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The role of venture capital and private equity in the Portuguese market

JOÃO MIGUEL CABRITO CALDEIRA[1] & CARLOS MANUEL PINHEIRO[1]

[1] Universidade Europeia

Contacting author: joao.caldeira@sapo.pt

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Objectives | The origin of private equity in Portugal dates to the end of the 1980s, having emerged in a very specific context of easy access to credit. So, initially, it was associated with companies for which it would be more difficult to tap other forms of financing. This clearly diverged from the concept of private equity in the North American and European more developed markets. There has been an evolution of the use of this type of funding in Portugal, although it remains a specific case, calling for a single-country analysis.

The venture capital and private equity progressive evolution over the last couple of decades, has attracted the attention of academics. Extant studies resulted in a heterogeneous set of themes: (i) venture capital and private equity adoption, financing processes, roles and governance; (ii) syndication; (iii) creation of public organizations, reputation, and investment performance (Cumming and Johan, 2013). Studies focusing on a single country are concentrated in the U.S., although China is attracting more studies.

Can venture capitalists add value to the companies beyond the money they supply?

Sapienza (1992) was the first to address this question by conducting surveys to venture capitalists and entrepreneurs. Other studies adopt a more holistic view and analyse the roles of venture capitalists (Gorman & Sahlman, 1989; Sapienza et al., 1996). Douglas Cumming from Florida Atlantic University, U.S. is the most prolific and one of the most cited authors in this field.

Building on the theory of the firm and the agency theory (Fama, 1980), the main contribution of this study on the Portuguese market, spanning 2000 to 2022, is to analyse whether venture capitalists and private equity investors (henceforth VC&PE) create value for the companies they are financing and whether the gains persist in the medium-long run, thus contributing to the long-term financial sustainability of the financed companies.

The mechanisms through which VC&PE can add value to a company, beyond the money they provide, might originate from their expertise and strategic guidance, as well as their connections.

The effects can also be propagated to the governance of the borrowers (Wynant et al., 2023). As medium and small firms are less scrutinized, VC&PE can provide external oversight and act as a governance mechanism.

Methodology | The research will focus on the Venture Capital industry in Portugal, namely on the capacity of this type of investor to bring value to the companies they support.

The study addresses the VC&PE market in Portugal over the last 20 years and considers deals for which exits have already taken place for at least three full years, in order to assess whether the possible value creation capacity contributed to companies by these investors is maintained after the exit. To do so our data set of hand collected data is organized to set the moment of entry and the moment of exit in a comparable way. The maturities of each tranche (the key unit of reference in loans) are also normalized. Loans comprise all deals signed between a borrower and a lender.

A "comparable company" with traditional funding is the benchmark to ascertain the excess value, namely in terms of value added. These "comparables" are entered into the sample together with a dummy to differentiate between VC&PE funding and traditional credit.

The data on deals are hand-collected. Firms' characteristics are sourced from ORBIS, a Bureau van Dijk comprehensive database.

Baseline specification:

$$\Delta Value\ added_{it} = \alpha + \beta dummy + \delta deal\ characteristics_{it} + \gamma controls_{it} + \eta_i + \varepsilon_{it}$$

where i is the funded company and t is time. Controls include variables deployed in extant studies: at the firm level (size, seniority/date of inception, leverage, efficiency, industry sector) and at the macroeconomic level (GDP, CPI). Firm and time fixed effects (η_i) are used to capture unobserved variables and avoid results being driven by a specific firm or year. A Heckman selection model tests for sample selection.

The econometric setup includes parametric and non-parametric tests for differences between two subsamples (VC&PE and traditional funding), to gauge the influence of venture capitalists on the governance of funded firms (e.g. board structure and composition, including the addition of seasoned executives or industry experts).

The study caters to Tourism and other sectors, comparing the betas.

In robustness tests we run GMM entering 1-lagged Value added as an instrument.

Main Results and Contributions | Exploratory analysis has catered to the heterogeneity of industry sectors and focused namely on the tourism industry. Deals in the sector of Tourism represent around 10% of all the VC&PE contracts in Portugal in the last 20 years. The maturities of VC&PE deals of tourism are somewhat longer (5.7 years) than the average across sectors (5.3 years). From our preliminary analysis stands out that Hospitality is the most active subsector in the market. The funding in Hospitality as in other subsectors and sectors is used for buyouts. In Hospitality the most active uses of VC&PE capital are for real estate and construction, as well as refurbishment of existing units. The results highlight the specificity of Tourism and Hospitality in terms of access to

VC&PE and are expected to contribute, namely, by providing insights on the benefits of VC&PE in terms of management practices, as compared to other economic sectors.

Limitations | Our sample includes only the deals for which there is public information.

Conclusions| The research is expected to unveil the factors explaining the influence of venture capitalists and private equity investors on managerial practices of borrowers, both in terms of firm financial performance and governance, in the medium-term.

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