The Emergence of Growth Equity as a Private Class of Asset

A. Seetharaman¹, Shriram Nagarajan¹, Nitin Patwa¹, Farah Naaz¹ & Ami Metha¹

¹ S P Jain School of Global Management – Dubai – Mumbai – Singapore – Sydney

Correspondence: Nitin Patwa, S P Jain School of Global Management – Dubai – Mumbai – Singapore – Sydney

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Abstract

This paper explores the issues in the emergence of growth equity as a private class of asset in a company portfolio. The independent variables investigated will be investment size, duration, risk and return, exit or repayment of funds, and timing. The driving factors of all five variables assist in the understanding of the emergence of growth equity. The driving factors in the paper include the availability of capital, competitiveness, regulation of the business atmosphere, stability of the firm, home-grown marketing of the products, and honesty in both regional and global trade. The paper further investigates the problems of each variable and the potential hindrance to the emergence of growth equity. The paper provides a significant contribution to corporate finance professionals and practitioners to better understand the problems and the potential in the emergence of growth equity as a private class of asset.

Keywords: growth equity, risk and return, exit or repayment of funds, stock duration, stock timing

1. Introduction

It has been found that growth equity asset had out-classed venture capital (Bartlett, 2008). Several institutional investors are on the rise in recognizing growth equity as a private class of equity asset that is distinct and separate from leveraged and capital buyouts. The emergence of growth equity is more evident by evaluating its risk characteristics, return profile and the company profile that plays a role in receiving growth equity investment to the leveraged buyout and venture capital asset classes (Cornell, 2014). There has been a massive shift over the last five years from the initial stages of investment and old leverage buyout funds (Fleming, 2000).

Growth equity is a link between leverage buyouts and late-stage venture on the spectrum of strategies of private investment (Schoen, 2015). The process helps in establishing companies that can benefit from more capital in growth acceleration. Most companies usually lack prior institutional investment, substantial organic revenue growth, proven models of business, and ownership by the founder (Sharma & Saini, 2014). There are several potential reasons for the material growth of target companies without the requirement of outside institutional capital. The main reason is the desire for growth acceleration with the help of investing in new product development, infrastructure, human capital, and new geographic regions (Rozwadowski & Young, 2005). Also, include monetizing a portion of management ownership or making add-on acquisitions.

The emergence of growth equity typically lowers stakes by the use of little if any leverage at the investment level while expecting to be the last round of all financial wants. Growth equity acquires a more prominent position than common equity. The investment often comes with contrary control negotiations in giving both approval and provision rights in trying to mitigate the risks of owning positions of a minority. Investors are likely to receive the rights in approving the business plans, divestitures or new acquisitions, and the issue of equity or new debt (Karmeshu & Sharma, 2014). A growth equity investor often has the rights to participation in or initiation of a liquidity event that follows a given period, usually 3 to 5 years (Karam, 2002). One can instructively contract buyout with growth equity deals and venture capital transactions.

Companies are also involved in leveraged buyouts with a stable earnings stream. Such involvement of companies may grow less aggressively and used in facilitating debt assumption (Sharma & Saini, 2014). The debt assumptions are expected to contribute materially to the return of investment. Venture capital investors play a role in receiving the same preferred equity positions as the ones given in growth equity funds. There is always some lack of the downside protection because of the most venture capitalist (Brown, 2014). The sharing of control with a syndicate of different institutional investors usually involves conflicting priorities and interests, and thus growth equity investors usually avoid such a scenario. This research is expected to play an essential role in understanding the importance of emerging growth equity. This research would be helpful for various professionals who fall under the private equity
stream, as they would be able to place more focus on this area where the risk is low, and returns are assured because the investing companies are mature. The topic of growth capital is less researched because there is limited access to data; therefore, research in this area is still preliminary and inconclusive.

2. Literature Survey

Growth equity investors must always be proactive, especially when sourcing deals. The process does not necessarily require many candidates to raise capital. The most attractive companies need to be found and convinced of the necessity of value proposition (Sharma & Saini, 2014). There is a use of a cold-calling approach in growth equity with team members that reach out to the teams of management of potential interests in companies in building a relationship and gaining the knowledge about the operation of the company. The effort requires common responsibility in the levels of associations of professionals (Pichhadze, 2010). The levels of organizations include databases, industry news, tradeshows, and other sources when searching for potential target investments and the use of advanced customer relationship management systems in tracking efforts.
2.1 Factors

2.1.1 Investment Size

**Dilemma:** Problems in the investment size result depend on the evaluation of the performance of both executive management and boards of the emergence of growth equity. The practices always present more questions than answers (Sadker, 2000). Every company faces some specific concerns as the more challenging problems of investment size persist. The persistence of the issues is evident across several companies, as they show no relationship to the regulations, industry, competitive landscape, or geography (Sharma & Saini, 2014). The examination of the problems and the creation of solutions are helpful in the management of the organization, providing room for better equipment in revamping and developing enterprise programs for managing risk.

Types of private equity investment are the emergence of growth equity, expansion capital, or growth capital. The investment size variable usually hinders the emergence of growth equity, expansion capital, or growth capital when trying to look for capital that helps in the expansion and restructuring of operations (Wooldridge & Gooden, 2009). The entrance of investment size into finance or a new market plays a significant role in acquisition without any control changes to the business. The set of building blocks includes earnings growth, income return, and multiple expansions (Bibi, 2012). The components that forecast growth equity are similar to the components of decomposition. Minority side of the investment is also a hindrance to the emergence of growth equity.

**Contributions:** The type of variable involves assessing the company’s strength to help in gauging pre-money valuation and the amount of risk. The years 1992 and 2008 saw an investment of nearly 50% growth in technology that included communication companies and media. It was followed by 20% & 15% growth in retail & financial services respectively. This scenario is similar to the venture capital that requires the same period of 63% of the sum of capital that goes into technology companies. The next in sequence is the life sciences with 27% (Foighel, 1979). The managers of buyouts always tend to make investments across a broader range of sectors. Technology tops the sector with 30% and the retail or consumer sector with 25% (Sharma & Saini, 2014). The manufacturing and related industrial sectors have 14%. The emergence of growth equity is most evident in the bright areas of capital loss ratios of 1. Increasing the investment increases the returns, meaning there is a direct variation of the two variables. The investment size provides for lower risks in the emergence of growth equity (Irle & Kattenbeck, 2015). Private equity firms continue to give more funds to mature companies than new ones.

The driving factors that influence investment size include Capital availability, Competitiveness, Regulatory environment, Stability, Local market, Openness to both international and regional trade. The local region provides an opportunity for investors to place risk in comprised capital (Oberli, 2015). Both the general economic environment and the global capital market environment play a significant role in determining the flow of investment size. The driving factors for investment rest on its development of labor and physical resource availability, infrastructure, workforce skills, and productivity, and development (Bose, 2005). A developing and growing economy needs both resources and support in trying to facilitate the sale of both services and goods (Wooldridge & Gooden, 2009). The maturation of the elements due to the lower transactions helps investors earn returns on their investments. These investments can generate enough profits (Fpmpia, 2014). The driving factors also help in attracting all available investment sizes of skilled employees who possess the right experience, attitude, and proficiencies in creating, manufacturing, and providing services and goods.

2.1.2 Risk and Return

**Dilemma:** The possible problems of the risk and return are evident in organizations that use enterprise risk management. The possible problems include: Assessing the emergence of growth equity, Defining risk, Privilege, Time horizon, Quantitative versus qualitative, Risk assessment method. Risk and return employ the rare combination of the company consensus in focusing on appreciation and stronger executive management for the various sensitive programs (Schoen, 2015). One of the measures aims at driving shareholders and protecting capital value.

Risk and return hinder the emergence of growth equity, as the companies seeking growth capital always do so when financing their life-cycle transformational events. Equity risk and return are equal to real earnings growth plus current dividend yield plus currency adjustment plus the change in valuation. The final component represents the group un-hedged foreign investment. The data source is the emergence of growth equity that presents a series of clear language shown in the white paper in setting forth the methodology (Wilson, 1988). Working out the emergence of growth equity requires the use of three criteria. These criteria include robustness, transparency, and timeliness, which are helpful in the calculation and description of the framework behind asset risks projection, returns, and correlations (Wooldridge & Gooden, 2009). The dealings with the different types of criteria hinder the
emergence of growth equity.

**Contributions:** The risk and return look at private equity's three unique asset classes of capital growth, venture capital, and leveraged buyouts (Hawley & Williams, 2000). The use of an effective cold-calling strategy has become a prerequisite for the successful growth in equity investing in an increasingly competitive market (Gianfrate & Loewenthal, 2015). There should be a general cold-calling program measurement in order to take the sound decision. The markets are increasingly becoming institutionalized, especially for more significant deals in places such as North America (Williams, 1982). Proprietary sales are becoming harder to find. Growth equity funds look the same as venture capital funds regarding the allocation of the sector with its significant exposure to technology. Risk and return deal with mature companies using their resources in the capital expansion. Companies with no prior institutional investments and with greater financial strength or growth are the ones getting the investments.

There is a link between return and risk in such a way that higher the investments lead to higher uncertainty. The uncertainty is the risk in any form of business when expecting a rate of return. Risk includes the following: Managing portfolio risk, both risk and uncertain returns, Relationship between return and risk, Asset Allocation, Diversification, Specific type of risk. Risk and return play a significant role as driving factors in the emergence of growth equity in money in banks and money market securities (O'Connor, 2013).

2.1.3 Duration

**Dilemma:** The problem of duration occurs in areas where the organizations or companies struggle in demonstrating the value of the emergence of growth equity in an attempt to justify implementation costs (Wooldridge & Gooden, 2009). There is an evaluation of traditional duration by the use of a reward metric and shared risks, like the risks adjusted on capital, return on equity, and return on assets. The first component, the current dividend yield, has been the most reliable part of the ownership of stock over the last 200 years (Ritter, 2011). This component means that long-term investors get to earn much of their internal rate of return than short-term investors.

Duration hinders the emergence of growth equity, as it may make companies more mature than companies funded by Capitals (Wooldridge & Gooden, 2009). The duration is likely to allow for the accumulation of profits and the generation of revenues from new companies. The duration analysis involved in the emergence of growth equity includes calculations and the use of the emergence of growth equity (Livdan&Nezlobin, 2013). There is an assumption that increasing retained earnings and the corresponding reduction in the payout ratio of duration result in higher and higher growth rates (Bhakdi, 2013). Higher future growth does not result from lower payouts. Therefore, there is a common assumption that low current dividend yield implies that future returns are less than the historical realization.

**Contributions:** The investment period is vital in holding asset class. Several factors affect the duration in the emergence of growth equity, such as the inflation rate and interest rate. The investment holding period of growth companies is longer. Equity prices always fluctuate, and therefore there is always a chance of providing a negative or positive yield (Siming, 2010). The impacts must always be taken care of while investing in mature companies. The years between 1992 and 2008 show an apparent growth of equity investment in the generation of overall capital loss rates of 13% in comparison to 35% for venture capital and 15% for leveraged capital (Fox &Ortman, 2000). It is noteworthy to compare loss ratios between leveraged capital and growth equity. Growth equity forms one of the segments of equity industries of private sectors, also known as the growth capital. Growth capital is the extension of the venture capital. Venture capital focuses on early-stage companies, whereas growth capital mainly concentrates on mature companies (Sylvester &Egeli, 2000). The reasons that few companies approach growth equity include the necessary expansion of operations, restructuring of the current business, entrance into a new market or development of new products in the already existing market, and acquisition of the competing business (Nisar, 2005). Duration as an independent variable is significant in the emergence of growth equity.

There is low beta and reliable, high-quality performance for a good number of years that is likely to result in huge shock. Bond yields of 90% are evident in countries such as the United States (Wilson, 1988). The dividing factors of emergence in growth equity are likely to result from the most vulnerable of shorter-duration sectors. The shorter-duration sectors include financial and cyclical nature and it helps in placing outperformance during the rise of bond yields. Healthcare and customer staples face the most risk in the emergence of growth equity. The consistency of performance and a moderate duration result in the rise of bond yields (Rozwadowski& Young, 2005). The rise in bond yields does not depend on inflation or the real growth that divides the bond yields.
2.1.4 Exit/Repayment of Funds

**Dilemma:** Exit or repayment of funds faces the problem of allowing the management of a company to quantify the risks of the same company. The risk information continues to rise as the repayment of funds is difficult to quantify (Wooldridge & Gooden, 2009). The decision is likely to arise in suing the company lawyers when relating the risk distribution to the constituents, external regulators, and auditors. There is a commonly held assumption that mean-reverting are common in valuation multiples and the correspondingly low dividend yields of the high multiples (Siming, 2010). The effect is the lowering of future returns and vice versa. Dealing with the problem requires the company to balance the visibility of risk and legal exposure.

Exit or repayment poses the most significant challenge that hinders the emergence of growth equity when trying to establish a standard and consistent application of nomenclature risks (Oberli, 2015). Any of the differences between the methodologies or risk definitions are likely to hinder the emergence of growth equity. The primary aim of exit or repayment of funds for the type of modeling framework is helpful in providing a set of exhaustive and mutually exclusive components (Umbrell, 2003). The collective research goals help in capturing drivers of the emergence of growth equity. Further improper handling of exit or repayment of funds continues to hinder the emergence of growth equity.

**Contributions:** Exit or repayment of funds of a private equity fund results in companies making investments (ISI Bulletin, 1949). The investments are also known as portfolio companies (Umbrell, 2003). All processes can be either substantially or partially financed by the debt. There is always leverage of the transactions of some equity investment (Mustafa, 1999). The flow of cash from a portfolio company always provides a source of debt payments. There is a target of gross returns of 3x to 5x by growth equity managers at the level of investment, which falls under the buyouts (Cornell, 2014). The buyouts go up to 3x but trend lower at present (White, 2008). The venture capital is potentially higher than 10x in the early stages of the deal. The managers take into account the typical targets in funding level returns of 2.5x to about 3.5x for the funds of venture capital with 2x to 3x for the growth fund of equity (Heitman, 2015). The buyout funds result in 1.5x to 2.5x. Past decades provide evidence of stronger actual performance with reliable caveat data on the asset classes that do not go further. There are also end-to-end net returns for growth equity over periods of 3, 5, and 10 years (Vismara, 2015). The net returns outperform venture capital and compete with leveraged buyouts. The portfolio of the company usually bases its acquisition price on several multiples.

The exit or repayment of funds acts as the dividing factor in the emergence of growth equity. The repayment of fund plays a role in the outperformance of both high-quality stocks and beta stocks as the most persistent trends (Schoen, 2015). Investors can play a significant role in reducing risks and simultaneously increasing returns in counter-intuitive certainties. The strong performance of the emergence of growth equity presents suggestions as a candidate for the greatest finance anomaly. The work on exit or repayment of funds offers different perspectives on the emergence of growth equity dividing factors (Wooldridge & Gooden, 2009). Growth equity forms one of the factors that contribute to the exit or repayment of funds and the outperformance of expectation precisions.

2.1.5 Timing

**Dilemma:** The problem of timing seems to be more complicated, as it explores the difficulties in research timing. The process refers to a systematic way to solve research problems. It involves following a step-by-step method in trying to solve a particular problem referred to research knowledge (Benninger, 1986). The method also relates to a systematic and scientific search for pertinent information on specific topics. Timing revolves around different sources of secondary data that are in line with the emerging growth equity. The timely identification of the company data is likely to be more tedious and wasteful.

A lack of proper timing of companies hinders the emergence of growth equity. There must be some alternative conduits that aim at securing capital for growth. Accessing the growth requires the critical pursuit of equity in necessitating marketing and sales initiatives, expansion of the facility, development of new products, and purchase of equipment (Nisar, 2005). Timing is also useful in affecting the balance sheet of a company, especially when reducing the leverage (Wooldridge & Gooden, 2009). Timing also hinders the emergence of growth capital when certain investors use hybrid securities with contractual variables.

**Contributions:** Time helps in building up an idea that the returns depend on influencing several factors for the firm to either invest or not invest (Wold & Laux, 2011). Past returns substantially show favor in growth capitalism. There is evidence of growth equity generation in the years between 1992 and 2008. The result is a generation of the gross multiple of capital invested of 2.0 that is ahead of buyouts and in line with venture capital (Edwards, 2013). There is still no guarantee for the creation of Multiple OnInvested Capital (MOIC). The best example is the investment in
deals of 60% capital with less than cost value, comparing the 60% figure to 35% for growth equity and the creation of an additional 60% venture capital (Sadker, 2000). Capital investments generate in deals a MOIC that is greater than 6% with evidence of high performance in deals in growth unity that account for 9% of all dollars invested with only a total value of 37% (Teugels, 2005). Growth equity delivers similar historical returns as already noted; the delivery gets done with lesser dispersion among both the dealers and the manager. Another consequence of proper market timing is earning uncertainty (Fleming, 2000). The uncertainty may result in the high growth of firms. This showcases all the observations frequency of fund level of net internal rates of returns between the years 1992 and 2008 for venture capital, growth equity, and leveraged buyout funds. Overall, the growth equity has a narrower and taller curve that implies less visibility in returns (Claessens, 1995). Excluding growth equity funds greater than 1 billion dollars makes the curve shorter and shift slightly to the right. There is still the process of a fair number of large growth equity funds maturing that may eventually generate an upside type of performance (Gupta, 2006). The same process is done to venture capital.

Timing plays a significant role as a dividing factor in the emergence of growth equity. Thinking of the average timing helps in accruing dividends that are useful in the expression of equity equivalent to perpetual bonds (Sylvester & Egeli, 2000). The expression for time is represented by timing = 1 divided by the difference of discount rate and growth rate. There is an estimation of a period of 30 to 40 years when dealing with timing as a dividing factor for the emergence of growth equity. Timing plays a role in the measurement of sensitivities of price equity about changes in discount rates. There is also an assumption that bond yields are likely to rise when focusing on the emergence of growth equity in timing (Wooldridge & Gooden, 2009). Growth equity timing depends on the growth rate dividends, the rate of discounts, and volatility of dividend growth. There is evidence of 11 periods of global bond yields that rose over the past 40 years. The timing gives a range of between 5 months and slightly over 2 years, making the bond yields rise by approximately 83 basis points.

3. Research Methodology

The present study revolves around different sources of secondary data that are in line with the emerging growth equity. Secondary data collection was useful in the decomposition of the emergence of growth equity into sets of building blocks. The sets of building blocks include earnings growth, income return, and multiple expansions (Bibi, 2012). The components that forecast growth equity are nearly similar to the components of decomposition. Equity return is equal to real earnings growth plus current dividend yield plus currency adjustment plus the change in valuation (Wold&Laux, 2011). The first component, the current dividend yield, has proven to be the most reliable component of stock ownership over the last 200 years (Ritter, 2011). This component represents the real internal rate of return derived from long-term investors. There is a commonly held assumption that means reverting is the valuation multiples and the correspondingly low dividend yields of the high multiples. The resultant effect is the lowering of future returns and vice versa. The final component represents the group un-hedged foreign investment. The data source is the emergence of growth equity that presents a series of clear language shown in the white paper in setting forth the methodology (Wilson, 1988). Working out the emergence of growth equity demands the use of three different criteria. The criteria include robustness, transparency, and timeliness, which are helpful in the calculation and description of the framework behind asset risk projection, returns, and correlations.

The data in the study were derived from the definitive investment agreement for various transactions and met all eligibility criteria for the study. Like debt instruments, the emergence of growth equity represents a significant asset of class in providing a way for corporations to raise capital.

4. Discussion, Analysis, and Findings

Investment size uses quantitative benefits that are helpful in improving awareness, risk accountability, management, risk transparency, risk management elimination activities, and financial and risk metrics of statements (Teugels, 2005). Most companies try risk management since it is part of business and risk integration, the process of risk-assessment enhancement, the standard practice of business, and the concerns of governance (Wooldridge & Gooden, 2009). The activities are likely to require the following: technologies, new resources, process enhancement, and policies. All activities assume different degrees of the emergence of growth equity and capital expenditure (Wooldridge & Gooden, 2009). A potential solution arises when trying to protect sensitive information by gathering or reporting back the necessary data. The correct deal size of an investment is the only way out.

Risk and return try to focus on company courting, which takes time (Hawley & Williams, 2000). The shareholder benefits include the driving of equity premium by the public with a positive perception, the integration of results of risks, and the improvement of the risk score or credit rating (Pichhadze, 2010). The next approach to solving problems is trying to avoid risk. Avoiding risk requires the reduction of volatility through insurance products,
hedging, and risk mitigation through control of increments (Karmeshu & Sharma, 2014). The employment of hard dollar savings is also helpful in finding solutions to problems. This method uses hard dollar savings like process consolidation, risk infrastructure, cost and insurance reduction, and reduction of capital requirements. There should be some strengthening of the money market in trying to find a solution to the risk and return problems.

The effort of time duration requires responsibility in the levels of associations of professionals (Pichhadze, 2010). The levels of organizations include getting industrial news and articles when searching for prospective target investments. The clients advance the link of management systems in tracking efforts. There can be a total loss of business direction beyond the money (White, 2008). The growth capital firm tries to remain active, which is good, but it can result in the loss of necessary control of the elements in a business, such as hiring and firing workers, setting the strategy, and choosing the management team. Another possible option is relinquishing control (Williams, 1982). Private equity firms aim to make companies more vulnerable, investing in companies and selling off stakes for more substantial profits. Allowing for more extended time duration is helpful in gaining more profits.

Increasing the exit or repayment of funds increases returns, meaning there is a direct variation of the two variables. The sizes of funds provide for lower risks in the emergence of growth equity (Irle & Kattenbeck, 2015). Private equity firms continue to give more funds to mature companies than new ones. Venture capital focuses on early-stage companies, whereas growth capital mainly concentrates on mature companies (Sylvester & Egeli, 2000). The reasons that few companies approach growth equity include the necessary expansion of operations, restructuring of the current business, entrance into a new market or development of new products in the already existing market, and acquisition of the competing business (Nisar, 2005). Duration as an independent variable is significant in the emergence of growth equity due to its smooth operation methods.

There are end-to-end net returns for growth equity over periods of 3, 5, and 10 years (Vismara, 2015). The net returns outperform venture capital and compete with leveraged buyouts. The portfolio company usually bases its acquisition price on several multiples. The minority investment size is also a hindrance to the emergence of growth equity. Dealing with the problem requires the company to balance the visibility of risk and legal exposure. Therefore, there should be an application of low current dividend yield in implying slightly less than future returns. There is evidence of 11 periods of global bond yields that rose over the past 40 years. The timing gives a range of between 5 months and slightly over 2 years, making the bond yields rise by approximately 83 basis points, solving any problems in the process.

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