned when the investment is made, the alignment of interests may shift over time. It is therefore of utmost importance that the exit process is negotiated at the outset of negotiations between investors and investee company managers (Palm, 2004:1).

Wall and Smith (1996:17) also discuss the importance of exit planning as part of initial deal structuring. Private equity investors, even those with long investment horizons, should consider and plan their actions in cases where their investments may be underperforming, when their capital is no longer needed to finance the portfolio company, or where the private equity investors simply become tired of managing the portfolio companies in which they invested. It is imperative that these eventualities be considered at the outset of investment planning and structuring (Wall & Smith, 1996:17).

Schwienbacher (2002:2) highlights the importance of the exit environment for the members of the private equity limited partnership. The author claims that to exit or to divest is often the only way that private equity investment funds realise returns on their investments, as most of the portfolio companies in which they invested did not show positive cash flows for most of the investment period. As a result of these challenges, exit planning and the exit environment (in terms of market conditions at the time of exit) are crucial for private equity investment success.

There are a number of exit routes and exit timing strategies that private equity firms can use to exit their investments and distribute the funds to the partners in the private equity investment partnership. These exit routes and exit timing strategies, along with their unique challenges and determinants are discussed in more detail in the next sections.

3.3.2 Factors influencing exit timing decisions

As mentioned in Chapter One Section 1.3, the primary objective of this study was to investigate the factors that influence the exit decisions of South African private equity investors investing in Africa, with specific attention being given to the exit timing and exit route.

Exit timing refers to *when* private equity investors decide to divest from portfolio companies (Povaly, 2006). At this point it is important to distinguish between the holding period of an investment and the expected lifetime of a private equity limited partnership. The holding period refers to the amount of time that the limited partnership invests in a specific portfolio company. This period is often shorter than the life of the private equity limited partnership, with limited partnerships lasting anything between seven and ten years, while the partnerships' investment in their portfolio companies lasts anything between three and six years. This implies (in line

with the dynamic nature of the private equity investment process) that investment and divestment usually takes place concurrently, with new portfolio companies being purchased while others are being sold (Povaly, 2006, Wall & Smith, 1996:5)

According to Povaly (2006:116-122), the key factors that are relevant to determine *when* portfolio companies will be sold by private equity limited partnerships are decided by marginal value-adding and monitoring cost, monitoring requirements for the portfolio company, performance requirements for the overall fund, performance requirements for individual investments, and investment duration limits. Given that these factors formed the basis of the survey questionnaire and interview guide used in this study, they will be discussed in more detail in the following section.

(a) Marginal value adding and monitoring cost

The timing of an exit may be affected by the marginal cost of adding value to the portfolio company. Fund managers will tend to exit their investments when the marginal cost of adding value to the portfolio company exceeds the marginal benefit. As mentioned earlier, one of the ways how value is added to a portfolio company is by providing managerial assistance and consulting to the board of the portfolio company. In doing so, the fund manager incurs management monitoring cost. Therefore, when the cost of providing these value-adding services exceeds the perceived benefit of it, the fund manager will start to consider an exit (Cumming & MacIntosh, 2003).

(b) Monitoring requirements for the portfolio company

It was mentioned earlier in Section 3.3.2(a) that private equity fund managers might consider the timing of divestments based on their marginal value-adding ability, which is measured against the cost of adding that value. Monitoring the investment is essential in determining when adding value is no longer taking place. The monitoring must be done by the fund managers along with the managers of the portfolio companies. Owing to restraints on the time and skill of these two groups of managers, it is important that managers consider when

monitoring is becoming too costly. Once the monitoring costs exceed the managers' ability to add value, it is time to divest (Povaly, 2006:259).

(c) Performance requirements for the overall fund

The performance requirements for a fund can influence the timing of an exit in three ways (Povaly, 2006:260). The first way relates to the need to provide adequate returns to investors as to compensate them for the investment risk they made. The exit timing is therefore an important consideration when the performance requirements for the overall fund are to be met.

Meeting and exceeding fund performance requirements are also essential for future fundraising. Managers are therefore expected to time their divestment so that the requirements are met, which will likely have a positive impact on their reputation, and hence their future ability to raise capital (Gompers, 1996).

A third way how overall fund performance requirements may have an impact on divestment timing is the implications that delivering desired fund performance may have on the compensation of the private equity fund managers and the managers of the portfolio companies. As a result of this potential impact on compensation, these two groups of managers may decide to exit when the overall fund performance requirements have been met, to receive maximum compensation (Povaly, 2006:260).

(d) Performance requirements for the individual investments

Aside from the performance requirements for the overall portfolio, investors also expect individual investments made by the private equity fund to perform well. This is considered to be one of the most important considerations for investors (Wall & Smith, 1997:7). As mentioned in the previous section, it is vital that the exit is timed correctly to deliver maximum returns to investors. Performance is usually measured by calculating the internal rate of return, or by using the times-money ratio. These are the two most common performance measurement techniques used in private equity (Kocis *et al.*, 2009).

(e) Investment duration limits

Earlier it was explained that private equity funds as a whole usually have a lifespan of around ten years, but that individual investments made by the fund often have shorter investment horizons. The reason for individual investments generally having investment horizons shorter than the lifespan of the fund is that fund managers want to add as much value to the portfolio company in the shortest possible time (usually three to five years), so that these investments can be sold to free up resources for investment in new portfolio companies (Gompers & Lerner, 1999). Povaly (2006:261) asserts that private equity funds often have policies that force their fund managers to start the exit process after a certain defined investment period.

3.3.3 Exit routes used by private equity investors

A number of different exit routes are available to private equity investors who want to divest from their portfolio companies. These routes include initial public offerings (IPOs), acquisition sales, secondary sales, share buybacks, and write-offs (Cumming & Johan, 2007:3; MacIntosh, 1997:17). These exit routes are discussed in more detail next.

(a) Initial public offerings (IPOs)

An IPO refers to process whereby a firm issues shares to the general public for the first time, with these shares then trading in a public secondary equity market (Gompers & Lerner, 2001:159; Wang & Sim, 2001:341; MacIntosh, 1997:17).

IPOs are considered to be the most profitable exit route, which is most often used when private equity divestment takes place in developed markets. However, Cumming and Johan (2007:3) point out that it is one of the most difficult exit routes to manage successfully, especially if there are significant information asymmetries to overcome. Because IPOs are considered to be the most difficult way to divest, managers of private equity funds often promote themselves to institutional investors by focusing on their ability and success when taking portfolio companies public (Bottazzi & Da Rin, 2001:23).

IPOs as an exit strategy have a number of advantages and disadvantages. These are presented in Table 3.1.

Table 3.1 Advantages and disadvantages of IPOs as exit route

Advantages	Disadvantages
• IPOs are generally the most profitable exit route[(a)] • It is the exit route most favoured by fund managers • It may result in a dual-track exit, as a result of an acquisition sale bid that may also be offered at the time of exit • The private equity investor could still share in the future growth of the firm if they choose to retain some shares in the portfolio company.	• IPOs are the most expensive exit route • Lock-up agreements may limit the effectiveness of an IPO as an exit route[(b)] • If a stake in the portfolio company is retained by the private equity fund manager after an IPO, there is a risk that returns in the public market may not meet return requirements • Some public markets are illiquid, especially those in emerging markets like Africa, which may result in mispricing, and therefore volatility of returns • It is often not an option for small companies, because they often do not meet the listing requirements of a stock exchange • In the case of an IPO, a large number of investors have to be convinced by the private equity firm to purchase shares when they are offered, which can sometimes be difficult

(a) After expenses have been taken into account

(b) Lock-up agreements prohibit company insiders such as private equity investors from selling their shares in a portfolio company for a set period of time (Securities and Exchange Commission, 2011)

Source: Du Toit (2013:4); Wall & Smith (1996:8)

According to Cumming and Johan (2007:16), IPOs are most often used by private equity investors in later-stage investments, in contrast to secondary sales and buybacks, which are predominantly used in turnaround investments.

(b) Acquisition sales

An acquisition sale is characterised by shares held by the private equity investor in a portfolio company being sold to a third party that is usually a strategic acquirer (MacIntosh, 1997:17). Wang and Sim (2001:341) explain that during an acquisition sale, the founders of the portfolio

company also sell all their shares in the company, and not only the private equity investors. These strategic buyers are often conducting their business in the same industry as the target firm, with the buyers seeking firms that are a good strategic fit for their own line of business. Strategic alignment between buyers and sellers often results in increased market share in existing markets, access to new markets, as well as the acquisition of expertise and other strategic management resources (PriceWaterhouseCoopers, 2013:5).

Acquisition sales have a number of advantages and disadvantages. These are listed in Table 3.2.

Table 3.2 Advantages and disadvantages of acquisition sales

Advantages	Disadvantages
• Buyers may pay a premium for synergy, market entry, or market share • Exit is 100 per cent cash, which provides certainty of capital distribution, subject to the presence of warranties, indemnities, and arrangements regarding payment deferment • Less expensive than IPOs • Simpler and faster than IPOs • Fewer regulatory restrictions than IPOs • Provides a complete and immediate exit from the investment • Often the only exit option for smaller firms • Only one buyer has to be convinced to buy, rather than the entire market, as in the case of an IPO	• Could be opposed by the portfolio company management, who may be concerned about loss of independence and control • There may be a shortage of buyers in some countries • Most private equity firms will not give warranties to firms purchasing portfolio companies • Management of portfolio companies may be resistant to this route due to the management possibly being replaced once the deal is complete

Source: Hungarian Venture Capital Association (2015); Wall & Smith (1996:9)

Although it is accepted that IPOs are generally the most profitable exit route, acquisition sales may at times provide superior returns compared to IPOs. Wang and Sim (2001:341) and Wright, Pruthi and Lockett (1990) concur that this may be the case for some deals, due to the fact that purchasers may be more willing to pay a premium for expertise and business synergies. These premiums are often the result of the purchaser having a better understanding of the target firm's operation than the general public. For certain firms and industries, acquisition sales may be more appropriate and provide higher returns than IPOs, although this is generally not the

case. If information asymmetries are present, investors are more likely to exit their investments through acquisition sales (Amit, Brander & Zott, 1998:459).

(c) Secondary sales

Secondary sales are related to acquisition sales in that the private equity investor's holdings are sold to a third party. Unlike in the case of an acquisition sale, a secondary sale is not a total acquisition (Amit *et al.*, 1998:459). In the case of a secondary sale, only the shares in the portfolio company held by the private equity limited partnership, and not those held by the entrepreneur or founder of the firm, are sold to a third party (who is often a strategic acquirer) (Cumming & MacIntosh, 2003:514).

Wall and Smith (1996:9) mention that secondary sales are considered to be the third most profitable exit route, after IPOs and acquisition sales. One of the reasons that secondary sales may not be one of the more profitable exit routes results from the fact that the new owner of the stake in the portfolio company does not own the entire firm (Cumming & Johan, 2007:4).

(d) Share buybacks

Cumming (2002:45) defines a share buyback transaction as one where the investor exits their investment by selling their equity stake in the portfolio company back to the founder of the firm.

Wang and Sim (2001:340) contend that buybacks often occur when the investee company has additional cash or has access to debt finance from a bank. Provisions for an exit by means of a buyback are usually agreed to when the investee firm first receives funds from the investor. Call-or-put provisions are agreed to when the deal is structured. A call provision gives the investee the right to purchase the shares held by the investor, whereas a put provision makes it possible for the investor to sell back their equity stake to the investee company, usually in the case where the investee company is underperforming (Nasdaq, 2015).

According to Espenlaub, Khurshed and Mohamed (2010:19), buybacks usually involve high levels of debt finance used by the private equity investors. Debt providers may be hesitant to finance buyouts, especially when it is the investor who is trying to exit, as this could potentially indicate underperformance of the investee firm.

(e) Write-offs

A write-off is the most undesirable outcome for a private equity investor. A write-off would occur if a portfolio company has become insolvent, or the portfolio company is unable to continue with operations for some or other reason. Investors would use a write-off as an exit route as a last resort, if no other manner of divestment is possible (Cumming & MacIntosh, 2003:512; Wang & Sim, 2001:340).

Cumming (2002:18) notes that write-offs occur in the shortest investment duration, as a result of negative information becoming available quickly, and which can be considered a symptom of the presence of information asymmetries. The author adds that the firms that are written off are often those with the lowest market-to-book value ratios.

3.3.4 Factors influencing exit route decisions

In the preceding section, the discussion focused on the different exit routes that are available to private equity investors. The next section will investigate and discuss some of the underlying factors that drive the exit route choices of investors, as identified by Povaly (2006). These factors are: the industry-specific merger-and-acquisition market, the size of the portfolio company, certainty of execution, transaction cost, and agency theory.

(a) The industry-specific merger-and-acquisition market

Povaly (2006:267) indicates that the conditions in the merger-and-acquisition market in the industry in which the portfolio company functions, is an important factor when private equity

investors decide which exit route to use. It is predicted that fund managers would be more likely to use the exit routes most prevalent in the specific industry. This factor is closely related to the conditions in the capital and equity markets, which will be discussed later.

(b) The size of the portfolio company

The size of the portfolio company at the time of exit determines the choice of exit route in a number of ways, with a smaller size often limiting the possible exit route choices. The effect of size on exit route choice can be seen most clearly when considering IPOs. Regulatory requirements often stipulate that firms should be of a certain size before they are allowed to be listed on a stock exchange (Povaly, 2006:267).

Portfolio company size also has an impact on the level of information asymmetry, with the latter being less prevalent in larger firms. If information asymmetries are low, it is expected that an IPO will be used as an exit route (Cumming & MacIntosh, 2003).

(c) Certainty of execution

Exits are exposed to a certain degree of execution risk. This is particularly true in the case of IPOs, due to the preparation time needed for this exit route. During the sometimes extensive preparation time, conditions in the equity and capital markets may change, which is the source of this execution risk (Lerner, Shane & Tsai, 2003). Other exit routes face a lower degree of execution risk, especially when a dual or multi-track exit route is pursued. Because of the different levels of execution risk that are linked to the different exit routes, certainty of execution is an important factor to consider when an exit route is chosen (Povaly, 2006:269).

(d) Transaction cost

The different exit routes all have their own cost implications, with some (usually IPOs) being more expensive than others. Therefore, the transaction cost inherent to each exit route is an

important consideration for investors when they make exit route decisions (Povaly, 2006:269; Wall & Smith, 1997:8).

(e) Agency theory

Jensen and Meckling (1976:5) denote an agency relationship as one where a party or parties (the principal/s) enter into a contract with another person or persons (the agents). The agents are expected under the terms of the contract to perform certain duties or services on behalf of the principal, which involves the delegation of a degree of decision-making authority to the agent. Rose (2011:9) adds to this definition by stating that the principal is the party that has resources that they are unable to deploy. To deploy these resources, the principal gives an agent a degree of authority, or complete authority, to deploy those resources, to the benefit of the principal. One of the main purposes of the agency theory is to describe the agent-principal problem, as well as focusing on how to negate the agency costs in the case where the agent-principal relationship is not functioning effectively.

Agency theory relates to exit route decisions in that it encourages investors to use IPOs over other forms of exit, as a result of the dispersion of ownership resulting from an IPO. The result of this ownership dispersal is beneficial for company founders and managers, in that the firm is then not owned by one major shareholder only, as would be the case in a trade sale (Povaly, 2006:122).

The choice of an IPO over a trade sale may constitute an agency problem in some cases, as managers and owners are incentivised to choose an IPO as exit route even if it is not the most appropriate route in all situations. This incentive is in the form of the dispersion of ownership that was just mentioned. However, agency cost can be mitigated more easily in the case of an IPO. This can be done by compensating management and founders of the portfolio company using share options and other incentives to align the interests of both the managers and investors (Povaly, 2006).

3.3.5 Factors influencing both exit timing and exit route decisions

The focus in the preceding sections was on the factors that separately influence investors' decisions regarding the exit timing and exit route. In this section, factors that are believed to have an impact on both the exit timing and exit route decisions will be discussed.

(a) The state of the capital market environment

The impact that conditions in the capital market have on exit timing firstly relates to the market for the issuing of new public equity. If conditions in the capital market are unfavourable, investors will likely postpone the exit, or consider other exit routes (Povaly, 2006).

Conditions in the debt capital market also affect the timing of exits. Debt financing is an important tool used in buyout transactions. Therefore, if the investors decide to make use of such a route, they are likely to wait until conditions in these markets are conducive to attractive debt finance (Nahata, 2004; Diamond, 1993).

The choice of exit route relates primarily to the relative profitability of the different channels. An exit route choice is thus closely linked to the exit timing, due to the profitability of different forms of exit that changes as the capital market conditions change (Povaly, 2006:266).

(b) Portfolio company performance

The performance and future performance of a portfolio company has a substantial impact on the entire exit process (Povaly, 2006:268; Wall & Smith, 1997:12; Nahata, 2004). When considering portfolio company performance, fund managers thus focus on its financial and operating performance, specifically existing profitability and future revenue growth.

As mentioned earlier, exit timing may be influenced by the trade-off between adding value and the cost of doing so. The future portfolio company performance is therefore important for managers to monitor, and to decide when they should exit (Cumming & MacIntosh, 2001).

Portfolio company performance is also an important point when an appropriate divestment route is considered. Once again, the expected future performance of the portfolio company should be the main focus of managers when they decide on an exit route. Should an IPO be considered, the portfolio company should have strong indicators of high growth, while in the case of trade sales and buyouts, investors usually seek to buy portfolio companies with more stable growth outlooks (Povaly, 2006:268).

(c) Fundraising requirements

It was mentioned earlier that exit behaviour and the performance of those exits have an impact on a private equity fund manager's ability to raise capital for future funds (Gompers, 1996). Therefore, fundraising requirements play a role in the exit behaviour (both in terms of exit timing and exit route) of private equity fund managers.

(d) The capacity of private equity professionals

It was mentioned earlier that private equity professionals only have limited resources pertaining their time and skills to monitor and manage their private equity funds. Because of this scarcity of time and skills, private equity managers have to work as smart as possible. This implies that the managers have to be aware of the time and effort that a possible exit process may require. As a result, these scarce resources may have an impact on the exit timing of investments (Povaly, 2006:260; Cumming & MacIntosh, 2001).

Povaly (2006:268) mentions that the capacity of private equity professionals is another consideration when deciding on an exit route, arguing that different exit routes place different demands on the team of management professionals. However, it is possible to outsource some of the efforts related to the planning and execution of the exit process, to professionals outside the fund management firm (Wall & Smith, 1997:20).

(e) Capacity of the portfolio company's executive management

The previous section discussed the capacity of private equity professionals as it relates to exit timing and exit route decisions. However, the management capacity of the executive management of the portfolio company is also a factor in exit-related decisions. One of the most important attributes that the executive managers of the portfolio company need to possess is commitment to the exit process, as they are intimately involved in its execution. It is therefore important to ensure that commitment on their part is present (Povaly, 2006:269; Wall & Smith, 1997:15).

(f) B-BBEE legislation

As far as could be established, no prior research exists on the effect that Broad-based Black Empowerment (B-BBEE) legislation could have on the exit timing and exit route decisions of South African private equity investors. For this reason, B-BBEE has been added as a variable in this study. The majority of private equity transactions in South Africa have a B-BBEE component, which makes it likely that B-BBEE legislation may have an impact on the exit process both in terms of timing and the exit route chosen (Bowman Gilfillan, 2014b:275).

(g) Asymmetric information and certification

Information asymmetry describes a situation that arises when two parties enter into a contract in which one party is the principal and the other the agent acting on behalf of the principal, and where information about the activities of the agent is not known to the principal, in whole or in part. When information asymmetries are present, it often leads to conflict between the agent and the principal. The presence of asymmetrical information results in agency cost and other conflicts in the relationship (Povaly, 2006).

Cumming and MacIntosh (2003) note that longer ownership duration on the part of the fund manager may be seen as a 'certification of quality' of the portfolio company. This situation

only holds if the fund manager has a sound reputation. This increased ownership duration is then though to decrease the information asymmetry between the fund manager and the potential buyer of the portfolio company. This increased ownership duration therefore constitutes an exit timing effect.

In the discussion on the effect of information asymmetry on the timing of exits, it was mentioned that information asymmetry exists between the management of the portfolio company, as well as between the fund manager and the eventual purchaser of that company. In the second case, the fund manager has more information on the portfolio company than the potential purchaser. This information asymmetry relates to the choice of exit route in that a higher degree of asymmetry may result in the sales price of the portfolio being discounted more. The fund manager would like to avoid selling the portfolio company at a discount, and would therefore be inclined to use the exit route that reduces asymmetry the most (Povaly, 2006).

(h) Grandstanding

Gompers (1996:154) states that reputational concerns are a determining factor in the exit timing decisions of private equity investors, especially young private equity funds. The managers of these funds will try to take their portfolio companies public earlier than more established and older private equity firms, to build a reputation. A sound reputation is essential when these firms seek to raise new capital for future investments (Hibara, 2004:77; Gompers, 1996:154).

One tool that young private equity firms sometimes use to establish their reputation, is the underpricing of IPOs. Because these shares are initially underpriced, large gains are expected when the shares begin to trade. As a result of these gains that were manufactured through underpricing, the private equity firm gains a reputation for facilitating IPOs that generate substantial returns (Neus & Walz, 2005). This action is described as ‘grandstanding’.

Against this background, it is clear that grandstanding may have an impact on exit timing. It is expected that if grandstanding is found to be practiced by the private equity investment company, the company is more likely to exit investments earlier, and may use underpricing to achieve improved exit results over the short term.

As mentioned, if grandstanding is present, fund managers will tend to exit investments earlier. However, grandstanding also has an effect on the type of exit route that is used (Gompers, 1996). Successful IPO exits have the greatest impact on building the reputation of fund managers. Therefore, because of the importance of developing a reputation, the effect that grandstanding will have on exit route decisions is that IPOs will tend to be favoured by fund managers, especially young fund managers.

3.4 SUMMARY AND CONCLUSIONS

The focus of this chapter was on the private equity investment process, especially the exit stage. The six stages of the private equity investment process were discussed in detail, namely fundraising, investing (with its own sub-stages), monitoring, adding value, exiting, and reinvestment. The importance of the exit stage in this process was highlighted, as well as the fact that it is often overlooked in both theory and practice. It was concluded that correct exit planning is essential to create shareholder value.

The discussion then progressed to the factors that have an effect on the exit route and timing. The factors related to exit timing include marginal value-adding and monitoring cost, monitoring requirements for the portfolio company, performance requirements for the overall fund, performance requirements for the individual investments, and investment duration limits.

The exit routes used by private equity investors were considered next. Investors could use IPOs, acquisition sales, secondary sales, share buybacks, and write-offs when divesting. Each of these routes was found to have their own advantages and disadvantages. The broad factors that had an impact on the exit routes used by investors included the industry-specific mergers-and-acquisition market, the size of the portfolio company, certainty of execution, transaction costs, and agency theory.

A number of factors were also identified that may affect both the exit timing and exit route. These include: the state of the capital market environment, portfolio company performance, fundraising requirements, the capacity of private equity professionals, the capacity of the portfolio company's executive management, B-BBEE legislation, asymmetric information and certification, and grandstanding.

From the information presented in this chapter, it can be concluded that the private equity investment process is complex, with many factors that may have an effect on the process. Furthermore, the exit stage in itself is complex, and it was pointed out that it is essential to create value for investors.

All the factors that were identified as having a potential effect on the exit timing and exit route, were used as the basis for questions asked in the survey questionnaire and the semi-structured interviews. The design of these research instruments are discussed in detail in the next chapter, as well as the overall research design and methodology followed in the study.

CHAPTER FOUR
RESEARCH DESIGN AND METHODOLOGY

4.1 INTRODUCTION

Before data collection can commence and data can be processed and analysed, it is important to develop a well-designed research plan. The key elements of the plan designed for this study will be laid out in this chapter. The broad concept of business research will first be defined, followed by a discussion of the various elements of the research process set out in Table 4.1.

Table 4.1 The research process

Step	Key activities of the research process	Corresponding chapters and sections
1	Identifying and formulating the research problem	Chapter 1 Section 1.3
2	Determining the research objectives	Chapter 1 Section 1.4
3	Developing a research design	Section 4.3
3.1	Selecting the appropriate research methodology	Section 4.3.1
3.2	Identifying the type of research that will be undertaken	Section 4.3.2
4	Conducting secondary research	Chapter 2 and 3
5	Conducting primary research	Section 4.5
5.1	Determining the population and sample frame	Section 4.5.1
5.2	Choosing an appropriate sampling technique and drawing the sample(s)	Section 4.5.1
5.3	Designing the research instruments	Section 4.5.2
6	Collecting the data	Section 4.6
7	Analysing the data	Section 4.7
8	Reporting the research findings	Chapter 5

Source: Adapted from Cant, Gerber-Nel and Kotze (2003:39)

As indicated in Table 4.1, the research problem was identified along with the research objectives and questions during the first two steps of the research process. The problem statement of this study was articulated in Chapter One and centred on identifying the factors which could influence South African private equity investors' exit decisions when investing in Africa. The research objectives and questions were also discussed in detail in Chapter One.

4.2 DEFINING BUSINESS RESEARCH

The primary goal of any form of research is to provide information for decision-making purposes. This is also true in a business context, where various forms of information are needed by managers to make informed decisions. Key decisions in the business context deal with value-maximising tactics and strategies, as well as developing and growing the business or service (Walliman, 2011:1; Zikmund & Babin, 2010:3).

A variety of research projects can be grouped under the term 'business research'. Business research is defined by Cooper and Schindler (2014:4) as a process of systematic inquiry to provide information to business decision-makers. This process entails planning, acquiring, analysing and disseminating the relevant data, information and insights gained from the research to the relevant decision-makers. The data that are collected should be used to mobilise the organisation to take action to maximise the organisation's performance. In the case of this study, these decision-makers are the private equity fund managers, whose objective should be to create value in the portfolio companies in which they invest.

Zikmund and Babin (2010:5) describe business research along similar lines. They view it as a scientific and systematic process that includes the generation of ideas and the development of theories, defining the research problem, searching for and collecting information, analysing the collected data, and communicating the findings and their implications.

Both these definitions suggest that business research should be conducted systematically, that is, according to a formal process. As explained earlier, the research process followed in this study was based on the steps set out in Table 4.1. The first two steps were already dealt with in Chapter One. The third and remaining steps will be discussed in the subsequent sections of this chapter. First, the steps relevant to the Povaly (2006) replication study will be explained. This step constituted the collecting of the quantitative primary data. Thereafter, the research steps that were followed in the qualitative part of the study will be reviewed.

4.3 DEVELOPING A RESEARCH DESIGN

The third step or stage of the research process is the development of a research design. A number of definitions are used in the literature when referring to a research design. Cooper and Schindler (2014:125), for example, refer to a research design as the blueprint for the collection, measurement and analysis of data. A research design is the structure and plan of an investigation pursuing to answer a specific research question. Saunders *et al.* (2009:136) and Greener (2008:38) assert that a research design is the grand plan for approaching the research project. These authors also mention the importance of a clearly defined research problem.

In the next section, the development of the study's research design is discussed, starting with the theoretical aspects of the research methodology. The type of research that was used in this study is then explained, along with the study's specific research design.

4.3.1 Selecting an appropriate research methodology

Two main research methodologies or paradigms are available to researchers, namely phenomenology and the positivistic paradigm (Walliman, 2011:21).

A positivistic research methodology or paradigm is relevant to this study. This paradigm is based on the argument that reality exists externally to the researcher, and that it should be investigated by using a rigorous scientific process (Gray, 2014:20). A positivistic paradigm promotes experimentation and the testing of hypotheses to create new knowledge. The main tenet of this research paradigm is that knowledge can only be created through observing social phenomena (Greener, 2008:16). The paradigm primarily uses quantitative methods to analyse data, and generally tends to make use of large samples to be able to generalise observations to the broader population (Gray, 2014:25).

The second relevant research methodology is phenomenology. Phenomenology refers to the way individuals make sense of the world around them (Saunders *et al.*, 2009:116). According to Zikmund and Babin (2010:137), phenomenology denotes a philosophical approach to study human experiences. It is based on the notion that human experience is inherently subjective, and is determined by the context in which people live. Phenomenology is alternatively defined

as a research philosophy that considers all phenomena as socially constructed. This philosophy thus centres on gaining meaning or insight from individuals in society (Saunders *et al.*, 2009:597). Phenomenological researchers typically use small samples over a specific time frame to gain in-depth insights, and using multiple methods to establish different views of the same phenomenon. It must also be noted that phenomenological research is mainly qualitative in nature (Gray, 2014:25).

This study used both these paradigms, to increase the reliability and validity of the study. Furthermore, the use of both paradigms is the result of the first phase of the research yielding an unsatisfactory response rate. Initially the positivistic paradigm was favoured, as the original aim was to replicate the study by Povaly (2006). However, due to the poor response rate, a decision was made to change the course of the study, which resulted in the adoption of a phenomenological paradigm.

4.3.2 Identifying the type of research that will be undertaken

In this section the different types of research are introduced and the relevant research types are discussed.

(a) Descriptive, exploratory and explanatory research

Descriptive studies are structured and formalised, and have clearly stated investigative questions. These studies describe the characteristics of a population, estimate the proportion of the population that exhibit these characteristics, and attempt to discover the relationships among the different factors of the study (Cooper & Schindler, 2014:134). The present study attempted to describe the South African and African private equity investment market.

Exploratory research studies aim to develop hypotheses that can be tested, rather than actually testing them. Exploratory research is most often used when the researcher lacks a clear idea of the research problem (Cooper & Schindler, 2014:129). Exploratory studies are less formalised and structured than descriptive studies (Kothari, 2004:4). Exploratory research is relevant to

this study, as the study explored the factors and themes that could influence the exit decisions of private equity investors.

The primary objective of explanatory research is to establish whether relationships between the relevant dependent and independent variables exist (Saunders *et al.*, 2009:140). Initially the present study set out to determine if relationships existed between the dependent and independent variables. However, this was no longer the case, as the focus of the study shifted to identify the factors that could have an impact on South African private equity investors' decisions when they invest in Africa, including South Africa.

(b) Deductive and inductive research

Aside from the different types of research discussed in the preceding section, research can also be classified as being either deductive or inductive. According to Greener (2008:16), deductive research originates from existing theory. A research focus is then formulated, with hypotheses then being developed from the existing theory to test new theory. Inductive research begins from the point of the research focus, which is often a certain business problem. By using various research methods, a theory is then formulated.

Cooper and Schindler (2014:64) add that deductive research aims to reach particular conclusions based on general premises. Deductive research progresses through five stages. During the first stage a testable hypothesis or proposition (in the case of qualitative studies) is usually developed from the extant literature . This proposition will then be stated in operational terms, tested, and the specific outcomes of the inquiry will then be measured. Finally, the original theory may be adapted in light of the new findings. As indicated in Chapter One Section 1.3 several factors that could influence exit timing and exit route were explored in this study.

In contrast, the concept of inductive research is based on the logical process of establishing general propositions on the basis of particular facts (Zikmund & Babin, 2010:44). Walliman (2011:17) also defines inductive research and reasoning as research that starts with observations and experiences, leading to general conclusions about the observed phenomenon.

This study is deductive in nature, as deductions were made about the factors that could influence the exit timing and route decisions of South African private equity investors by means of quantitative and qualitative data analyses.

(c) Quantitative and qualitative research

Research can furthermore be defined in terms of the nature of the data collected, as opposed to its source (Walliman, 2011:71). Collected data can be either quantitative or qualitative in nature.

Quantitative data are gathered by using quantitative research methods, with quantitative data being defined as numerical data or data that have been quantified (Saunders *et al.*, 2009:598). According to Zikmund and Babin (2010:135) and Greener (2008:17), quantitative research is most often associated with a deductive approach, and makes use of numbers to quantify and measure variables when testing theories, and to measure concepts with scales that either directly or indirectly provide numerical values. The basic purpose of quantitative research is therefore that a researcher can project their findings onto a larger population through an objective process by using numerical data (Boreggo, Douglas & Amelink, 2009:54).

The other main type of data that researchers can gather is qualitative in nature. Eriksson and Kovalainen (2008:5) contend that qualitative research is the most relevant when prior insights about a certain phenomenon are modest, as was the case in this study. This implies that qualitative research tends to be exploratory and flexible in nature, due to the unstructured nature of the research problem. Qualitative research is driven by the aim to discover the underlying motives and desires of research subjects. Such research produces data in a non-quantitative form. This means that the data are not based on numbers (Kothari, 2004:3-5).

In the present study, both qualitative and quantitative data were collected. The combination of these methods was not initially anticipated. In the end, the combination of quantitative and qualitative data was, however, highly beneficial to gain a deeper understanding of the phenomenon under investigation. It also contributed to the reliability and validity of the study.

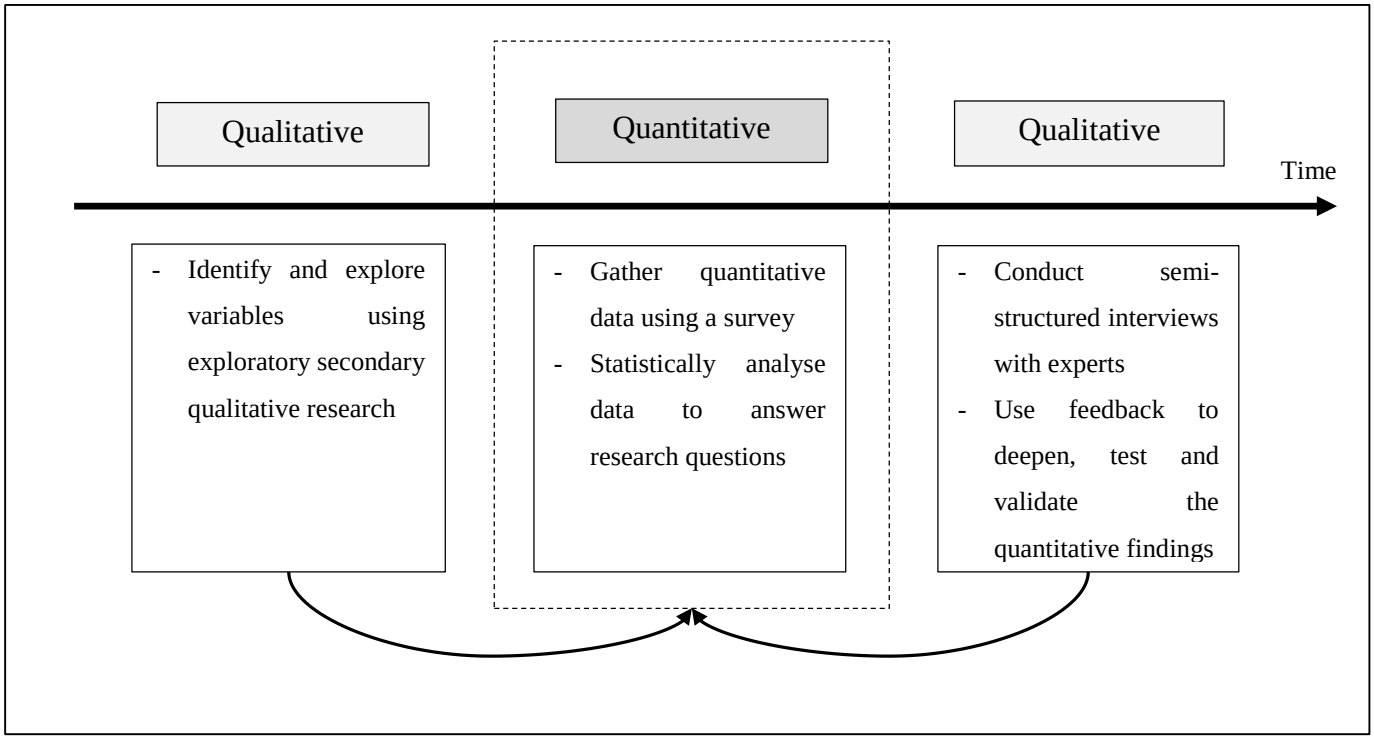
4.3.3 The research design of this study

This study made use of triangulation as its research design. Triangulation refers to the process of combining a number of qualitative methods, or combining qualitative and quantitative methods when conducting research (Cooper & Schindler, 2014:166). In the present study, the latter form of triangulation was used. The goal of triangulation and mixed-method research in general is to offset the counteracting biases of different research methods when researching the same phenomenon. This offsetting of biases leads to the results of a study having a much higher degree of validity (Greene, Carcelli & Graham, 1989:256). Stated more simply, triangulation ensures that the data are telling the researcher what the researcher thought it was telling him or her (Saunders *et al.*, 2009:146). Although triangulation was used in this study, it must be noted that the research design evolved over time, as a result of the insufficient response rate to the survey questionnaire.

The mixed-method paradigm is considered to be in its early stages of development, but is increasingly viewed as a valuable way to conduct research, as it combines the strengths of both qualitative and quantitative research techniques (Kidd, Wengstrom & Rowa-Dewar, 2010:369; Leech & Onwuegbuzie, 2007:265). According to Boreggo *et al.* (2009:53), one method should not be considered superior to others. This approach concurs with other authors who argue that a combination of methods plays to their individual strengths.

The intention was that the study would replicate certain sections of a study by Povaly (2006), who explored exit behaviour in the European private equity market. Povaly's study made use of a mixed-method research design. As a result, it is appropriate to use the same research design in this study, as it is closely related in terms of influencing factors and research objectives. Figure 4.1 depicts the triangulation process followed by Povaly (2006), which was consequently adapted and used in the present study.

Figure 4.1 The triangulation process



Source: Povaly (2006:7)

The triangulation process begins with the identification and exploration of a study's key factors, which is done by using exploratory secondary qualitative research. In the case of this study, the identified factors were based on research by Povaly (2006), as well as other theories, which were reported in the literature review in Chapters Two and Three.

After the factors were identified, a survey questionnaire was designed to collect quantitative data about the factors influencing the exit behaviour of South African private equity investors. This questionnaire was based on Povaly's (2006) questionnaire, but was adapted to make it relevant to the African context. A copy of the survey questionnaire is included as Appendix A. The design of the survey questionnaire is discussed in more detail in Section 4.5.2(b).

As part of the triangulation process, semi-structured interviews with experts in the South African private equity industry were conducted, to gain a deeper understanding of the motivations behind their exit decisions. The questions asked during the interviews were based on the responses received during the survey stage to clarify those results. This part of the triangulation process served to increase the reliability and validity of the study, as the qualitative results provided clearer insights into the quantitative survey answers.

4.4 CONDUCTING SECONDARY RESEARCH

Conducting secondary research is the fourth stage in the research process as presented in Table 4.1.

Secondary research is part of the process of exploration, which must be carried out to gain a clearer understanding of the research problem. Through exploratory research the relevant concepts are developed, research priorities are defined, operational definitions are stated, and the final research design is refined and improved (Cooper & Schindler, 2014:94).

A defining characteristic of secondary data is that between the event and the recording of the data, at least one level of interpretation has been inserted (Cooper & Schindler, 2014:86; Kothari, 2004:95). In similar vein, Walliman (2011:71) and Zikmund and Babin (2010:161) define secondary data as data that have been previously recorded and interpreted. Often, however, secondary data have been collected for a purpose and to achieve objectives that differ from the research project at hand.

Secondary research and the data collected in the process have a number of advantages and disadvantages. The advantages of secondary data include that the information is relatively easily available and affordable to obtain, that the data can be gathered unobtrusively without causing much disruption to an organisation, and that it can lead to unforeseen discoveries by the identification of patterns in the previously gathered data (Saunders *et al.*, 2009:269). It is often impossible for the researcher to gather primary data due to time, cost, and/or ethical considerations. In such cases, secondary data may be the only source of data available. Conducting secondary research may also reduce the amount and complexity of doing primary research (Zikmund & Babin, 2010:161).

There are a number of disadvantages to secondary research. Secondary data are often gathered to achieve different objectives than the research project at hand. Researchers should therefore be careful and ensure that the secondary data are in some way relevant to their research project (Zikmund & Babin, 2010:161). In line with this recommendation, Kothari (2004:111) adds that researchers should ensure that the secondary data that have been gathered are reliable, suitable, and adequate before using it. Although easy access and relatively low cost were previously cited as advantages, secondary data may not always be easy and affordable to access (Saunders *et al.*, 2009:270).

Other disadvantages of secondary data include the data being outdated, that terms that are used may be defined differently, that different units of measurement may have been used, and that the accuracy of the data may be difficult to verify (Zikmund and Babin, 2010:161).

Secondary data may be obtained from a number of sources. These sources are generally easily available in the public domain (Greener, 2008:21) and include news bulletins, newspapers, magazines, documentaries, the Internet, academic journals, textbooks, libraries, dictionaries, trade publications, and books (Saunders *et al.*, 2014:266; Walliman, 2011:71; Zikmund & Babin, 2010:172).

Secondary research was used to create the theoretical framework of this study (see Chapters Two and Three), and to explore the existing knowledge in the fields of private equity and exit strategy. This secondary research was not in itself sufficient to address the research questions, but served as a starting point to develop a research design for the primary research that was required. The primary research that was conducted as part of the study is discussed in the following section.

4.5 CONDUCTING PRIMARY RESEARCH

Primary research must be conducted after the completion of secondary research. Conducting primary research is the fifth stage of the business research process, as outlined in Table 4.1.

The goal of primary research is to gather, assemble, and analyse primary data for the specific project at hand (Zikmund & Babin, 2010:186). Primary data can be described as data that have been observed, experienced or recorded close to the actual event. They are the first and most immediate recording of a particular situation (Walliman, 2011:69).

A number of different methods of primary data gathering exist. According to Kothari (2004:17), primary data can be collected either by means of experiments or surveys, with the experiments usually yielding quantitative results. In contrast, surveys can be used to gather both qualitative and quantitative data. Qualitative data can be coded to provide numeric values that can then be statistically analysed. A number of methods can be used to gather qualitative primary data, including observations, personal interviews, telephone interviews and questionnaires (Zikmund & Babin, 2010; Kothari, 2004:17).

In this study, the researcher collected quantitative and qualitative primary data using a survey questionnaire and semi-structured personal and telephone interviews. These data gathering methods are discussed in more detail in Section 4.5.2 of this chapter.

4.5.1 Determining the population, sample frame and sample

The term 'population' refers to the full set of cases from which a sample can be drawn. It is a collective term describing the total quantity of type of things relevant to the research (Walliman, 2011:94; Saunders *et al.*, 2009:212).

Earlier it was mentioned that primary data for this study were gathered in two phases through the process of triangulation. In the first phase the data were collected by means of a survey, while the second phase involved the use of semi-structured interviews. Each of these phases had its own distinct population.

The population for the survey consisted of 95 South African private equity firms that were full members of the South African Venture Capital Association (SAVCA) as at 31 December 2014, and 41 associate members of the Association (South African Venture Capital Association, 2014a). The total size of the population was therefore 136 individuals. The unit of analysis within the population was the private equity experts working in those firms.

Once the survey data were analysed, semi-structured interviews were conducted. The population for the semi-structured interviews consisted of the experts in the private equity firms that took part in the survey. The population consisted of 13 private equity industry experts. Eight of these experts were interviewed. The reason that only eight of the thirteen experts were interviewed was that data saturation occurred. Data saturation refers to a situation where additional data collection provides few, if any new insights (Saunders *et al.*, 2009:235).

Because the data were gathered in two phases, two sample frames were also used. A sampling frame refers to a list of all the elements from which a sample can be drawn, and is closely related to the population (Cooper & Schindler, 2014:347). It is important that this source list should be as representative of the population as possible, as well as being comprehensive, reliable, appropriate, and correct (Kothari, 2004:56).

A sampling frame for the survey phase consisted of a list of the names of the 136 South African private equity firms and associated organisations that were full and associate members of SAVCA as at 31 December 2014. The list contained the contact details and physical addresses of fund managers and industry specialists in all 136 private equity firms and associated organisations.

A sampling frame also existed for the qualitative data collection phase. This list consisted of the names and contact details of all individuals who participated in the survey and who indicated their willingness to be interviewed.

Researchers can use a probability or non-probability sampling technique to draw a sample. According to Cooper and Schindler (2014:343), random selection is the basis of probability sampling. Probability sampling is a strictly systematic procedure and the characteristic of the process is that each element of the population has a known, usually equal, non-zero chance of selection, in contrast to non-probability sampling (Cooper & Schindler, 2014:343; Saunders *et al.*, 2009:213).

Non-probability sampling implies that the sample was not randomly drawn. This results in some population elements having higher chances of being selected than others (Greener, 2008:48). The probability of a population element being drawn is not known, and it is impossible to make inferences about the characteristics of the total population from the data collected with non-probability sampling (Saunders *et al.*, 2009:213).

A number of non-probability sampling techniques exists, namely convenience sampling, judgment sampling, quota sampling, and snowball sampling (Cooper and Schindler, 2014:359; Zikmund & Babin, 2010:396).

Convenience sampling implies that a sample is chosen in a non-random manner based on the ease or convenience of reaching sample elements. It is a method that selects population elements that are immediately available (Walliman, 2011:167; Greener, 2008:48). Judgment sampling (also known as purposive sampling) is used when a researcher non-randomly selects sample members based on some or other criteria. This technique is typically used in the early stages of an exploratory study (Cooper & Schindler, 2014:359).

Researchers use quota sampling when they try to balance a sample by selecting responses from equal numbers of different respondents (Walliman, 2011:176). Quota sampling is related to stratified sampling in that certain proportions of particular variables are included in the sample.

Quota sampling is, however, not a random sampling technique, as is the case with stratified sampling (Greener, 2008:48). Snowball sampling is another non-probability sampling technique used by researchers. This sampling method entails selecting initial respondents using probabilistic methods, and thereafter obtaining the details of additional respondents using the information provided by the initial respondents. It is a valuable technique to reach members of rare populations (Zikmund & Babin, 2010:398).

Different sampling techniques were used for the two phases of the data collection in the present study.

The sampling technique used during the first phase falls into the category of convenience sampling, because although the total population of private equity managers and other industry-related firms could have exceeded the identified 136 members of SAVCA on 31 December 2014 (South African Venture Capital Association, 2014a), only these 136 fund management and related firms were considered for this study. This is so because their contact details and physical addresses were conveniently available. The sampling units were the decision-makers and experts in those 136 firms.

Judgment sampling was used to draw the sample for the semi-structured interviews. Judgments about the suitability of possible interviewees were based on responses obtained from the survey. These interviewees were considered experts in their firms. The sample was drawn from 13 individuals who completed the survey questionnaire that was sent to all 136 SAVCA members between 10 February 2016 and 10 March 2016. The interviews were conducted both telephonically and in person between 25 April 2016 and 26 May 2016. The interviewees were situated in Cape Town, Stellenbosch and Johannesburg.

4.5.2 Designing the research instruments

In this section, the two research instruments used in the study will be discussed. First, the different measurement scales that can be used to design a survey questionnaire are mentioned. The design of both the survey questionnaire and the interview guide is then explained.

(a) Measurement scales used in the construction of a survey questionnaire

Four types of measurement scales can be used when formulating survey questions. These scales are the nominal, ordinal, interval, and ratio measurement scales. The type of measurement scale that is selected for data collection often determines which statistical inference test should be used to analyse the gathered data (Pagano, 2004:1).

Nominal scales are widely applied in business research and entail systematically assigning numbers or symbols to events in order to label them (Cooper & Schindler, 2014:250; Kothari, 2004:71). Descriptive data are often measured with a nominal scale, with the data simply counting the number of occurrences for each category of a variable (Saunders *et al.*, 2009:418). Kothari (2004:71) and Pagano (2004:1) point out that the nominal scale is the weakest form of measurement, as it indicates no order or distance relationship between data, and only describes differences between data by assigning them to categories.

Ordinal scales include the characteristics of nominal scales and are further used to assign a rank order to data, based on how much of a certain characteristic they pose (Cooper & Schindler, 2014:252; Zikmund & Babin, 2010:298). It is important to note that although an ordinal scale places data in order, it does not make the intervals of the scale equal according to some rule. Therefore, it gives the researcher the ability to determine if data are less than or greater than other data in value, without giving an indication of how much lesser or greater (Cooper & Schindler, 2014:252; Kothari, 2004:71).

In the case of interval scales, the attributes of both nominal and ordinal scales are included, with the added characteristic of the equality of the intervals on the scale (Cooper & Schindler, 2014:253). In other words, interval scales capture relative quantities as distances between observations (Zikmund & Babin, 2010:300). However, interval scales have the main disadvantage of not having a true zero point, which implies that the scale cannot measure the absence of a specific characteristic or trait (Kothari, 2004:72).

Finally, ratio scales represent the highest form of measurement. These scales include all the properties of interval scales, while having the added benefit of being able to measure absolute values (Zikmund & Babin, 2010:300; Pagano, 2004:2). Another important characteristic, and one of the main differences from the other measurement scales, is the fact that ratio scales allow the researcher to express values in multiples of fractional parts, with the ratios being true ratios

(Walliman, 2011:76). This study employed both nominal and interval scales in the survey questionnaire. The survey questionnaire can be found in Appendix A.

(b) Survey questionnaire design

It is vital to design a survey questionnaire correctly, as the data provided by respondents are only as good as the questions being asked (Zikmund & Babin, 2010:336). A survey was conducted using a questionnaire that was based on one that was developed by Povaly (2006). The questionnaire was adapted to ensure its relevance, as well as adding questions that were needed to address specific factors of this study (in this case, the effect of B-BBEE on the decisions of private equity investors regarding exit timing and exit route). After the questionnaire was developed, it was converted into an electronic online format and emailed to potential respondents.

The questionnaire was divided into three main sections. Section A collected demographic information about the fund management firm and the respondent. Some of these questions included the name of the private equity firm, portfolio company information, funds under management, the job title and description of the respondent, the respondent's number of years of private equity experience, as well as the respondent's years of experience in doing business in Africa.

Section B of the questionnaire dealt with the factors that could affect exit timing. These factors were identified and discussed in Chapter Three Section 3.3.2 and 3.3.5. For each of these factors, between four and five statement were formulated to collect data about the possible impact of a specific factor on the exit timing. The statements were closed-ended, with a five-point Likert scale being used to quantify the responses. The scale ranged from 'strongly disagree' to 'strongly agree'. In total, 33 statements were given pertaining to exit timing. A 'not applicable' option was also included, as well as a final open-ended question where respondents could add any other factors or variables that they felt could have an impact on exit timing.

Section C was designed to collect data about factors that could have an effect on the type of exit route. In total, 30 questions regarding the exit route factors were formulated. These factors

were discussed in Chapter Three Sections 3.3.4 and 3.3.5. The design of this section of the questionnaire was identical to that of Section B.

(c) Interview guide design

An interview guide was compiled to conduct the semi-structured interviews. The questions in the interview guide were based on the data gathered from the survey questionnaire. More specifically, questions were asked about interesting trends that were observed in the survey data. The interview guide was divided into two main sections: Section A dealt with the biographical information of the interviewees, while Section B comprised 22 open-ended questions.

4.6 COLLECTING THE DATA

Data collection is the sixth stage in the research process (Table 4.1). It is the process of gathering or collecting primary data. The data collection stage starts once the sampling plan has been finalised (Zikmund & Babin, 2010:69).

It was stated in Section 4.3.3 that as part of the triangulation process followed in this study, data are collected in two stages. As part of the first phase, a survey was employed to collect data using an online survey questionnaire.

During the second phase of data collection, semi-structured interviews were conducted. As mentioned, these interviews were done with private equity firm experts who responded to the questionnaires as part of the first stage of data collection. The sample used for conducting the semi-structured interviews was discussed in Section 4.5.1.

4.7 ANALYSING THE DATA

The data analysis and/or processing is done by applying reason to make sense of the data that have been gathered (Zikmund & Babin, 2010:70). The data gathered by means of the survey

questionnaire were processed quantitatively by using descriptive statistics. It was not possible to conduct inferential statistics due to the low response rate achieved in the survey questionnaire. It must be noted that the initial research design had a quantitative focus, with the idea that additional qualitative data would be gathered by means of semi-structured interviews to validate the quantitative results. Given the inadequate response rate of 9.55 per cent (13 responses out of 136 individuals contacted), it was not possible to conduct an in-depth statistical analysis. Repeated attempts were made to contact potential respondents to achieve a higher response rate, with two rounds of follow-up emails and telephone calls. The data were also processed through qualitative methods to extract meaning from the responses obtained through the survey and structured interviews.

It was further thought that qualitative data analysis was more appropriate, as richer data could be obtained from the responses of the interviewees. This is in line with the phenomenological paradigm being adopted instead of a quantitative one, because of the richer data that could be gathered.

4.7.1 Data coding

Before statistical analyses can be conducted on gathered survey data, the data must be transformed into a form that can be analysed using these statistical processes. This stage of the data processing process is referred to as coding.

Coding begins once the fieldwork has been completed and the data have been gathered. It entails that meaningful categories and symbols be assigned to groups of responses. It is known as the process of interpreting, recording, categorising, and transferring the collected data to some form of storage media (Zikmund & Babin, 2010:70). In the present study, coding was conducted on the data that were gathered by means of the survey and assigning an acronym to each of the variables that was tested. These acronyms were then used as the basis of sorting the questions asked per variable during the data analysis stage.

The coding and analysis of the qualitative data that were collected with the semi-structured interviews are discussed in detail in Section 4.7.3.

4.7.2 Descriptive statistics

Descriptive statistics allow the researcher to describe and compare variables numerically (Saunders *et al.*, 2009:444). The authors also mention that two types of descriptive statistics exist, the first being measures of central tendency, and the second being measures of dispersion. Walliman (2011:170) also offers a definition of descriptive statistics, suggesting that it is a method of quantifying the characteristics of parametric numerical data in terms of how it is spread and where the centre is.

As mentioned earlier, descriptive statistics can either measure the degree of central tendency, or the degree of dispersion. Descriptive statistics that are measures of central tendency include the mode, the median, and the mean. The descriptive statistics that measure the degree of dispersion include the range, inter-quartile range, variance, the coefficient of variation, and the standard deviation (Cooper & Schindler, 2014:400; Saunders *et al.*, 2009:444).

The mode is determined by listing all possible values and counting the number of times each of them occurs (Zikmund & Babin, 2010:655). The median is the middle value of a dataset, and is found by ranking all values in ascending order and finding the mid-point of that distribution (Saunders *et al.*, 2009:444). The mean is simply the arithmetic average of a set of values. It is calculated by adding together all the values in the dataset, and then dividing the total by the number of values (Cooper & Schindler, 2014:400).

In this study, the mode was used as the main descriptive statistic, due to the low number of responses.

4.7.3 Qualitative data processing

During this stage of the data analysis process, common themes that emerged from the interviewees' responses were identified and investigated. Themes can typically emanate from either gathered primary data, or from a researcher's prior theoretical understanding of the phenomenon being investigated. However, themes are most often induced from empirical data, such as texts, images and sounds, as was the case in this study (Ryan & Bernard, 2003:88).

A number of steps were followed to analyse the qualitative data gathered from the semi-structured interviews. The interviews were conducted in person or telephonically, and were recorded. These recordings were then transcribed into text by professional transcribers.

The next stage of the data analysis process entailed the proofreading of the transcriptions and the marking or underlining of key phrases for each of the questions that were asked. This is in line with the methods for qualitative data analysis as recommended by Ryan and Bernard (2003:88). After all the transcriptions were marked and key phrases identified, the phrases were summarised in a single document on a question-by-question basis. Copies of the transcriptions are available from the researcher upon request.

Once the researcher had summarised the responses of the interviewees, several key themes emerged. A detailed discussion of the main themes is presented in Chapter Five Section 5.4.

4.8 REPORTING THE RESEARCH FINDINGS

The eighth and final step in the research process is the reporting of the research findings. A detailed discussion of the study's findings is presented in Chapter Five.

4.9 RESEARCH ETHICS, RELIABILITY AND VALIDITY

In the following section the relevant ethical considerations, and the importance of reliability and validity will be delineated. The sections will provide a theoretical background on the relevant topics, and will also explain how these concepts have been integrated into this study.

4.9.1 Research ethics

According to Cooper and Schindler (2014:28), ethics refers to the norms and standards of behaviour that guide an individual's moral choices about their own behaviour and their relationships with others. The authors mention that it is crucial that ethics are applied in the field of research so that no parties are adversely affected or harmed as a result of research activities.

The first ethical issue that was relevant to this study centred on whether or not respondents would need to provide informed consent. Informed consent is achieved when all the intended participants are fully informed about the nature, purpose and use of the research being conducted, as well as their role in the research (Saunders *et al.*, 2009:593, Zikmund & Babin, 2010:653). This study required respondents and interviewees to give informed consent.

The identities of the respondents were kept confidential. The data that were gathered from the survey and interview guide were also kept confidential and were protected from unauthorised access. Respondents were also free to answer only those questions that they were comfortable with.

To ensure that the researcher adhered to the ethical research standards required by Stellenbosch University, ethical clearance for this study was obtained from the Ethics Screening Committee of the Department of Business Management before data could be gathered by means of the survey and interviews.

4.9.2 Reliability and validity

Reliability is the degree to which a measure delivers a consistent result, while validity refers to the extent to which the measure that is used actually measures what the researcher wanted to measure. It is important to note that reliability is a necessary but not sufficient requirement for validity (Cooper & Schindler, 2014:257). Reliability therefore refers primarily to the repeatability or replicability of the results of a study (Golafshani, 2003:599).

Two different categories of validity exist, namely internal and external validity (Walliman, 2011:173). According to Zikmund and Babin (2010:274), internal validity describes to what extent the change in the independent variable(s) is truly responsible for the change observed in the dependent variable. It is a measure of control and sophistication in the design of the experiment (Walliman, 2011:173). External validity is concerned with whether the relationships found through the analysis of data gathered in an experiment can be generalised to the larger population (Abowitz & Toole, 2010:109). External validity is increased when the subjects of the study are highly representative of the whole population. A higher degree of external validity gives researchers the assurance that the results observed in an experiment will also be observed in the real world (Zikmund & Babin, 2010:277).

It was stated earlier that triangulation was used in this study to increase its reliability and validity. Triangulation increases reliability and validity by combining the strengths of different research methods and types of data, and is used for confirmation of results, as well as increasing the generalisability of the research findings (Golafshani, 2003:603).

4.10 SUMMARY AND CONCLUSIONS

In this chapter, business research was defined as a process of systematic inquiry to provide information to guide business decision-making. Thereafter, an eight-step research process was presented and contextualised to the study at hand.

As part of the first and second stages, the research problem and the research objectives were identified. The research problem was stated as investigating the factors influencing the exit decisions of South African private equity investors who invest in Africa.

The chapter explained the study's use of both the positivistic and phenomenological research methodologies as part of the research design, to improve reliability and validity. The study was classified as being descriptive, exploratory, and explanatory. The research was deductive in nature. The specific research design was based on the process of triangulation, which entails that both qualitative and quantitative research methods are used to gain deeper insights into the research results.

The theory underlying the secondary research was explained. Thereafter, the focus moved to primary research. The population was identified as the 136 private equity firms and related industry participants who were members of the SAVCA on 31 December 2014. The appropriate sampling methods were then determined as being non-probabilistic in nature, with convenience and judgement sampling being used in this study.

The design of the research instruments used in the study was furthermore discussed, along with the theory underlying the different measurement scales. The measurement scales applicable to this study were mainly nominal and interval scales. To collect quantitative data, a survey questionnaire was designed. The questionnaire was based on a questionnaire employed by Povaly (2006), with adjustments being made to make it relevant to the local private equity market. Questions relating to the effect of B-BBEE on the exit decisions of investors were also

included. An interview guide was designed to gather data as part of the semi-structured interview process. The questions in the interview guide were based on the responses from the survey questionnaire.

The data processing methods used in the study were then outlined. Descriptive statistics were used for quantitative data, whereas the qualitative data were processed by the identification of central themes in the transcribed interviews.

Finally, a section was included on the reliability and validity of the study, as well as the ethical issues considered in the study. The reliability and validity were improved by the use of a triangulation process.

The empirical results of the study are discussed in the next chapter.

CHAPTER FIVE

EMPIRICAL RESULTS

5.1 INTRODUCTION

In this chapter the main themes that emerged from the survey questionnaire and the semi-structured interviews will be discussed. The results of the survey questionnaire are presented first, followed by a description of the sample used for the semi-structured interviews. Thereafter, the responses of the interviewees who participated in the study are provided. Finally, some pertinent conclusions are drawn from the results, which are compared to the literature throughout the chapter.

5.2 EMPIRICAL RESULTS OF THE SURVEY QUESTIONNAIRE

As explained in Chapter Four Section 4.6, an online survey questionnaire was distributed to a sample of private equity professionals to gain insight into the variables that could influence the exit timing and the exit route decisions of private equity investors. The results of the survey questionnaire were used to formulate the open-ended questions that were posed to private equity experts during the semi-structured interviews. This process was followed to gain a deeper understanding of the phenomenon under investigation.

5.2.1 Exit timing factors

The quantitative results of the survey questionnaire relating to the factors that may affect the exit timing decisions are presented in Table 5.1. This table sets out the median per question, as well as the standard deviation. The median was used, as it was felt that this was the most appropriate measure given the small sample size. For each question, thirteen (13) responses were received. The factors are ranked in order of importance.

Table 5.1 Factors affecting exit timing decisions (N=13)

1. Performance requirements for the overall fund			
#	**Statement**	**Median**	**SD**
2.2	It is time to exit when the fund performance is below the required level in the long term.	2.5	1.11
2.5	It is time to exit when *fund managers* can receive maximum compensation measured against contractually agreed levels of the internal rate of return or times-money ratio.	2.5	0.94
2.15	Exit timing is important to deliver maximum returns to investors.	4.0	0.84
2.16	Meeting fund performance requirements is important for future fundraising.	4.5	0.43
2. Investment duration limits			
#	**Statement**	**Median**	**SD**
2.12	It is time to exit when offers or intentions to purchase a portfolio company are received.	3.5	0.74
2.20	Fund managers seek to add value to investments in the shortest time possible.	4.0	0.58
2.21	Portfolio companies are sold before the end of the fund lifespan to free up resources for other investments.	2.0	0.72
2.22	In my firm, there are policies enforcing certain investment duration limits on individual investments.	3.0	1.33
2.33	Individual investments have shorter lifespans than that of the overall fund.	4.0	0.72
3. Monitoring requirements for the portfolio company			
#	**Statement**	**Median**	**SD**
2.1	It is time to exit when value is no longer being added to the portfolio company.	3.5	0.89
2.14	Adding value to a portfolio company is measured against the cost of monitoring the value adding process in my firm.	2.5	1.05
2.29	As a result of insufficient time on the part of fund managers, the costs associated with the monitoring of portfolio companies increase.	3.0	0.71
2.30	As a result of insufficient management skill, the costs associated with the monitoring of portfolio companies increase.	3.5	0.92
4. Performance requirements for individual investments			
#	**Statement**	**Median**	**SD**
2.3	It is time to exit when *portfolio company managers* can receive maximum compensation measured against contractually agreed levels of the internal rate of return.	2.5	1.02
2.4	It is time to exit when *portfolio company managers* can receive maximum compensation measured against a contractually agreed times-money ratio.	2.5	0.94
2.6	It is time to exit when individual investments in a fund do not meet requirements.	3.5	0.83
2.17	Investors expect individual investments in a fund to meet performance requirements.	3.5	0.88
2.18	The compensation of portfolio company managers is an important incentive for achieving the required individual investment performance.	3.5	0.92
2.19	Exits are timed so that portfolio company managers can receive maximum compensation.	3.0	0.82

No responses to the open-ended questions regarding further factors that could influence exit timing were received.

The variables that could have an impact on the exit timing were defined and explained in Chapter Three Section 3.3.2(a)-(e). The respondents' views pertaining to these variables are discussed next:

Firstly, performance requirements for the overall fund were defined as an exit timing variable. Respondents stated that long-term underperformance of the overall fund was not a reason to exit the fund. This response seemed counter-intuitive, and was subsequently used as a question in the interview guide. Respondents were also mostly indifferent on the question whether fund manager compensation was linked to fund performance against certain performance metrics and if manager compensation affected exit timing. This finding thus calls for further investigation, as literature suggests that manager compensation could have an impact on exit timing (Fenn *et al.*, 1997:50). Respondents strongly agreed that exit timing was important to yield maximum returns to investors and that meeting fund performance requirements had an impact on future fundraising. These two findings concur with the predictions of Povaly (2006:260) and Gompers (1996) as reported in the literature review. These responses were used as a basis for questions asked in the interviews to confirm these results.

Secondly, investment duration limits were considered an exit timing factor. Respondents agreed that exits were considered when intentions to purchase the portfolio company were received from a potential buyer. They also concurred that fund managers strived to add value to portfolio companies in the shortest time possible. This finding is in line with the predictions of Gompers and Lerner (1999). Respondents disagreed that portfolio companies were sold before the end of the life of the fund to free up resources for other investments. This response is in contrast to the predictions by Gompers and Lerner (1999) and Wall and Smith (1996:5) that portfolio companies are sold to free up resources for investment in new portfolio companies. Respondents agreed that there were often policies enforcing certain investment duration limits, and also agreed that investments were often held for a shorter period than the entire life of the fund. These two findings confirm those of Povaly (2006:261).

Thirdly, monitoring cost and monitoring requirements for the portfolio company was a factor that only related to the exit timing. The respondents generally agreed that it was time to exit a private equity investment when value was no longer being added to the portfolio company. This finding is in line with the predictions of Povaly (2006:259). In the context of the present study, 'value' refers to the value of the portfolio company, as determined by valuation methods such as discounted cash flow valuation and valuation through comparable public company

analysis. However, the respondents did not agree that value adding should be measured against the cost of monitoring the investment in the portfolio company. This response was used as the basis for a question in the interview guide, as it contradicted the literature which reports that value adding is indeed measured against monitoring cost (Cumming & MacIntosh, 2003).

Finally, the performance requirements for individual investments were defined as an exit timing variable. Respondents agreed that management compensation in the form of bonuses did incentivise portfolio company managers to add value to portfolio companies. The respondents also agreed that it was time to exit when individual portfolio companies were underperforming. This result is in contrast to the earlier response that fund managers would not exit the entire fund when the overall fund was underperforming in the long run. It can be deduced from the last finding that they would rather exit individual underperforming investments than exiting the whole fund.

5.2.2 Exit route factors

The quantitative results of the survey questionnaire regarding the factors influencing exit route decisions are presented in Table 5.2. These factors were also ranked in order of importance, according to the ranking process described in the previous section.

Table 5.2 Factors affecting exit route decisions (N=13)

1. Certainty of execution			
#	**Question/Statement**	**Median**	**SD**
3.3	The choice of an exit route depends on the certainty of executing the proposed exit route.	4.0	0.58
3.4	Changing conditions in public *debt* markets affect the certainty of execution.	3.5	0.76
3.5	Changing conditions in public *equity* markets affect the certainty of execution.	4.0	0.55
3.6	The possibility of dual or multi-track exit routes increases the certainty of execution.	4.0	0.68
2. The industry-specific merger-and-acquisition market			
#	**Statement**	**Median**	**SD**
2.27	The stage in the industry life cycle (developing industry; mature industry; declining industry) has an impact on whether an exit will be considered.	3.5	0.92
2.28	If many mergers and acquisitions are taking place in a specific industry, it is more likely that an exit will be considered.	4.0	0.64
3.8	The exit route that is most prevalent in the industry in which the portfolio company operates will be used.	3.5	0.84
3.26	The conditions in an industry's merger-and-acquisition market have an effect on the extent of financing available for private equity transactions.	4.0	0.55
3. The size of the portfolio company (N=13)			
#	**Statement**	**Median**	**SD**
3.1	Asymmetric information is more prevalent in smaller portfolio companies. Asymmetric information refers to a situation where one party has more or better information than the other, thus creating an imbalance of power in transactions.	4.0	0.62
3.2	Regulatory requirements relating to firm size limit the number of exit routes available to private equity investors.	3.5	1.08
3.9	A higher degree of asymmetric information due to smaller portfolio company size limits the number of available exit routes.	3.0	0.62
3.10	Investments in large portfolio companies will generally be exited by means of IPOs.	3.0	1.13
4. Transaction cost			
#	**Statement**	**Median**	**SD**
3.7	Fund managers favour exit routes with lower transaction costs.	3.5	0.92
3.11	It is more expensive to exit investments in larger portfolio companies.	3.5	1.02
3.12	There is a negative relationship between transaction cost and exit performance.	2.0	0.64
3.13	Exits in Africa are more expensive than in other emerging markets.	3.0	0.7

Firstly, certainty of execution was an important exit route variable. In the case of statements relating to this factor, respondents mostly agreed that the choice of exit route depended on the certainty of execution, that changing conditions in the public debt and equity markets affected the certainty of execution, and that dual or multi-track exit routes increased the certainty of execution. All these responses correspond with what was predicted by Povaly (2006:269), and Lerner *et al.* (2003).

The second variable that was identified as an exit route factor was the industry-specific merger-and-acquisition (M&A) market. Respondents agreed that the industry and portfolio company life cycle stage had an impact on whether an exit would be considered, and that it was likely that an exit would be considered if many M&As were taking place in a particular industry. They further agreed that the exit route most prevalent in a certain industry would most likely be used in future exits. Finally, respondents agreed that the conditions in an industry's M&A market had an effect on the extent of financing available for future deals. This result was the basis of an interview question to gain more insight into the effect of the M&A market on exit route decisions.

Thirdly, the size of the portfolio company was identified as an exit route factor. Respondents agreed that asymmetric information was more prevalent in smaller portfolio companies than larger companies. This response was reported in the literature by Cumming and MacIntosh (2003). The respondents were largely indifferent about the statement that stock exchange listing requirements regarding firm size (especially in the case of IPOs) had an impact on the exit route that was used. They were also impartial on the statement that asymmetric information in smaller firms limited the number of exit route options. The respondents were also mostly impartial on the statement that exits for larger firms were mostly done by means of IPOs.

Finally, transaction cost was regarded as an exit route variable. Respondents preferred the least expensive exit route, and indicated that it was more expensive to exit investments in larger portfolio companies. However, they did not agree that there was a positive relationship between transaction cost and exit performance. A statement about the impact of transaction cost on the exit route and exit timing was asked during the interviews. The respondents were indifferent when asked if exits were more expensive in Africa than in other markets. Their indifference could be due to the fact that fund managers did not have experience with exits in markets other than Africa. The responses to the questions regarding transaction cost constitute new research, and could thus not be compared to the literature (Povaly, 2006:269; Wall & Smith, 1997:8), which merely refers to transaction cost as a consideration when exit routes are deliberated.

5.2.3 Factors that affect both exit timing and exit route

The quantitative results of the survey questionnaire regarding the factors influencing exit route decisions are presented in Table 5.3. These factors were also ranked in order of importance, according to the ranking process described at the beginning of Section 5.2.1.

Table 5.3 Factors that affect both exit timing and exit route decisions

1. Fundraising requirements (N=13)			
#	**Question/Statement**	**Median**	**SD**
2.31	When an exit delivers maximum performance, the fund manager develops a good reputation.	4.0	0.63
2.32	A good reputation makes future fundraising easier.	4.5	0.42
3.19	There is a positive relationship between current fund performance and the success of fundraising for future funds.	4.5	0.49
3.20	Young private equity firms will make use of more risky exit routes in the hope that superior exit performance is achieved so that future fundraising requirements are met.	3.0	0.72
3.21	In the case of IPOs, private equity firms will tend to underprice the issue to achieve substantial growth in the market once the shares start trading.	3.0	0.57
2. The state of the public equity and debt markets (N=13)			
#	**Question/Statement**	**Median**	**SD**
2.7	An exit will be considered when conditions in public *debt* markets are optimal (i.e. when markets are performing well).	3.5	0.75
2.8	An exit will be considered when conditions in public *equity* markets are optimal (i.e. when markets are performing well).	3.5	0.9
2.13	An exit will be considered when macro issues arise, forcing a deviation from initial exit planning. Macro issues could be of an economic, political, social or technological nature.	4.0	0.57
2.23	Managers will delay an exit if conditions in the public equity market are sub-optimal (i.e. when the market performs poorly).	3.5	0.76
3.15	Managers will consider exit routes other than IPOs if conditions in public equity markets are sub-optimal.	4.0	0.41
3. The capacity of the portfolio company's executive management (N=13)			
#	**Question/Statement**	**Median**	**SD**
2.11	It is time to exit when portfolio company managers are underperforming.	2.5	0.72
3.23	The management capacity of the managers of the portfolio company has an effect on the exit process.	4.0	0.53
3.24	Portfolio company managers are intimately involved in the execution of the exit process.	4.0	0.53
3.25	When a portfolio company performs poorly due to a lack of skill on the part of portfolio company management, the particular management team is likely to be replaced.	4.0	0.58
4. Portfolio company performance (N=13)			
#	**Question/Statement**	**Median**	**SD**
2.24	Expected future portfolio company performance is an important consideration where exit timing is concerned.	4.0	0.63
3.16	Expected future portfolio company performance is a key decision factor when an exit route is chosen.	4.0	0.77

3.17	IPOs are generally used as exit routes in the case of high-growth portfolio companies.	3.0	0.65
3.18	Exit routes other than IPOs are used in the case of portfolio companies that exhibit stable growth.	3.0	0.62
5. B-BBEE legislation (N=13)			
#	**Question/Statement**	**Median**	**SD**
3.27	B-BBEE is an important consideration when exits are planned in the South African context.	3.5	0.9
3.28	B-BBEE legislation makes it more likely that multiple exit routes will be considered when portfolio companies are domiciled in South Africa.	3.5	0.87
3.29	Exits that are affected by B-BBEE legislation are more expensive than exits that are not.	3.0	0.64
3.30	B-BBEE legislation adversely affects exit performance.	3.0	0.6
6. The capacity of private equity professionals (N=13)			
#	**Question/Statement**	**Median**	**SD**
2.9	It is time to exit when resources in terms of time become scarce.	3.0	0.92
2.10	It is time to exit when resources in terms of management skills become scarce.	3.0	0.8
2.25	The monitoring of investments is the main drain on the *time* of fund managers.	3.5	0.8
2.26	The monitoring of investments is taxing on the *skill* of fund managers.	2.5	1
3.22	Parts of the exit planning process may be outsourced if the management capacity of the fund managers is exceeded.	3.5	0.89

No responses to the open-ended questions regarding further factors that could influence exit timing as well as exit route were received.

In Chapter Three Section 3.3.5(a)-(h) the factors were identified that could have an effect on both the exit timing and exit route decisions of private equity investors. These factors are discussed next.

The first exit route and exit timing factor identified was fundraising requirements. Respondents agreed that when an exit delivered maximum performance, the fund manager gained a sound reputation, and that a sound reputation made future fundraising easier. This finding is supported by the literature (Gompers, 1996), which stated that exits that perform well would have a positive impact on the fundraising ability of private equity fund managers. The respondents also agreed that current fund performance had an impact on the success of future fundraising. Respondents were indifferent on the question that stated that young private equity firms would use more risky exit routes in the hope of superior exit performance so that they could gain a good reputation, and in the end, secure future fundraising. They were impartial when asked whether fund managers would deliberately under-price an IPO issue to gain superior exit returns.

Secondly, the state of public equity and debt markets was defined as both an exit timing and exit route factor. Respondents agreed that it was time to exit a private equity investment when public equity and debt markets were performing well, and conversely, that they would delay an exit if these markets were performing poorly. They also agreed that changes in the macro-environment could affect exit timing and that IPOs would be less likely to be considered if public market conditions were less than optimal. All these responses support the findings made by Povaly (2006:266), Nahata (2004) and Diamond (1993) in the literature review, namely that the state of public equity and debt markets is an exit decision factor.

Thirdly, the capacity of the portfolio company's executive management was an exit route and exit timing factor. Respondents disagreed that it was time to exit when portfolio company managers were underperforming. This finding formed the basis of a question asked during the interviews. They agreed that the management capacity of portfolio company managers had an impact on the exit process, and agreed that portfolio company managers were intimately involved in the exit process. These findings are supported by Povaly (2006:269) and Wall and Smith (1997:15), who found that portfolio company managers should be committed to the exit process for it to be successful. Respondents further agreed that the portfolio company managers were likely to be replaced if a portfolio company was performing poorly.

A fourth factor that was identified as both an exit route and exit timing variable, was portfolio company performance. Respondents agreed that expected portfolio company performance affected both exit timing and exit route. This finding is in line with the literature, which predicted that portfolio company performance would have an impact on the exit process (Povaly, 2006:268; Wall & Smith, 1997:12). It was also mentioned in the literature that the expected future performance of the portfolio company was particularly important when an exit was considered (Nahata, 2004; Cumming & MacIntosh, 2001). The respondents disagreed that IPOs were generally used as an exit route in the case of high-growth companies, and that routes other than IPOs would be used in the case of stable-growth companies. Both these findings are interesting, as it seemed to contradict literature, which reported that IPOs were more likely to be considered for high-growth portfolio companies. The literature also predicted that routes such as trade sales and secondary sales would more likely be used for portfolio companies showing stable growth (Povaly, 2006:268).

Fifthly, B-BBEE legislation was considered both an exit route and exit timing variable. Respondents agreed that Broad-based Black Economic Empowerment (B-BBEE) was an

important consideration when exits were planned in the South African context. They were indifferent as to whether multiple exit routes would be considered in the case of an exit that had a B-BBEE element. They were also impartial when asked whether B-BBEE made exits more expensive, and being indifferent when asked if B-BBEE adversely affected exit performance. Owing to the small sample size, it was important to further explore the effects of B-BBEE during the interview stage, and in doing so, a question relating to the effects of B-BBEE on exit decisions was asked.

Finally, the capacity of private equity professionals was identified both an exit route and exit timing factor. Respondents disagreed that it was time to exit a private equity investment when resources such as time and management skills became scarce. This finding formed the basis of a question posed to interviewees, to gain a clearer understanding of this result. The respondents were indifferent when asked if the monitoring of investments was the so-called 'main drain' on the time and skills of managers. Respondents agreed that parts of the exit process could be outsourced when the management capacity of fund managers were exceeded. This response is supported by Wall and Smith (1997:20), who notes that it is possible to outsource some parts of the exit process.

In the preceding sections, the results of the survey questionnaire were discussed. Some of these results were contrary to what was predicted in the literature in Chapter Three by researchers such as Povaly (2006), Wall and Smith (1997), Cumming and MacIntosh (2001), Nahata (2004) and Diamond (1993). It was therefore important to conduct primary qualitative research to gain more insight into the factors that may influence the exit decisions of private equity investors. The results of the survey questionnaire that were discussed formed the basis of the questions that were asked in the semi-structured interviews. In the next section, the characteristics of the private equity experts who participated in the semi-structured interviews will be discussed.

5.3 SAMPLE CHARACTERISTICS OF THE SEMI-STRUCTURED INTERVIEWS

The sample for the semi-structured interviews consisted of eight fund managers and one private equity industry consultant. As mentioned in Chapter Four Section 4.5.1, these experts were

drawn from the individuals who responded to the survey questionnaire. Throughout this chapter and subsequent chapters reference will be made to Interviewee A to Interviewee H.

Biographic details of the interviewees are presented in Table 5.4. Some of them were not in a position to provide detailed fund information for confidentiality reasons. However, from the information in Table 5.4, it is apparent that all interviewees were experienced investment professionals, including current and former fund and portfolio company CEOs, each with a number of years of experience in the African private equity industry. All interviewees were male. The information in Table 5.4 indicates that the sample was very diverse in terms of the size of the funds, as well as the number of portfolio companies invested in. The same applies to the percentage of ownership stake held in each portfolio company.

Table 5.4 Interviewee characteristics

Interviewee	A	B	C	D[a]	E	F	G	H
Number of portfolio companies invested in	7	5	40	N/A	12	34	9	5
Average percentage ownership held per portfolio company	100	70	N/A	N/A	30	Between 25 and 90	30	39
Average amount invested per portfolio company	N/A	R315m	N/A	N/A	R35m	R5m to R100m	R18m	R120m
Approximate funds under management by your firm	R480m	R579bn	R152bn	N/A	R1.5bn	R750m	R150m	R1bn
Approximate funds invested in Africa (excluding South Africa) by your firm	R480m	R5bn	N/A	N/A	R0[b]	R19m	N/A	R50m
Approximate funds invested in South Africa by your firm	R0	R500bn	N/A	N/A	R1.25bn	R731m	N/A	R950m
Approximate funds under management under your personal care	N/A	R2.5bn	N/A	N/A	N/A	R165m	N/A	R1bn
Job title/description	Head of research	Principal	Associate principal	Head of research	Principal	Senior dealmaker	Investment executive	CEO
Years of private equity experience	5 ≤ 10	21 ≤ 30	5 ≤ 10	11 ≤ 15	5 ≤ 10	16 ≤ 20	5 ≤ 10	22
Years of work experience doing deals with African portfolio companies	5 ≤ 10	11 ≤ 15	5 ≤ 10	11 ≤ 15	5 ≤ 10	N/A	5 ≤ 10	12

[a] Interviewee D was an industry consultant and not a fund manager, therefore no fund data could be reported

[b] Interviewee E's fund attempted investments in Africa, but most of these investments failed. Thus, at the time of the interviews, they did not have any funds that directly invested in Africa (outside of South Africa), but might consider investing on the continent again if an opportunity arose

5.4 MAJOR THEMES IDENTIFIED IN THE QUALITATIVE DATA

Several themes emerged from the responses of the interviewees regarding factors that could influence exit timing and exit route decisions. These themes included conditions in the M&A and public debt and equity markets; the importance of the exit price; the size of the portfolio company; factors that could shorten the holding period of private equity investments; factors that could extend the holding period of private equity investments; certainty of execution; the performance of individual investments and the overall fund; Africa-specific factors that could have an impact on exit decisions; and value creation in portfolio companies. As some responses did not fit into any of these major themes, they were discussed separately.

5.4.1 Conditions in the M&A and public equity and debt markets

Market conditions emerged as a theme mentioned by most participants as being an important driver of the exit decisions of private equity investors. In this study's context, market conditions refer to both the conditions in public equity and debt markets and conditions in the mergers-and-acquisitions (M&A) market in a portfolio company's specific industry.

Participants were asked if the state of public debt and equity markets would have an effect on their exit timing and exit route decisions. All eight interviewees agreed that the state of public markets was a key factor when exit decisions were made, both in terms of exit timing and exit route. This response was expected based on the literature review, in which Povaly (2006), Nahata (2004), and Diamond (1993) all concur that the state of public debt and equity markets would have an impact on the exit decisions of private equity investors.

According to Interviewees B and E, the state of public debt and equity markets had an effect on liquidity and deal flow, and the demand by potential buyers for exit transactions. Favourable conditions in financial markets also increased execution certainty, with exits potentially being brought forward if there were high demand due to market conditions. The main themes of 'execution certainty' and 'factors that may shorten the holding period of private equity investments' are discussed in more detail in Sections 5.4.4 and 5.4.6 of this chapter. Participant G also said that there would be a greater likelihood of exits if markets were performing well, and that exit prices were likely to be higher than when markets were performing poorly.

Three interviewees noted that financial markets were important in an exit context, as public companies were often used as valuation benchmarks when private companies were valued before an exit. Further, the state of these markets was cited as an important factor related to potential buyers' ability to raise the funds necessary to buy a portfolio company. Interviewee D noted that market conditions could also have an impact on the exit route, as IPOs would be less likely if markets were performing poorly.

According to Povaly (2006), previous researchers found that conditions in the public equity market would determine whether an exit was made earlier or was deferred. It was also suggested that conditions in the debt market influenced the exit route, with investors likely to wait to exit until they could get the cheapest debt to finance an exit transaction (Nahata, 2004; Diamond, 1993). The responses from the interviewees regarding the conditions in public equity and debt markets were thus in line with the extant literature.

The interviewees were asked whether they would base their exit timing and route decisions on the state of the M&A market in the industry of the portfolio company.

According to Interviewee A, an exit would be more likely in an active M&A market, and would make use of the most prevalent exit route in that market because it would be easiest to execute the deal. In contrast, Interviewee B would not exit simply because the M&A market was active, but would rather wait for the right opportunity to exit. According to Interviewee C, they would also be more likely to consider an exit in a busy M&A market, but would, however, hold on to the investment until they could get the best exit price. Interviewee C added, along with Participant D, that they would probably use the exit route that generated the best price and that had the highest degree of exit certainty.

It must be noted that even in the responses related to market conditions, the themes of 'execution certainty' and 'the importance of exit price' also emerged. These themes are discussed in more detail in subsequent sections of this chapter. Interviewees D and H also provided a reason why they would be likely to exit in an active M&A market, arguing that in an active M&A market, valuations were likely to be higher. They further mentioned that there would be more demand for the portfolio company being sold.

Povaly (2006:267) postulated that conditions in a portfolio company's M&A market would have an impact on the exit route chosen by fund managers. The responses of the interviewees were found to be in line with this prediction. In addition to having an effect on exit route

decisions, it was also clear from the interviewees' responses that conditions in the M&A market would also have an effect on the exit timing.

5.4.2 The importance of exit price

A common thread through all the responses was the maximisation of the exit price. From the responses it became apparent that private equity fund managers would generally time an exit and choose an exit route so that they could make the most profit and achieve the highest sales price for a portfolio company.

Achieving the maximum exit price first emerged as a theme when interviewees were asked to comment on the importance of the reputation of a private equity fund manager pertaining to future fundraising. In the literature review, Gompers (1996) emphasised that a fund manager's reputation was derived from achieving a good exit performance, and that a sound fund manager reputation was critical to ensure future fundraising. All the interviewees agreed that fund manager reputation was critical to future fundraising. They also mentioned that a number of factors could have an impact on fund manager reputation, one of the most important being the maximisation of exit price.

According to all the interviewees, the major drivers of fund manager reputation were fund performance and the fund manager's track record, along with being able to deploy capital and to exit on time. Interviewee F expanded on this notion by stating that fund manager reputation was also based on managing the fund well and within an agreed time, generating good returns, managing the fund capably, and adding value to portfolio companies. Interviewee H also added to this list by stating: "Reputation is everything. Reputation of being ethical, reputation of being consistent, reputation of being true to promises, reputation of executing, and reputation of acting in away, in a fashion that investors can relate to". The value adding process is discussed in more detail in Section 5.4.9 of this chapter.

As mentioned earlier, most interviewees agreed that the key factor influencing a fund manager's reputation was overall fund returns, which was ultimately driven by the final exit price of each of the individual portfolio companies. This finding once again highlights the importance of achieving the maximum exit price.

The theme of 'the importance of exit price' from the portfolio company also emerged when interviewees were asked how important exit timing was to create maximum exit price. All interviewees agreed that exit timing was vital to achieve the maximum price.

Most interviewees were of the opinion that a fund manager would want to add value to a portfolio company as quickly as possible and then exit. This is because the internal rate of return (IRR) (one of the two main measurements of performance in private equity; the other being the times-money multiple) is influenced by the length of time the portfolio company is held. The shorter the holding period, the higher the IRR will be. This finding coincides with the theory of the time value of money, which asserts that money that is available at present is more valuable than the same amount in the future due to its potential earning capacity. This theory is based on the assumption that the present amount of money can earn interest, meaning that any amount of money is worth more the sooner it is received (Damodaran, 2013).

Interviewee F stated that the only reason a fund manager would hold on to a portfolio company for an extended period of time was when they expected to generate substantially higher returns in the long term than in the short term. In his own words: "You must not only get a little bit more in the longer term, you must get a big amount more". This response links to the themes of 'factors that may shorten the holding period of private equity investments' and 'factors that may extend the holding period of private equity investments'. These two themes are explained in more detail in subsequent sections of this chapter.

The importance of exit timing was emphasised by Interviewee C who cautioned that a fund manager should not exit too early, and then fail to generate the maximum IRR as it may lead to the fund manager not achieving the maximum exit price. Exiting too early is a particular concern in some industries (for instance pharmaceuticals), as it can take a long time for the money spent on research and development to generate returns. However, investors should also not wait too long to exit, because then there would be no growth potential left in the portfolio company and the fund manager would not be able to negotiate a good price for the portfolio company when exiting. This response implies that investors should not wait until the portfolio company is in the decline phase of its company life cycle.

When asked what they considered to be the key driver of a fund manager's exit timing decision, most of the interviewees responded that it was the exit price. They would therefore time an exit to achieve the best returns whilst obtaining the maximum price at the time of exit. Interviewee A highlighted the importance of the exit price by stating that "exit price is the ultimate factor determining the success of the underlying investment".

A number of other factors were also mentioned. According to Interviewee B, investors preferred to time their exit in such a way that they could sell all portfolio companies at the same time, to avoid being stuck with investments by the end of the fund life. Interviewee C added that exit timing was based on the value that was created in the portfolio company as well as the future growth outlook of the portfolio company. Interviewees E and H noted that a fund manager would exit when they could receive maximum value for the portfolio company and when the ability to add value was exhausted.

Interviewee F said that the state of the general economy and particularly the conditions in a portfolio company's industry had a considerable impact on the timing decision. If the industry were doing well, there would be more buyers and growth opportunities for portfolio companies.

Interviewees were asked what they believed to be the single biggest factor influencing the exit route decisions of private equity fund managers. Once again, as with exit timing, the biggest driver seemed to be the exit price.

Apart from choosing an exit route that would deliver the maximum exit price, the exit route that offered the most certainty of execution was likely to be chosen, according to Interviewees C and G. Interviewees E, F and H considered the size and the life cycle stage of the portfolio company to be the biggest drivers of exit route decisions. Interviewee H added that the choice of exit route was industry and company-specific, and that a portfolio company's future prospects and growth potential also played a role in exit route decisions.

Although the maximum exit price seemed to be a significant theme and driver of exit timing and exit route decisions, it was not directly identified in theory or literature as one of the major factors influencing exit decisions. It is therefore an interesting finding that exit price appears to have such a large impact on private equity investors' exit decisions.

5.4.3 Portfolio company size

The theme of 'portfolio company size' emerged in a number of interviewees' responses. Portfolio company size (as determined by discounted cash flow valuation and comparative public company analysis) was found to be relevant when considering B-BBEE, as portfolio company size imposed certain legislative requirements and restrictions on private equity fund

managers, which could affect their exit decisions. The concept of B-BBEE is discussed in more detail in Section 5.4.8.

A central theme that emerged was the impact that portfolio company size had on the choice of exit route. Most interviewees mentioned that portfolio company size could either increase or limit the possible number of exit routes available to a fund manager should they want to exit. As indicated in the literature review, smaller portfolio companies often have a more limited number of exit routes than larger ones (Povaly, 2006:267). Almost all interviewees mentioned that small portfolio companies were unlikely to be listed through an IPO, whereas listing became more likely the larger the portfolio company was. In fact, in the case of large portfolio companies, listing became the only exit route option. Interviewees A, C and F stated that small portfolio companies were usually exited by means of trade sales or management buyouts, owing to the fact that a listing would be too complex and costly.

The theme of portfolio company size was further made clear when interviewees stated that some companies were probably too small to be listed. Interviewees were asked whether high-growth portfolio companies were more likely to be exited through IPOs, and that more mature portfolio companies would be exited through exit routes other than IPOs. This question was based on the theory by Povaly (2006:268). All interviewees, except Interviewee B, agreed that this would probably be the case.

According to Interviewee B, the statement that more mature portfolio companies were more likely to be exited through IPOs did not hold true in the African context. He contended that this was the result of a lack of liquidity in public equity markets, especially those outside South Africa: “I think that’s the major differentiator [between African and European private equity markets]. We do not have the levels of liquidity or scale that European markets have”. Therefore it can be deduced that, in the African context, exit routes other than IPOs would likely be used. This finding was expected, as it has been shown in the literature review that Africa lacks developed and liquid public equity markets (United Nations, 2014:2).

Those interviewees who agreed with the theory provided a number of reasons for agreeing, as well as why there could be exceptions to the rule. It must first be demonstrated that the portfolio company being considered for listing is a high-growth company. According to Interviewee C, portfolio company size could be an issue when a listing was considered, as certain high-growth companies were too small to be listed. Interviewee D concurred with this observation, stating that listings were less likely in Africa (compared to Europe and the United States) because of portfolio company size constraints. Buyers would be more likely to buy into a company with

growth potential when listed through an IPO, while portfolio companies demonstrating stable growth would more likely be sold through trade sales to strategic buyers (Interviewee E). High-growth companies needed the cash infusion generated by an IPO to sustain further growth, while it was easier to integrate stable and mature portfolio companies into existing structures within the buying company (Interviewee H).

When asked what exit route they used most often in the African context, portfolio company size was mentioned once again. Almost all the interviewees stated that the most prevalent exit routes used were trade sales or secondary sales to strategic players or other companies in the same industry as the portfolio company. Management buyouts were also used in some cases. The size of the portfolio companies again played a role in the exit route decisions of fund managers, with most stating that they would consider IPOs if the portfolio company were of an optimal size.

Finally, the theme of portfolio company size once again emerged when the interviewees were asked what the most important driver of an exit route choice was. Three interviewees considered portfolio company size and the life cycle stage of the portfolio company to be the most important drivers of exit route decisions. Interviewee H further argued that the choice of exit route is industry and company-specific, and that a portfolio company's future prospects and growth potential also played a role. It can therefore be concluded that the size of the portfolio company had an effect on the exit route choice of private equity fund managers.

The literature presented in Chapter Three Section 3.3.4(b) that portfolio company size is a driver of exit route decisions is thus supported by the interviewees' responses. Furthermore, these findings are in line with previous studies showing that portfolio company size affects the number of exit routes, with larger portfolio companies having more exit route options than smaller portfolio companies (Povaly, 2006:267).

5.4.4 Factors that may shorten the holding period of private equity investments

A theme that emerged from the qualitative data analysis was that exits would be timed so that the investment is held for the shortest time possible. This theme first appeared when interviewees were asked if investments were exited before the end of the life of the fund. The average life of a private equity fund is believed to be between seven and ten years. All interviewees agreed that they would do so. They provided a number of reasons for this.

Interviewees A and D mentioned that waiting until the end of the life of the fund to exit left private equity fund managers in a weaker bargaining position, which in turn could lead to not achieving the maximum exit price. According to Interviewee B, a fund manager would like to start distributing capital back to investors as soon as possible, which made it necessary to exit investments before the end of the life of the fund. Interviewees E and F mentioned that according to the initial agreement with investors, all capital should be returned to investors by the end of the life of the fund. Should this not be the case, the fund manager had to extend the fund, which would have negative implications for the reputation of the fund manager. Interviewee F stated: "If the life of the fund is ten years, the agreement is that you must have given back all the capital back to investors by the end of the fund life".

Interviewee H stated that it was necessary to exit before the end of the life of the fund, to demonstrate to investors that the fund manager was able to realise profits and returns. The ability to be able to realise profits and returns had a reputational effect, with fund manager reputation being important for future fundraising. He further said that an exit before the end of the life of the fund became more likely if an unsolicited bid for a portfolio company was received. A number of interviewees also mentioned that they would prefer to hold investments for as short a period as possible and would try to extract maximum value during that time. This preference again highlighted the importance that private equity investors attached to the time value of money.

The theme of 'factors that may shorten the holding period of private equity investments' was further supported when interviewees were asked if there were duration limits imposed on investments in the fund other than the natural life of the fund. All interviewees responded that the only real duration limit imposed on a fund was the fund's natural life of between seven and ten years.

According to Interviewee A, there were generally duration targets, but no limits. This interviewee continued by stating that if fixed duration limits were imposed, it would force the fund manager to time the exit poorly, which would have a negative impact on returns and would ultimately be a disadvantage for investors. For that reason, investors and fund managers very rarely entered into investment duration limit agreements. These findings contradict what has been predicted in the literature review, where Povaly (2006:261) in particular believes that private equity funds often have policies that force their fund managers to start the exit process after a certain defined investment period.

Interviewees agreed that there were generally no fixed investment duration limits imposed on particular investments. However, Interviewee G noted that if some investments were not exited by the end of the life of the fund, fund managers could incur penalties. He said: "What often happens, is that if you end up running over [the life of the fund] your fee levels drop".

In a case where some investments have not been exited by the end of the life of the fund, a fund manager will usually negotiate to extend the fund (usually by two years). The fund extension is necessary so that the last of the investments can be exited. Duration limits do therefore not appear to have an impact on the exit timing decisions of fund managers, other than the fact that all investments should be exited before the end of the life of the fund.

The interviewees' responses were in line with the literature reviewed in Chapter Three Section 3.3.2(e). Gompers and Lerner (1999) posit that investments would be exited before the end of the fund life, and the fact that fund managers would like to add as much value to a portfolio company in as short a time possible and then exit. However, the interviewees' answers did not support the suggestion that investment duration limits were relevant to exit timing, as was reported in the literature (Povaly, 2006:261).

5.4.5 Factors that may extend the holding period of private equity investments

The theme of 'deferring exits' emerged when interviewees were asked if they would exit investments due to portfolio company management underperformance, or due to fund manager constraints.

The interviewees were evenly split on whether they would exit in the case of a portfolio company manager underperforming. Interviewees C, D, F and H mentioned that they would consider an exit, while the remaining four interviewees would not. However, those who mentioned that they would exit qualified their statement by saying that exiting would be their last course of action if nothing could be done to remedy the situation. They also stated that exiting only became an option when there were major issues with the portfolio company's product and strategy, as well as a lack of strategic alignment between the fund manager and the portfolio company managers. All interviewees agreed that the first step in addressing management underperformance was to replace incumbent management.

Povaly (2006:269) and Wall and Smith (1997:15) studied the capacity of the portfolio company's management to deliver performance and add value as an exit consideration. It was a consideration due to the fact that the portfolio company managers must be fully committed to the exit process to achieve a maximum exit price. The responses of the interviewees were evenly split as to whether portfolio company manager performance would indeed be an exit driver.

Interviewees were questioned on whether they would consider exiting some investments if the management capacity of the fund manager became constrained in terms of time and personnel. Most interviewees stated that fund manager constraints were not a driver of exit decisions. This finding is in line with what the researcher expected.

Interviewees A, B and F mentioned that a fund manager would first try to address management constraints by hiring more people to help with the management of the fund and portfolio companies before considering an exit. Interviewee A added that he would consider an exit if management constraints could not be overcome: "If those [management] constraints remain, then it would be your fiduciary duty to exit because it would mean that you are not doing your job properly".

Interviewee D commented that constraints in the fund management firm were not a driver of their decision to exit, but that management constraints made the managing of the fund more challenging, especially if the fund manager lost key members of the management team. According to Interviewee G, the possibility of an exit in the case of fund manager constraints would be determined by the size of the investment. If it was a small investment that was taking up considerable time and effort from the management team, an exit would be considered. Otherwise, more people were likely to be hired, or some of the management duties could be outsourced.

Interviewee H remarked that management constraints were often the result of poor delegation among the management team, and that an exit due to fund manager constraints would be seen as a poor excuse for poor management.

A question was put to interviewees as to whether they would consider exiting an investment if the portfolio company managers were underperforming or guilty of mismanagement. This question was asked to test the impact of portfolio company management performance on the timing of exits. Interviewee H defined underperformance as "repeatedly not meeting key performance criteria and not creating value".

On another question about the theme of 'factors that may extend the holding period of investments', interviewees indicated that fund managers were also unlikely to exit one investment early to free up resources for another investment. The interviewees were asked if they would exit one investment to free up resources and capital for other investments. The interviewees generally agreed that they would *not* exit one investment to fund another. They stated that due to the structure of most private equity funds, capital received from the sale of a portfolio company needed to be returned to investors, and that capital could not flow from one investment to another.

In contrast to the general consensus, Interviewees C and H pointed out that they would consider selling one investment to free up capital for other investments. They did, however, name certain conditions under which this option would be considered. According to Interviewee C, one would only consider selling one investment for another if you could obtain the best possible price for the investment that you were selling. Also, the company that one intended to purchase with the freed-up capital should provide substantially more value than the company being sold. They stated: "Using that capital for another [investment] can be done as long as the second or follow-on [investment] that you are going to do from that is more value accretive than the current investment you have". Interviewee H added that a fund manager would consider switching one investment for another if value could no longer be added to the existing investment.

When questioned about the effect that the M&A market had on the exit decisions of private equity managers, the theme of deferring exits surfaced again. Interviewee B would defer an exit until the right opportunity arose, and not exit merely because the M&A market was active. According to Interviewee C, they would also defer an exit to obtain the best exit price, even if the M&A market was very active. This response corresponds with the discussion in Section 5.4.2, where it was reported that exit timing was driven by achieving maximum exit value.

5.4.6 Certainty of execution

'Certainty of execution' emerged as a theme that could have an impact on the exit timing and exit route decisions of private equity fund managers. This occurrence coincides with the findings reported in Section 5.2.2 regarding certainty of execution.

When interviewees were asked whether execution certainty had an impact on their exit timing and exit route decisions, they all agreed that it was indeed the case.

Interviewees B and C both stated that the credentials of the buyer in terms of their ability to close the deal was key to the certainty of execution. Interviewee D mentioned that the existence of synergies between the portfolio company and the buyer increased the certainty of execution. According to Participant E, unsolicited offers to buy a portfolio company also increased execution certainty, because of the buyer being serious about the transaction. Interviewee C added to this by indicating that having multiple potential buyers interested in a portfolio company also made it more likely for a deal to succeed, and wasting less time when a potential deal with a certain buyer fell through. Interviewee C noted: "But, yes, having multiple channels open at the same time does help [execution certainty] because if one drops off you can hopefully still carry on the [exit] process and haven't lost too much ground". All interviewees agreed that they would time an exit in such a way that execution was most certain, and that they would choose the exit route that would provide the highest level of execution certainty.

The notion that execution certainty had an effect on exit decisions was further supported by responses to the question of what the main exit route driver was. Aside from choosing the route that would deliver the maximum exit price, Interviewees C and G also mentioned that the exit route that offered the most certainty of execution was likely to be chosen.

Certainty of execution was identified and mentioned in Chapter Three Section 3.3.4(c) as being a potential driver of exit route decisions. Because of the different levels of execution risk linked to the different exit routes, certainty of execution is an important factor to consider when an exit route is chosen (Povaly, 2006:269). The interviewees' belief that certainty of execution could affect exit routes were in line with findings by Lerner *et al.* (2003). However, the interviewees added that certainty of execution could have an effect on exit timing as well, which is an interesting result, as this effect was not predicted in the literature.

5.4.7 Performance of individual investments and the overall fund

The 'importance of fund performance' also emerged as a theme during the qualitative data analysis. A question was asked relating to the importance of fund manager reputation for future fundraising. The interviewees were of the opinion that fund performance was critical for fund manager reputation, which in turn had an effect on the ability of fund managers to raise capital in the future. They mentioned a number of factors that could have an impact on fund manager reputation.

According to the interviewees, the key drivers of fund manager reputation were fund performance and the fund manager's track record, along with being able to deploy capital and to exit on time. Fund manager reputation emanated from managing the fund well and within the agreed time, generating good returns, managing the fund capably, and adding value to portfolio companies (Interviewee F). A fund manager's reputation was further based on being ethical, consistent, keeping promises, and executing exits well (Interviewee H). However, as mentioned earlier, most interviewees agreed that the most important factor influencing fund manager reputation was fund returns, which was driven by exit price.

The liquidation of funds that were performing poorly in the long term also linked to the theme of fund performance, which implies that fund performance is indeed an important consideration in the exit decisions made by private equity investors.

A question was put to interviewees on whether they would consider liquidating a fund if all the investments in the fund were underperforming over the long run. The interviewees provided a wide range of answers. Interviewees A, C and D stated that they would consider liquidating the fund if it was underperforming in the long term. Liquidation should always remain an option and a consideration, especially when the fund was performing poorly, they said. Furthermore, if fund performance was lagging, earlier exits would be considered (Interviewee A). According to Interviewee C, the potential for fund liquidation depended on the future outlook of the portfolio companies in the fund. If the outlook was negative, liquidation of the fund would become more likely and exits could be accelerated. This response is also in line with the earlier theme dealing with 'factors that may shorten the holding period of private equity investments'. Interviewee D mentioned that liquidation would be a consideration, but only as a last resort. He continued by saying that a fund manager would rather consider a fund extension, to try and extract more value from investments. In his own words: "Ja, I think it's a last resort [the liquidation of funds]. I think what we see in most instances is an extension of funds".

The majority of interviewees (B, E, F, G and H) would not liquidate the fund when it was underperforming in the long run. Interviewee B said that in the case of underperformance, "at least [you should] get the principal back for your investors". They further commented that liquidating a fund would have a negative impact on the reputation of the fund manager, which could make it harder to raise capital for a future fund. Participants E, F, G and H all mentioned that instead of liquidating the fund, they would try and extract as much value from the underperforming investments by, for example, selling-off portfolio company assets. This response relates to the theme of 'value creation in portfolio companies'.

Researchers such as Povaly (2006:260) and Gompers (1996) suggest that fund performance and the performance of individual investments are important considerations when timing an exit, due to the need to provide adequate returns to investors and generating a good reputation which is needed for future fundraising. The overall conclusion that can be drawn from the interviewees' responses is that fund performance is a critically important consideration when deciding on exit timing, even though they may differ on the timing strategy that they will use.

5.4.8 Africa-specific factors that may have an impact on exit decisions

As this study relates to private equity investments in the African context, questions were asked regarding the impact of B-BBEE on private equity in South Africa, and the challenges that private equity investors faced when doing business in Africa. The general themes that materialised from the analysis will be discussed next.

One of the key themes was that B-BBEE was important in the South African private equity context. Another theme that emerged regarding B-BBEE was that it did have some effect on the exit decisions of private equity investors. Several challenges of doing business in Africa also emerged as a theme. These challenges (both in the case of B-BBEE and in the rest of Africa) made deals more complex, and often had an impact on the exit route chosen. Some examples of these challenges are discussed later in this section.

Interviewees were asked whether B-BBEE had an impact on the private equity industry in South Africa and whether B-BBEE influenced the exit decisions of fund managers. Interviewees A and B both were of the opinion that B-BBEE was beneficial and necessary for the South African private equity industry, but added that it complicated business deals, as B-BBEE added a further

administrative layer. They also stated that the effect of B-BBEE was client and sector-specific, and that it was particularly relevant when dealing with government.

According to the interviewees, B-BBEE had both disadvantages and benefits. One of the disadvantages related to the issue that if a portfolio company did not have the required B-BBEE status, the pool of potential investors could be limited. The researcher is of the opinion that a limited pool of investors may have an impact on deal value and exit price. Furthermore, B-BBEE may impose some exit restrictions on fund managers when exiting (in that the fund manager will have to maintain the B-BBEE shareholding percentage when selling, which might be a challenge). However, one advantage that B-BBEE has is that it creates a new transaction class, which could lead to more deal opportunities if the portfolio company had the required B-BBEE status.

Interviewees E, G and H noted that B-BBEE could influence the exit route and could have a negative impact on the exit price. The negative effect on the exit price was the result of fund managers often having reduced bargaining power in the case of B-BBEE business deals. According to Interviewee F, a further challenge often posed by B-BBEE was the difficulty to adhere to B-BBEE regulations in small portfolio companies, which made deals more complex and made it problematic to find a B-BBEE exit partner. Another challenge that was mentioned was that once a portfolio company reached a certain size, B-BBEE became a significant concern for that company. From these responses, it was evident that portfolio company size once again emerged as an important exit theme. Further, when doing B-BBEE deals, fund managers often needed government approval when trying to exit, which made the entire process even more complex and costly (Interviewee H).

As outlined in the literature review in Chapter Three Section 3.3.5 (f), as far as could be ascertained, no prior research on the impact of B-BBEE on exit decisions has been done, so there is unfortunately no theoretical base to which the responses of the interviewees can be compared. However, despite the lack of prior research on this specific topic, it was expected that B-BBEE would have some impact on exit decisions. The interviewees' responses are therefore the only indication of the effect of B-BBEE on exit timing and exit route.

The interviewees were also questioned about the unique challenges they faced when conducting private equity deals in Africa. Most of them referred to the same general challenges.

One of the major challenges that most interviewees highlighted was the regulatory environment in Africa, with regulations differing across countries, which made it strenuous to comply with

all regulatory requirements when doing business. Interviewee C added that there were a number of different nuances and ways of doing business on the continent, with Interviewee D stating that the diversity of Africa in terms of culture and different business environments were also challenging. Language differences were also cited as being a barrier to successful business deals in certain countries. These findings are in line with statements by Kocis *et al.* (2009:30), who mentioned language differences as a challenge to doing business.

Other difficulties that interviewees referred to include the poor standard of financial reporting, which made the analysis of potential portfolio companies more intricate, and the difficulty of finding skilled local management teams to manage the portfolio companies. Some countries also lacked developed infrastructure, which often made logistics a stumbling block. This response is in line with what was predicted by a report by the African Development Bank (2012:12).

Interviewees further mentioned undeveloped financial markets and a lack of investment intermediaries in markets outside South Africa. According to Interviewee E, fund managers often went to great lengths to find support for investment from local governments: "One of the main problems is that we have struggled to find projects that have got basically government support, you know". They also mentioned the fact that there was often political risk involved when investing in Africa. The exchange rate risk and the ability to 'get money out' of the countries once it was invested were also listed as potential issues.

Many of the challenges mentioned by the interviewees have also been reported in the literature. Babarinde (2012:68-69) refers to a number of challenges, including business environment issues, legal matters, questions relating to the quality and quantity of financial information, exit concerns, and a lack of skilled local private equity managers. Campbell (2009:403) identifies a number of risks regarding investment in Africa, namely country risk, industry risk, and currency risk. The author also notes the lack of liquidity in African markets. These risks are in line with those highlighted by the interviewees.

5.4.9 Value creation within portfolio companies

A theme that surfaced throughout the interviews was the importance of creating value in the portfolio companies that private equity investors invested in. It is important to note that in this

context, value creation refers to the creation of value during the period that the portfolio company is held, and not to the price received for the portfolio company at the time of exit.

The theme first appeared when interviewees were asked about the relationship between monitoring cost and adding value to portfolio companies. A question was put to the interviewees on whether value adding in a portfolio company was measured against the cost of monitoring, and if not, against what it was measured. None of the interviewees measured value adding against the cost of monitoring. They did, however, point to a number of factors against which value adding could be measured.

Interviewees A and F stated that "added value" was measured against a portfolio company's peers, the profit or growth generated by the value adding process, and the final exit price achieved. This response ties in with the importance of the theme of 'maximum exit price'. Interviewee D mentioned that value adding can also be measured in terms of the cost of bringing in new management into a portfolio company, the cost of using external consultants, the cost of changing a portfolio company's strategy, and the cost of additional capital. According to Interviewee H, the cost of value adding was limited to the cost of the management team, and that the cost of value adding would probably increase according to the size of the portfolio company. This response again highlights the theme of 'portfolio company size'. In the words of Interviewee H: "In the context of Africa, where you've got predominantly SME [small and medium-sized enterprises] based investments, the cost of value adding is limited to the management, to the team itself, to the private equity team… So the cost of monitoring is determined by the size of the team".

The literature suggests that value adding is measured against monitoring cost, and that if monitoring cost exceeded the marginal value being added, it would be time to consider an exit (Cumming & MacIntosh, 2003). However, the responses of the interviewees clearly indicate that they did not measure value adding against monitoring cost, which led to the conclusion that monitoring cost is not a driver of exit timing decisions.

Value creation was also mentioned in the context of underperforming portfolio companies, where it was stated that in the case of portfolio companies underperforming, fund managers would still try to add as much value to the portfolio company as possible. The interviewees' detailed responses regarding the performance of funds were presented in Section 5.4.7.

As part of the theme of 'value creation' in portfolio companies, it also emerged from the data coding that the monitoring of investments was crucial to the creation of value in portfolio companies, and that monitoring occurred parallel with value creation.

Interviewees were asked about the importance of the monitoring of investments. They all agreed that monitoring was vital to ensure investment success. Interviewee A commented that monitoring was particularly important in a weak regulatory environment, and that monitoring ran parallel with value creation. He said: "Basically, you buy something, then you add value. And then at the end you sell. But you've got to monitor how you add value". According to Interviewees B and C, the fund manager should be represented on the boards of portfolio companies so that they could have an influence on the portfolio company's strategy and provide managerial assistance. Interviewees A, D and G all mentioned that monitoring was a critical step in a three-part private equity investment process. According to them, the first step was to buy the right portfolio company at the right price. The second step consisted of adding value and monitoring the investment. These two activities would run parallel. The final step was to negotiate an optimal exit that would generate maximum return. Again, the importance of exit price was emphasised. In line with this process, Interviewee H noted that the importance of monitoring changed over time and that it was linked to the life cycle of the portfolio company.

The interviewees' responses were in line with what was predicted by the literature and discussed in Chapter Three Section 3.3.2(a). Previous researchers asserted that monitoring is important to determine when value is no longer being added to the portfolio company, in which case an exit should be considered (Povaly, 2006:259). Both the literature (Povaly, 2006:259) and the responses of the interviewees thus indicate that monitoring is also an important factor in the value creation process, and that monitoring is necessary to determine when it is time to exit.

5.4.10 Responses not related to the major themes

Responses that did not fit any of the major themes discussed in the preceding sections dealt with transaction cost. Transaction cost was a variable identified in the literature review that could have an impact on exit decisions. Interviewees were asked if transaction cost would have an impact on their exit timing and exit route decisions. All of them stated that it would *not* have any significant impact on their exit decisions. This finding was contrary to what was expected, as transaction cost is believed to be a major driver of exit decisions.

Interviewee A noted that transaction cost only accounted for a very small percentage of the final deal value, and would therefore not have a material effect on any exit decisions. Interviewee C concurred with Interviewee A in that transaction cost had no real effect on exit decisions. However, Interviewee C mentioned that exit performance could be influenced by transaction cost in the case of a low-value deal, but that even in such a case the effect would be negligible. They said the following: "So, yes, it [transaction cost] will impact, but not to a significant extent. And I think in terms of finding and exit route, you know, I don't think that would affect it. You are going to choose the exit route that overall gives you the highest return and that time as well" [Interviewees A and C]. This response relates to the theme of making exit decisions to achieve a maximum exit price.

The responses of the interviewees strongly contradict the theory posited by Povaly (2006:269) and Wall and Smith (1997:8) that transaction cost will have an impact on the exit decisions (especially related to exit route) of private equity investors. According to this theory, different exit routes have different transaction costs inherent to them, and that private equity investors will choose the exit route that has the lowest transaction cost.

5.5 SUMMARY AND CONCLUSIONS

In this chapter, the results of the survey questionnaire and semi-structured interviews were discussed. The purpose of the survey questionnaire was to investigate which of the factors that were identified in the literature review in Chapter Three had an impact on exit timing and exit route decisions of private equity investors. These results were based on descriptive statistical analyses that were conducted on the data gathered with the survey questionnaire. The results of the survey questionnaire served as the basis of the questions that were asked in the semi-structured interviews that were conducted with experts in the South African private equity industry.

The qualitative sample consisted of eight of the thirteen individuals who responded to the survey questionnaire. The characteristics and attributes of the interviewees were presented in Table 5.1. All the interviewees were considered experts in the private equity industry, especially with regard to their experience in African private equity investment. From Table 5.1 it was also clear that these experts came from varied backgrounds and that the nature of their private equity funds were diverse.

Nine themes emerged from the qualitative data analysis. These themes were: conditions in the M&A and public equity and debt markets; the importance of exit price; portfolio company size; factors that may shorten the holding period of private equity investments; and factors that may extent the holding period of private equity investments. The other four themes that were identified were certainty of execution; performance of individual investments and the overall fund; Africa-specific factors that may have an impact on exit decisions; and value creation in portfolio companies. One response relating to transaction cost did not fit into any of these themes, and was thus discussed separately.

From the themes that were identified, a number of conclusions can be drawn. Firstly, it would appear that the themes were not mutually exclusive. Quite a number of linkages between the themes were noted. These linkages imply that the exit decisions made by private equity investors are complex and affected by a number of factors. Further, the main themes seemed to generally support the potential exit timing and exit route variables that were identified in the literature review in Chapter Three.

From all the interrelated themes, one main narrative emerged. Interviewees repeatedly mentioned that, although the other themes had an impact on their exit decisions, they would primarily base their exit timing and route decisions on achieving the maximum exit price. Therefore, exit price appears to be the most important theme.

In the next chapter, a summary and conclusions of the study will be given in more detail, while pertinent recommendations will also be offered.

CHAPTER SIX

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION

In this chapter a summary of the main findings of the study will be provided, along with pertinent conclusions and recommendations. The limitations of the study will also be outlined and suggestions for future research will be offered. Answers to the research questions as outlined in Chapter One Section 1.4 will also be presented. These research questions are:

- How is the private equity industry structured?
- Which factors influence the exit strategies formulated by local private equity investors who invest in Africa?
- Which exit routes are most often used by South African private equity investors who invest in Africa? Why is this particular exit route favoured?
- What effect does Broad-Based Black Economic Empowerment (B-BBEE) legislation have on the exit decisions of South African private equity investors?
- How important is the timing of an exit?
- To what extent are private equity investors in South Africa interested in making investments in Africa?
- Has there been growth in the size and number of investments made in Africa by local private equity investors?

6.2 THE DEVELOPMENT AND STRUCTURE OF THE PRIVATE EQUITY INDUSTRY – GLOBALLY AND ON THE AFRICAN CONTINENT

As mentioned in Chapter Two Section 2.2.1, the private equity industry developed in the United States in the 1940s, and has since then grown in size and importance. A major driver of growth in the industry was the adoption of the limited partnership business structure which offered fewer investment restrictions than other corporate structures. This business structure also offers investors tax benefits (The Private Equiteer, 2011:22; Fenn *et al.*, 1997:14).

The private equity industry in Africa started in South Africa during the 1980s. In the rest of Africa, the growth in the industry has been mostly driven by the emergence of development finance institutions that focussed on projects that could deliver sustainable economic development and growth on the continent (African Development Bank, 2012:17; International Finance Corporation, 2011:14). Today, private equity is seen as one of the most direct means of investing in Africa due to the lack of developed financial markets in most African countries.

6.3 EXIT ROUTES MOST OFTEN USED BY SOUTH AFRICAN PRIVATE EQUITY INVESTORS

An analysis of the empirical data gathered during the study's survey and subsequent interviews suggests that the most prevalent exit routes used by South African private equity investors who invest in Africa include trade sales or secondary sales to strategic buyers, with management buyouts also being considered from time to time. Initial public offerings (IPOs) are considered less frequently, due to the complexity and cost of this exit route, and the lack of liquidity in public equity markets. The empirical findings are supported by those reported in the literature, especially pertaining to IPOs, namely that they are very rarely used because of the difference in market characteristics between developed and emerging markets (Wilton, 2012:57). The empirical findings also correspond with research by Bliss (2012:10) who found that the most prevalent private equity exit routes in emerging markets include trade sales and secondary sales.

6.4 THE EFFECT OF B-BBEE ON THE EXIT DECISIONS OF SOUTH AFRICAN PRIVATE EQUITY INVESTORS

B-BBEE was found to be a major exit route determinant in the South African private equity industry. In Chapter Two Section 2.4.2 it was highlighted that the majority of private equity deals in South Africa had a B-BBEE component (KPMG-SAVCA, 2014:4). The significance of B-BBEE further emerged in the empirical investigation of the present study. Industry experts mentioned that B-BBEE was beneficial to the local private equity industry in that it created a new transaction class. However, B-BBEE requirements also added more complexity to the investment deals, such as additional administrative processes and the need to find suitable B-

BBEE partners. This added complexity could be perceived as having a negative impact on the exit process. Overall, the impact of B-BBEE on the exit process and private equity in general, can therefore be described as varied.

6.5 THE IMPORTANCE OF EXIT TIMING

Exit timing was seen as an important consideration in the exit planning processes used by local private equity investors who invest in Africa. From the discussion on the importance of exit timing in Chapter Five Section 5.4.2, it can be deduced that exit timing played a major role in generating maximum exit price. As will be explained later in this chapter, the generation of the maximum exit price was also a key consideration for private equity investors who participated in this study.

6.6 THE EXTENT TO WHICH PRIVATE EQUITY INVESTORS ARE WILLING TO INVEST IN AFRICA AND THE GROWTH IN SIZE OF THESE INVESTMENTS

As mentioned in Chapter Two Section 2.4.1, the development of the South African private equity industry has been shaped by the unique structure of the economy. The growth and development of the industry has further been influenced by the growing significance of the financial sector in the economy, with the major investment focus of South African private equity being on development capital and the financing of buyout transactions (Lingelbach, 2012:226). Currently, the private equity industry is characterised by growth and successful fundraising on the back of a recovering global economy (Ernst & Young, 2014b:13). Institutional investors both locally and abroad are increasingly considering to invest in South African private equity initiatives. As mentioned earlier, B-BBEE plays a major role in the local industry, creating both challenges and opportunities for investors. In the future, the industry is expected to continue its growth trajectory. However, investment in South African private equity may make up an increasingly small percentage of the funds invested in the continent as a whole, due to South Africa's below average economic growth rate and the potential for political unrest (Cilliers & Aucoin, 2016:2; Lingelbach, 2012:237).

6.7 FACTORS INFLUENCING THE EXIT DECISIONS OF SOUTH AFRICAN PRIVATE EQUITY INVESTORS

In this section a summary is provided of the factors that may have an impact on the exit decisions of South African private equity investors investing in Africa. These factors are those that emerged from the literature review, and those factors that have been identified from the empirical investigation.

6.7.1 Factors identified in the extant literature

The factors that may influence the exit decisions of private equity investors as identified in the literature review, were first introduced in Chapter One, and are summarised again in Table 6.1:

Table 6.1: Factors that affect exit timing and exit route

Factors influencing exit timing	Factors influencing choice of exit route
• Marginal value-adding and monitoring cost • Monitoring requirements for the portfolio company • Performance requirements for the overall fund • Performance requirements for the individual investments • Investment duration limits	• The industry-specific merger-and-acquisition market environment • The size of the portfolio company • Certainty of execution • Transaction cost • Agency theory
Factors influencing both exit timing and exit route	
• The state of the capital market environment[(a)] • Portfolio company performance • Fundraising requirements • Capacity of private equity professionals • Capacity of portfolio company executive management • B-BBEE legislation • Asymmetric information and certification • Grandstanding	

(a) The first factor (the state of the capital market environment) was assessed at the time when divestment is considered

Source: Adapted from Povaly (2006)

(a) Exit timing factors

In terms of exit timing, factors identified in the literature included marginal value adding and monitoring cost, monitoring requirements for the portfolio company, performance requirements for individual investments and the overall fund, and investment duration limits.

Marginal value adding and monitoring cost were considered factors that would have an impact on the timing of an exit. The literature predicted that private equity investors would exit an investment when the marginal cost of value adding exceeded the marginal benefit (Cumming & MacIntosh, 2003). The monitoring requirements for the portfolio company were also mentioned as a related factor that could have an impact on exit timing. Povaly (2006:259) in particular indicated that because of the restraints on the time and effort that private equity fund managers generally experience, an exit would be considered when monitoring became too costly. Performance requirements for the overall fund and for individual investments were also identified by Povaly (2006:260) and Gompers (1996) as having an impact on exit timing. This impact was the result of future fundraising requirements, which means that an exit should be timed so that the overall fund and individual investments delivered maximum returns (Wall & Smith, 1997:7). As far as investment duration limits are concerned, the literature predicted that certain fixed duration limits on the holding period of investments were imposed, which would affect the exit timing (Povaly, 2006:261).

(b) Exit route factors

The factors that were identified in the literature to be relevant to exit route decisions include the industry-specific M&A market, the size of the portfolio company, certainty of execution, transaction cost, and the agency theory. The industry-specific M&A market may influence the specific exit route that is chosen, and it is thus more likely that the most prevalent exit route in the industry will be chosen (Povaly, 2006:267). The size of the portfolio company could have an impact on exit route decisions, with the prediction that larger portfolio companies would have more exit route options (Povaly, 2006:267; Cumming & MacIntosh, 2003). It was also reported in the literature review that certainty of execution could have an impact on the exit route chosen, and that the fund managers would most probably use the exit route that offered the most execution certainty (Povaly, 2006:269; Lerner, Shane & Tsai, 2003).

Transaction cost was identified as another important factor that could affect exit route decisions. Wall and Smith (1997:8) found that most fund managers were likely to choose the exit route with the least associated transaction cost. According to the agency theory argument, investors would be more likely to use IPOs due to the dispersal of ownership that this exit route creates. In the case of exit route choice, it was indicated that fund managers would choose an exit route that presented the least information asymmetry, as a high degree of information asymmetry between the fund manager and the potential buyer would have a negative effect on the exit price (Povaly, 2006:122).

(c) Factors affecting both exit timing and exit route

As illustrated in Table 6.1, a number of factors could have an impact on both the exit timing and exit route decisions of private equity investors.

According to the literature, capital market conditions are expected to influence both the exit timing and the exit route. Povaly (2006) pointed out that if market conditions were unfavourable, fund managers would probably postpone an exit and would consider different exit routes. In the case of portfolio company performance, the argument was made that current portfolio company performance, as well as predicted future performance, determined when a fund manager would exit the investment (Nahata, 2004). In terms of exit route choice, Povaly (2006:268) mentioned that it was likely that portfolio companies that display high growth would be exited by means of IPOs, whereas those portfolio companies that display stable growth and performance would be exited by means of routes other than IPOs.

According to Gompers (1996), fundraising requirements would affect both exit timing and exit route, as fund managers wanted to achieve a good exit to improve their reputation. It was found that fund managers with a sound reputation are likely to raise funds more easily. Povaly (2006:260) and Cumming and MacIntosh (2001) predicted that the capacity of private equity professionals would have an impact on exit timing, with exits likely to be timed so that professionals could devote maximum time and effort to the exit process. Povaly (2006:268) further claimed that different exit routes placed different demands on private equity professionals, which could have an impact on the exit route that they choose.

No literature could be found that specifically addresses the possible impact of B-BBEE on the exit process. However, since a large number of private equity deals in South Africa have a B-BBEE component (Bowman Gilfillan, 2014b:275), it was expected that B-BBEE would have an impact on the exit process. Asymmetric information and certification was postulated to influence exit timing because a high degree of information asymmetry made it likely that the portfolio company would be held for longer, because information asymmetry was expected to decrease over time (Felix *et al.*, 2008:7). Information asymmetry was furthermore predicted to affect exit route. Povaly (2006) found that fund managers would probably choose the exit route that reduced information asymmetry the most.

Grandstanding refers to a situation where young private equity funds would hold investments for shorter periods and underprice IPOs to create inflated exit performance, which constitutes an exit timing effect. Grandstanding was supposedly used to build a reputation so that private equity funds could more easily raise capital in the future (Hibara, 2004:77; Gompers, 1996:154). Grandstanding was again a relevant factor in the context of exit route decisions, as it was suggested that fund managers would be more likely to use IPOs so that they can underprice the issue and make seemingly large profits.

6.7.2 Factors identified through empirical results

A number of factors emerged from the qualitative data analysis. These factors include the conditions in the M&A market and public debt and equity markets, portfolio company size, certainty of execution, the performance of individual investments and the overall fund, Africa-specific factors, and the extent of value creation in portfolio companies. Factors were also identified that may extend or limit the holding period of a private equity investment. Most importantly, exit price was revealed to be the key driver of exit decisions. These factors were discussed in detail in Chapter Five.

Financial market conditions were found to have an impact on the exit decisions of private equity investors. Investors are likely to time an exit and choose an exit route so that they can take advantage of conditions in the market to achieve the maximum exit price. It was also discovered that portfolio company size had an impact on the exit routes chosen by private equity investors, with larger portfolio companies having more exit route options available. Certainty of execution had an impact on both exit timing and exit route decisions, with fund managers likely to time an exit and to choose an exit route that ensured the highest degree of exit certainty.

The performance of individual investments and funds was observed to have an effect on the reputation of fund managers, which in turn, had an effect on the fund managers' ability to raise funds in the future. Furthermore, it was established that the performance of funds had an impact on exit timing. Several Africa-specific factors were found to have an impact on exit decisions. These included political, legal and economic risk factors and a lack of developed financial markets and infrastructure (African Development Bank, 2012:12).

From the data analysis, it was clear that most private equity fund managers held an investment for the shortest time possible, whilst creating maximum value during the holding period. However, they would consider lengthening the holding period as to achieve the best exit price.

Finally, and most importantly, exit price was discovered to be the main driver of exit decisions of South African private equity investors. From the empirical data, it was apparent that private equity fund managers would generally time an exit and choose an exit route so that they would make maximum profit and achieve the highest exit price.

6.8 MAIN CONTRIBUTIONS OF THE STUDY

As mentioned in Chapter One Section 1.6, no research could be found that investigates the exit behaviour of South African private equity investors. The results of this study therefore address this research gap, specifically by developing a conceptual framework. As part of this framework, a number of factors that could have an effect on the exit decisions of private equity investors were identified. The researcher tested this framework empirically by interviewing a number of experts in the private equity industry. Some interesting findings were made. These findings include the fact that although a number of interrelated factors may influence the exit decisions of private equity investors, the key driver of these decisions appears to be achieving the maximum exit price. These results, summarised in the preceding section, were also discussed in detail in Chapter Five.

Apart from adding to the body of knowledge on the South African private equity industry, the results of the study can also be of value to private equity fund managers, private equity investors and professional institutions in the industry such as SAVCA. The study's contribution thus lies in providing new insights into the exit process and all the factors that may influence this process. These insights may enable private equity fund managers to plan an exit better, and in doing so, create value for investors and eventually the economy at large.

6.9 RECOMMENDATIONS

The results of this study have shown that the exit stage of the private equity investment process is highly complex, with a number of interrelated factors playing a role in the choice of the exit timing and exit route. However, as has been mentioned before, the main theme that emerged is that private equity investors base their exit decisions primarily on achieving the maximum exit price.

The researcher therefore recommends that exits are planned thoroughly and with due consideration of all the relevant factors that have been outlined, to generate a maximum exit price.

A further recommendation (or rather observation) is that private equity is a powerful tool to bring about social change, development and upliftment by the creation of jobs and the transfer of skills. As such, it would be good to see the industry shift its focus from purely financial gains and achieving maximum exit prices, to also include social and community development as part of their investment objectives. One of the ways that this can be achieved is by targeting the so-called 'under-served' sectors of the economy by means of the creation of private equity funds dedicated to a developmental role. Such funds have already been established in the United States and have yielded positive results by targeting rural enterprises, hiring low-skilled workers and supplying under-served customer groups. These positive results include job creation, ownership and management opportunities for women and under-represented social groups, and economic stimulus in disadvantaged communities (Ratcliffe, 2007:23).

In terms of developmental benefits of private equity in South Africa, a report by SAVCA and the Development Bank of South Africa (2013:11) clearly states that private equity has had a positive impact on innovation in portfolio companies, and on job creation. The positive effect of B-BBEE is also mentioned in the report, namely that private equity has led to an improvement in their B-BBEE status.

The third recommendation is related to educators. The researcher is of the opinion that there is too little focus on private equity in tertiary-level business courses. The emphasis is mostly on the functioning of public secondary markets, while private equity as an asset class and an industry per se is largely ignored. It is therefore recommended that more emphasis is placed on teaching the structure and functioning of the private equity market, so that students are better informed and equipped when they start working in this field. Furthermore, these courses can be

used to highlight the importance of the private equity industry in the broader economy. The developmental role of private equity can be further enhanced through education, as education can increase the number of individuals who will be able to work in the developmental area of private equity, and by doing so, have a positive impact on communities and the economy.

6.10 LIMITATIONS OF THE STUDY AND SUGGESTIONS FOR FUTURE RESEARCH

This study focused on the exit decisions of South African private equity investors who invest in Africa. This sample selection criterion could perhaps be seen as a limitation of the study, as investors from around the world also invest in Africa. Further research could therefore be conducted to determine the exit decision factors of non-South African private equity investors who invest in Africa.

Despite the fact that a wide range of factors influence the exit decisions of private equity investors, the deciding factor seems to be the final exit price. As a result, the researcher proposes that further research be done to ascertain why exit price outweighs all other exit considerations. It would also be interesting to investigate whether the pursuit of maximum exit price could lead to ethical conflicts in the industry.

Further research is also needed on the South African private equity industry in general, as most research has focused on its development and history, rather than its current structure and functioning. This recommendation is made in the wake of the growing importance of private equity in Africa and South Africa. In addition, the researcher proposes that studies be undertaken into the impact that private equity may have in a developmental context in Africa, specifically the impact of private equity on the development of communities. Therefore, the issue of non-monetary returns of private equity should also be further explored.

To conclude: the primary result of this study is that the first and foremost focus of private equity investors is to achieve the maximum exit price and, by doing so, making as much profit as possible. This finding is neatly summarised by the following quote:

"The role of private equity as fiduciaries is certainly to make money"

- Thomas G. Stemberg

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APPENDIX A

SURVEY QUESTIONNAIRE

SECTION A: COMPANY AND RESPONDENT DEMOGRAPHICS

1.1 Name of private equity firm

1.2 Portfolio company information

Number of portfolio companies invested in	
Average percentage ownership held per portfolio company	
Average amount invested per portfolio company (in Rand)	R

1.3 Funds under management (in Rand)

The following questions are not compulsory if the information is of a confidential nature:

Approximate funds under management by your company	R
Approximate funds invested in Africa (excluding South Africa) by your firm	R
Approximate funds invested in South Africa by your firm	R
Approximate funds under management under your personal care	R

1.4 Your job title/description

Analyst		1
Associate		2
Associate principal		3
Principal		4
Partner		5
Other (Please specify below):		6

1.5 Years of private equity experience

Less than 5 years		1
5 ≤ 10 years		2
11 ≤ 15 years		3
16 ≤ 20 years		4
21 ≤ 30 years		5
More than 30 years		6

1.6 Years of work experience in the private equity industry doing business with African portfolio companies (in years)

Less than 5 years		1
5 ≤ 10 years		2
11 ≤ 15 years		3
16 ≤ 20 years		4
21 ≤ 30 years		5
More than 30 years		6

SECTION B: EXIT *TIMING* VARIABLES

In the following section, statements are made with regard to the factors that may influence the exit timing decisions of private equity investors in Africa. Exit timing refers to *when* an exit takes place. Please indicate with an X to what extent you agree or disagree with the given statements on the scale, ranging from 1 ('strongly disagree') to 5 ('strongly agree'). For example, a (1) indicates that you strongly disagree, (2) indicates that you disagree, (3) indicates that you are neutral, (4) indicates that you agree, and (5) indicates that you strongly agree with the statement. A 'not applicable' option is also provided. Please note that there are no right or wrong answers. Also note that the questions are related to the decisions you have made, or to the policies of your firm.

	It is time to exit a private equity investment in Africa when:	**Strongly disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly agree**	**Not applicable**
2.1	value is no longer being added to the portfolio company.	1	2	3	4	5	-
2.2	when the fund performance is below the required level in the long term.	1	2	3	4	5	-
2.3	*portfolio company managers* can receive maximum compensation measured against contractually agreed levels of the internal rate of return.	1	2	3	4	5	-
2.4	*portfolio company managers* can receive maximum compensation measured against a contractually agreed times-money ratio.	1	2	3	4	5	
2.5	*fund managers* can receive maximum compensation measured against contractually agreed levels of the internal rate of return or times-money ratio.	1	2	3	4	5	-
2.6	individual investments in a fund do not meet requirements.	1	2	3	4	5	-
2.7	conditions in public *debt* markets are optimal (i.e. when markets are performing well).	1	2	3	4	5	-
2.8	conditions in public *equity* markets are optimal (i.e. when markets are performing well).	1	2	3	4	5	-
2.9	resources in terms of time become scarce.	1	2	3	4	5	-
2.10	resources in terms of management skills become scarce.	1	2	3	4	5	-
2.11	portfolio company managers are underperforming.	1	2	3	4	5	-
2.12	offers or intentions to purchase a portfolio company are received.	1	2	3	4	5	-
2.13	when macro issues arise, forcing a deviation from initial exit planning. Macro issues could be of an economic, political, social or technological nature.	1	2	3	4	5	-

	It is true that:	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Not applicable
2.14	adding value to a portfolio company is measured against the cost of monitoring the value adding process in my firm.	1	2	3	4	5	-
2.15	exit timing is important to deliver maximum returns to investors.	1	2	3	4	5	-
2.16	meeting fund performance requirements is important for future fundraising.	1	2	3	4	5	-
2.17	investors expect individual investments in a fund to meet performance requirements.	1	2	3	4	5	-
2.18	the compensation of portfolio company managers is an important incentive for achieving the required individual investment performance.	1	2	3	4	5	-
2.19	exits are timed so that portfolio company managers can receive maximum compensation.	1	2	3	4	5	-
2.20	fund managers seek to add value to investments in the shortest time possible.	1	2	3	4	5	-
2.21	portfolio companies are sold before the end of the fund lifespan to free up resources for other investments.	1	2	3	4	5	-
2.22	in my firm, there are policies enforcing certain investment duration limits on individual investments.	1	2	3	4	5	-
2.23	managers will delay an exit if conditions in the public equity market are sub-optimal (i.e. when the market performs poorly).	1	2	3	4	5	-
2.24	expected future portfolio company performance is an important consideration where exit timing is concerned.	1	2	3	4	5	-
2.25	the monitoring of investments is the main drain on the *time* of fund managers.	1	2	3	4	5	-
2.26	the monitoring of investments is taxing on the *skill* of fund managers.	1	2	3	4	5	-
2.27	the stage in the industry life cycle (developing industry; mature industry; declining industry) has an impact on whether an exit will be considered.	1	2	3	4	5	-
2.28	if many mergers and acquisitions are taking place in a specific industry, it is more likely that an exit will be considered.	1	2	3	4	5	-
2.29	as a result of insufficient time on the part of fund managers, the costs associated with the monitoring of portfolio companies increase.	1	2	3	4	5	-
2.30	as a result of insufficient management skill, the costs associated with the monitoring of portfolio companies increase.	1	2	3	4	5	-
2.31	when an exit delivers maximum performance, the fund manager develops a good reputation.	1	2	3	4	5	-
2.32	a good reputation makes future fundraising easier.	1	2	3	4	5	
2.33	individual investments have shorter lifespans than that of the overall fund.	1	2	3	4	5	-

2.34 If there are any other factors that may have an effect on the timing of exits, please specify them here:

SECTION C: EXIT *ROUTE* VARIABLES

In the following section, statements are made with regard to the factors that may influence the choice of the exit *routes* used by private equity investors. Examples of exit routes include initial public offerings (IPOs), acquisition sales, secondary sales, share buybacks, and write-offs. Please indicate with an X to what extent you agree or disagree with the given statements. A (1) indicates that you strongly disagree, (2) indicates that you disagree, (3) indicates that you are neutral, (4) indicates that you agree, and (5) indicates that you strongly agree. A 'not applicable'

option is also provided. Please note that there are no right or wrong answers. Also note that the questions are related to the decisions you have made, or to the policies of your firm.

	It is true that:	**Strongly disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly agree**	**Not applicable**
3.1	asymmetric information is more prevalent in smaller portfolio companies. Asymmetric information refers to a situation where one party has more or better information than the other, thus creating an imbalance of power in transactions.	1	2	3	4	5	-
3.2	regulatory requirements relating to firm size limit the number of exit routes available to private equity investors.	1	2	3	4	5	-
3.3	the choice of an exit route depends on the certainty of executing the proposed exit route.	1	2	3	4	5	-
3.4	changing conditions in public *debt* markets affect the certainty of execution.	1	2	3	4	5	-
3.5	changing conditions in public *equity* markets affect the certainty of execution.	1	2	3	4	5	-
3.6	the possibility of dual or multi-track exit routes increases the certainty of execution.	1	2	3	4	5	-
3.7	fund managers favour exit routes with lower transaction costs.	1	2	3	4	5	-
3.8	the exit route that is most prevalent in the industry in which the portfolio company operates will be used.	1	2	3	4	5	-
3.9	a higher degree of asymmetric information due to smaller portfolio company size limits the number of available exit routes.	1	2	3	4	5	-
3.10	investments in large portfolio companies will generally be exited by means of IPOs.	1	2	3	4	5	-
3.11	it is more expensive to exit investments in larger portfolio companies.	1	2	3	4	5	-
3.12	there is a negative relationship between transaction cost and exit performance.	1	2	3	4	5	-
3.13	exits in Africa are more expensive than in other emerging markets.	1	2	3	4	5	-
3.14	exits in Africa are more expensive than in developed markets.	1	2	3	4	5	
3.15	managers will consider exit routes other than IPOs if conditions in public equity markets are sub-optimal.	1	2	3	4	5	-
3.16	expected future portfolio company performance is a key decision factor when an exit route is chosen.	1	2	3	4	5	-
3.17	IPOs are generally used as exit routes in the case of high-growth portfolio companies.	1	2	3	4	5	-
3.18	exit routes other than IPOs are used in the case of portfolio companies that exhibit stable growth.	1	2	3	4	5	-
3.19	there is a positive relationship between current fund performance and the success of fundraising for future funds.	1	2	3	4	5	-
3.20	young private equity firms will make use of more risky exit routes in the hope that superior exit performance is achieved so that future fundraising requirements are met.	1	2	3	4	5	-
3.21	in the case of IPOs, private equity firms will tend to underprice the issue to achieve substantial growth in the market once the shares start trading.	1	2	3	4	5	-
3.22	parts of the exit planning process may be outsourced if the management capacity of the fund managers is exceeded.	1	2	3	4	5	-
3.23	the management capacity of the managers of the portfolio company has an effect on the exit process.	1	2	3	4	5	-
3.24	portfolio company managers are intimately involved in the execution of the exit process.	1	2	3	4	5	-

3.25	when a portfolio company performs poorly due to a lack of skill on the part of portfolio company management, the particular management team is likely to be replaced.	1	2	3	4	5	-
3.26	the conditions in an industry's merger-and-acquisition market have an effect on the extent of financing available for private equity transactions.	1	2	3	4	5	-
3.27	B-BBEE is an important consideration when exits are planned in the South African context.	1	2	3	4	5	-
3.28	B-BBEE legislation makes it more likely that multiple exit routes will be considered when portfolio companies are domiciled in South Africa.	1	2	3	4	5	-
3.29	exits that are affected by B-BBEE legislation are more expensive than exits that are not.	1	2	3	4	5	-
3.30	B-BBEE legislation adversely affects exit performance.	1	2	3	4	5	-

3.31 If there are any other factors that may influence the choice of an exit route, please specify them here:

APPENDIX B

INTERVIEW GUIDE

SECTION A: FIRM AND RESPONDENT DEMOGRAPHICS

1.1 Name of private equity company

1.2 Portfolio company information

Number of portfolio companies invested in	
Average percentage ownership held per portfolio company	
Average amount invested per portfolio company (in Rand)	R

1.3 Funds under management (in Rand)

The following questions are not compulsory if the information is of a confidential nature:

Approximate funds under management by your firm	R
Approximate funds invested in Africa (excluding South Africa) by your firm	R
Approximate funds invested in South Africa by your firm	R
Approximate funds under management under your personal care	R

1.4 Your job title/description

1.5 Years of private equity experience

1.6 Years of work experience in the private equity industry doing deals with African portfolio companies (in years)

SECTION A: VARIABLES INFLUENCING DECISIONS ON EXIT *TIMING* AND EXIT *ROUTE* OF PRIVATE EQUITY INVESTMENTS UNDERTAKEN IN AFRICA

The following questions are based on the responses obtained from an extensive literature review and a pilot survey. The questions relate to fund managers' decisions regarding the timing of exits, as well as the exit route used, specifically in the African context. Exit timing refers to *when* an investment is exited, while exit route refers to the *type* of transaction that was used to complete the exit. These transaction types include initial public offerings (IPOs), acquisition sales, secondary sales, share buybacks, and write-offs.

2.1 Compensation for both fund and portfolio managers do not appear to be a driver of decisions regarding exit timing and/or exit route. Do you agree? If so, why do you think this might be the case?

2.2 It seems that value adding is not measured against the cost of monitoring investments. If not against monitoring, against what is the cost of adding value measured and how would that affect exit timing?

2.3 Overall fund performance is sometimes less than under some required level in the long run. If this is the case, would you consider liquidating the fund? If not, why?

2.4 Would you exit investments in portfolio companies to free up resources for other investments? If so, why? In what other way can resources for further investments be obtained?

2.5 Is it true that investments are exited before the end of the life of the fund? If so, why do you think this the case?

2.6 To what extent does transaction cost influence exit timing and exit route decisions, as well as exit performance?

2.7 How important is the monitoring of investments in portfolio companies and how much time and skill does it require?

2.8 Would you exit an investment when the portfolio company's managers are underperforming? If not, what remedial action would you take to address the underperformance? What would you regard as underperformance?

2.9 What effect does B-BBEE have on the private equity industry in South Africa? Does it make exits more complex/costly? To what extent are B-BBEE partners benefitted?

2.10 What effect does portfolio company size have in terms of the choice of exit route and exit timing? Could you please provide some examples in this regard?

2.11 What unique challenges do you face when doing deals on the African continent?

2.12 Which exit route is used most often by your fund and why?

2.13 Literature suggests that exit timing is important for delivering maximum returns to investors. Do you believe that this is true? If not, why?

2.14 Are there generally any investment duration limits imposed on investments in portfolio companies? If so, what would be the effect on exit timing?

2.15 Is the certainty of execution of an exit an important consideration when deciding on exit timing and exit route? What factors influence the certainty of execution? Do multi-track exit routes impact the certainty of execution?

2.16 How important is the state of the public debt and equity markets in driving exit decisions regarding exit timing and exit route? What other macro issues could have an effect on exit decisions?

2.17 Literature suggests that IPOs would likely be used as an exit route in the case of high growth portfolio companies, and that routes other than IPOs would be used in the case of stable growth or mature companies. Is this the case in your experience? If not, why?

2.18 How important is the reputation of a fund manager when it comes to future fundraising? What has an impact on a fund manager's reputation?

2.19 According to research, the management capacity of fund managers is limited by time and other constraints. Would you consider an exit if management capacity becomes constrained? How do you deal with management constraints?

2.20 If an industry has an active mergers and acquisition market, will you be more likely to consider an exit? If so, would your exit route decisions be based on the most prevalent exit route in that industry?

2.21 What, according to you, is the main factor influencing exit *timing* decisions?

2.22 What, according to you, is the main factor influencing exit *route* decisions?