

Dorota Podedworna-Tarnowska

Collegium of Business Administration
Warsaw School of Economics

IPO as a VC-Funds Type of Exit

ABSTRACT

The key characteristic of private equity finance is that investors hold their investments only for a limited period of time. The key goal of VC funds is to grow the company to a point where it can be sold at a price that far exceeds the amount of capital invested. This process is called an exit or divestment. There are three basic types of exits: going public, being acquired by a larger corporation, a sale to a third-party investor.

It is a widely believed and accepted proposition in private equity literature that the initial public offering of a private equity portfolio company is the most successful and profitable exit opportunity. However, according to the few sources of literature, public offerings are not the preferred divestment type for venture capital firms. Going public is one of the most critical decisions in the lifecycle of a firm. This is not easy, as the process is very comprehensive and complex. Hence, a lot of considerations should be taken into account. Because every investee firm is different, a development plan to achieve a successful exit takes into consideration a number of macroeconomic and microeconomic factors. Moreover, several advantages and disadvantages of exit through an IPO could be indicated. The objective of this paper is to show the success and profitability of going public by VC funds. The VC's exit type as a way of cashing out on its investment in a portfolio company is a consequence of the exit strategy, which means the plan for generating profits for owners and investors of a company. While an IPO is the most spectacular and visible form of exit, it is not the most common one, as historically in the US it was, but still in Europe it has not been yet. There will be both literature and statistical data coming from different studies and reports used in this research.

Keywords: Venture Capital, corporate finance and governance, financial markets, financial instruments, value of firms, capital and ownership structure

JEL Codes: G24 G34 D53 G23 G32

Introduction

The key goal of VC funds is to grow the company to a point where it can be sold at a price that far exceeds the amount of capital invested. This process is called an exit or divestment. The above indicated goal is not easy and approximately one-third of portfolio companies fail. This means that out of a portfolio of 10 investments, the average venture results are as following¹:

- One or two will collapse through bad management or bad luck;
- Three or four will underperform badly so that they just hang on by the tips of their fingers;
- A couple will perform just above expectations;
- One or perhaps two will be real stars.

A venture capitalist must liquidate the investment and distribute proceeds to investors within the predefined time of the fund. From the point of view of the venture capitalist, it represents a long-term and quite illiquid investment for many years. Since most of these firms initially do not earn positive cash flows, the exit from the venture is the primary way for the venture capitalist to realize a positive return on the investment².

As the process of private equity investment consists of three main stages: fund-raising, investing and exiting, which are interrelated, the reverse mechanism is observed. This means that the exit stage has a feedback effect on the fund-raising and investing phases³.

When a venture-backed company exits the portfolio, the VC distributes the profits to the fund's investors and eventually leaves the portfolio company's board of

¹ S. Bloomfield, *Venture Capital Funding: A Practical Guide to Raising Finance*, Kogan Page Ltd., London 2008, p. 104.

² A. Schwienbacher, *An Empirical Analysis of Venture Capital Exits in Europe and the United States*, Working paper, University of Amsterdam, January 2005, pp. 1–38.

³ A. Hyytinen, *How Important Are Exits for Venture Capital Finance? Evidence from Finland*, [in:] *Venture Capital, Entrepreneurship, and Public Policy*, V. Kanninen and Ch. Keuschnigg (Eds.), MIT 2005, pp.127–149.

directors. That is why the choice among exit options may have important distributional consequences between the entrepreneur and the venture capitalist. The fund ends once all the investments of a particular fund have been exited and the profits have been distributed. In many cases, the institutional investors reinvest the earnings into the new funds and the process begins anew.

It is a widely believed and accepted proposition in private equity literature that an initial public offering of a private equity portfolio company is the most successful and profitable exit opportunity⁴. However, according to the few sources of literature, public offerings are not the preferred divestment route for venture capital firms⁵.

The purpose of this paper is to review a wide body of research relating to the venture capital exit route and to indicate the most popular forms of divestment. The main focus will be concentrated on an IPO as a type of exit. In undertaking such a task, it is important to provide answers to the following questions concentrating on the exit process management:

1. What kind of exit do VC funds prefer?
2. What are the positive and negative aspects of an exit by IPO?
3. Is an IPO really the most successful and profitable exit opportunity?
4. Which factors are the key decision drivers regarding the choice of an exit route?

This article is divided into 5 sections beyond the Introduction and Conclusion. The paper is structured as follows.

In Section 1 the definitions and differences between venture capital and private equity are developed. The framework and types of exits in theory and practice and a venture capitalist's involvement on the exit choice are gathered in Section 2. Section 3 is dedicated for details of initial public offering as a kind of a VC type of exit. In section 4 underpricing of venture-backed companies and control after exit is indicated. The most common type of exit in the USA, Europe and Poland by highlighting a number of specificities of these markets are described in Section 5. The conclusions are included in the last Section together with indicating possible directions for future research.

⁴ See for example P.A. Gompers, J.A. Lerner, *The Venture Capital Cycle*, The MIT Press, Cambridge 1999.

⁵ M. Wright, K. Robbie, *Venture Capital and Private Equity: A Review and Synthesis*, "Journal of Business Finance & Accounting", June/July 1998, Vol. 25, Issue 5–6, pp. 521–570.

1. Venture Capital versus Private Equity

Both in theory and practice, even sometimes in statistical data, there are two terms that are used interchangeably: “venture capital” and “private equity”. It is important to distinguish between these two industry terms.

According to the European Venture Capital Association (EVCA)⁶, private equity is a form of equity investment into private companies not listed on the stock exchange. It is a medium to long-term investment, characterized by active ownership. Private equity builds better businesses by strengthening management expertise, delivering operational improvements and helping companies to access new markets. While venture capital is a type of private equity focused on start-up companies, venture capital funds back entrepreneurs with innovative ideas for a product or service, who need investment and expert help in growing their companies.

Similar definitions are used by the Polish Private Equity Association (PSIK)⁷, which describes venture capital as a professional equity co-invested with the entrepreneur to fund an early-stage (seed and start-up) or expansion venture. In this specific high-risk investment, the investors expect higher than average returns. However, according to the PSIK, private equity provides equity capital to enterprises that are not quoted on a stock market, this association stipulates that private equity can be used for different reasons:

- to develop new products and technologies;
- to expand working capital, to make acquisitions;
- to strengthen a company’s balance sheet;
- to resolve ownership and management issues.

The National Venture Capital Association (NVCA) defines venture capital as focusing on investments in new companies with high growth potential and accompanying high risk and private equity as investments in non-public companies, usually specified as being made up of venture capital funds and buyout funds. The NVCA uses in its reports the following definition⁸:

Private Equity = Venture Capital + Buyout/Mezzanine

In this sense, venture capital is regarded as a subset of private equity, referring more to investments made during the launch stages of a business. The connotation differs depending on a region and country, which has a historical background. North

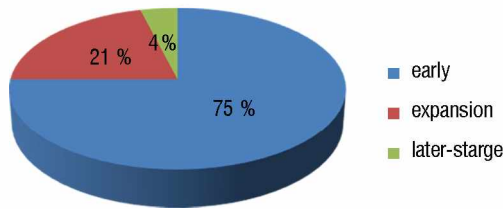
⁶ <https://www.investeurope.eu/about-private-equity/private-equity-explained/>, retrieved on 5.04.2017.

⁷ <http://www.psiik.org.pl/glossary.html/>, retrieved on 5.04.2017.

⁸ See for example *NVCA Yearbook 2016*, pp. 62, 92, 95.

American investors used to prefer investing in early-stage firms); hence, their investments were increasingly regarded as venture capital (see the stages of investment in the US in Figure 1 below).

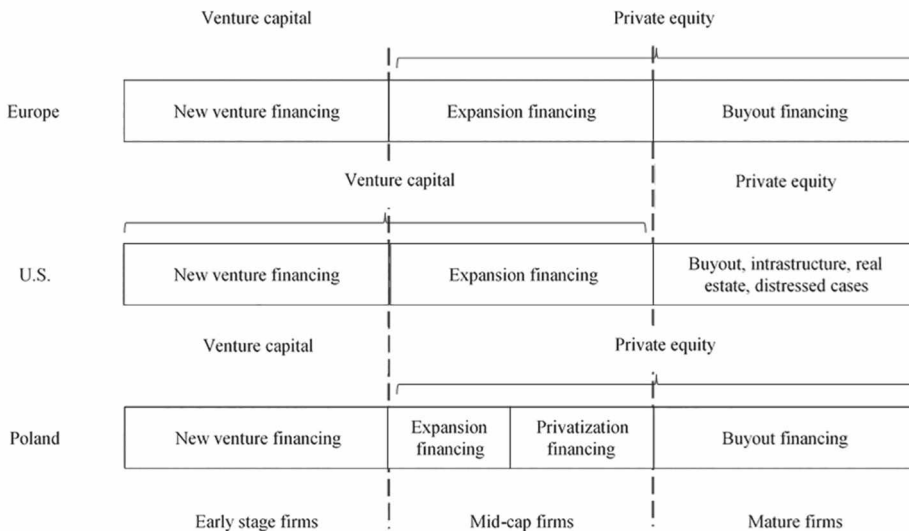
Figure 1. Stages of investment of VC funds in the USA



Source: *Emerging best practices for building the next generation of venture-backed leadership*, Spencer Stuart and NVCA 2010 Study, p. 8.

Comparatively, European investors historically pursued later-stage expansion deals and consequently, they preferred the term private equity. This is the basic reason for which these two terms and their definitions differ according to regional perceptions (see Figure 2 below)⁹.

Figure 2. The spectrum of venture capital and private equity in different places.



Source: D. Klonowski, *Private equity in Poland, Winning Leadership in Emerging Markets*, Polgrave MacMillan 2011, p. 8.

⁹ In this article both terms venture capital (VC) and private equity (PE) will be used alternatively depending on the region.

Another research made by J.R. Ritter shows that growth capital-backed IPOs are IPOs with a financial sponsor that, unlike a buyout-sponsored deal, typically owns far less than 90% of the equity prior to the IPO. Furthermore, many growth capital-backed IPOs have debt in their capital structure. The main criteria for classifying a financial sponsor as growth capital rather than venture capital is whether the company is investing in tangible assets or intangibles, which is highly correlated with the industry of the company. If the company is growing via acquisitions, it would generally be categorized as growth capital-backed rather than venture-backed. The data is shown in the table below.

Table 1. VC-backed, growth capital-backed, and buyout-backed IPOs, 1980–2015

Year	Number of IPOs	Financial sponsor-backed		VC-backed		Growth capital-backed		Buyout-backed	
		No.	%	No.	%	No.	%	No.	%
1980–1989	2044	653	32%	440	22%	73	4%	140	7%
1990–1998	3613	1676	46%	1065	29%	193	5%	418	12%
1999–2000	858	580	67%	498	58%	19	2%	63	7%
2001–2015	1664	1218	73%	662	40%	94	6%	462	28%
1980–2015	8178	4127	50%	2665	33%	379	5%	1083	13%

Source: J.R. Ritter, *Initial Public Offerings: VC-backed IPO Statistics through 2015*, January 6, 2016, p. 9, <https://site.warrington.ufl.edu/ritter/files/2016/02/Initial-Public-Offerings-VC-backed-IPO-Statistics-Through-2015-2016-01-06.pdf> (retrieved on 5.04.2017).

Although in many studies the differences between venture capital and private equity are emphasized, several use these segments of market interchangeably. The main scarcity of available statistic data appears to be the reason for that.

2. The Framework and Types of Exits in Theory and Practice

VC investors are active, value-added investors that bring not only capital to the table, but knowledge, skills, and a network of legal, accounting, investment banking, marketing, and other contacts that are useful to an enterprise. Hence, VCs will exit from an investment when the projected marginal value added as a result of the VCs' efforts (all things that VCs can do to add value to an enterprise), at any given measurement interval (points in time at which the VC formally or informally reassesses its continued commitment to an investment), is less than the projected cost (all the direct and overhead costs associated with creating value, the costs of monitoring and

periodically re-evaluating the investment, as well as the opportunity cost associated with alternative deployments of capital)¹⁰.

The framework for the exits can differ among the funds but typically it consists of ten steps (see the table below).

Table 2. Typical exit steps

Step	Characteristic
1	Identification of an exit opportunity
2	Evaluation of a portfolio firm and exit routes
3	Designing the exit process and mandating advisers
4	Assigning roles and responsibilities, negotiating incentives
5	Preparation before the launch of the exit process
6	Launch of the exit process
7	Conduct of the exit process, negotiations with bidders
8	Evaluation of the exit options and offers
9	Transaction closing
10	Ex-post review

Source: the author’s own study based on S. Povaly, *Private Equity Exits. Divestment Process Management for Leveraged Buyouts*, Springer 2007, p. 183.

There can be indicated three basic types of exits: going public, being acquired by a larger corporation or a sale to a third-party investor. Apart from these three basic ways out of an investment for VCs, the term “commercial collapse” is being taken into account as one of the kinds of exits, although it is not a way for a beneficial realization of the investment. However, in theory and practice there are five principal types of VC exits¹¹:

- an initial public offering (IPO), in which a significant portion of the firm is sold into the public market;
- an acquisition exit, in which the entire firm is bought by a third party;
- a secondary sale, in which only the VC’s shares are sold to a third party (again, typically a strategic acquirer);
- a buyback, in which the VC’s shares are repurchased by the entrepreneurial firm;
- a write-off, in which the VC walks away from the investment.

¹⁰ D.J. Cumming, J.G. MacIntosh, *A Cross-Country Comparison of Full and Partial Venture Capital Exit Strategies*, “Journal of Banking and Finance” 2003, Vol. 27, pp. 511–548.

¹¹ J.G. MacIntosh, *Venture capital exits in Canada and the United States*, [in:] P.J. Halpern (Ed.), *Financing Growth in Canada*, University of Calgary Press 1997, pp. 279–356.

The National Venture Capital Association (NVCA) shows only three types of exit routes: acquisition, IPO and buyout. As European market is more diversified according to the European Venture Capital Association (EVCA), there are the following types of divestments¹²:

- divestment by trade sale – the sale of company shares to industrial investors;
- divestment by public offering;
 - **divestment on flotation (IPO) – the sale or distribution of a company’s shares to the public for the first time by listing the company on the stock exchange;**
 - sale of the quoted equity – the sale of quoted shares only if connected to a former private equity investment, e.g. the sale of quoted shares after a lock-up period;
- divestment by write-off – the total or partial write-down of a portfolio company’s value to zero or a symbolic amount (the sale for a nominal amount) with the consequent exit from the company or reduction of the shares owned; the value of the investment is eliminated and the return to investors is a full or partial loss;
- repayment of silent partnerships – a silent partnership is a type of mezzanine financing instrument. It is similar to a long-term bank loan but, in contrast to a loan, a silent partnership is subject to a subordination clause, so that in the event of insolvency all other creditors are paid before the silent partner. The company has to repay the partnership and has to pay interest and possibly a profit-related compensation. The subordination clause gives the capital the status of equity despite its loan character. This financing instrument is frequently used in Germany;
- repayment of principal loans – if a private equity firm provided loans or purchased preference shares in the company at the time of the investment, then their repayment according to the amortization schedule represents a decrease of the financial claim of the firm into the company, and hence a divestment;
- sale to another private equity house – the sale of company shares to another direct private equity firm;
- sale to a financial institution – the sale of company shares to banks, insurance companies, pension funds, endowments, foundations and other asset managers other than private;
- sale to the management;
- divestment by other means.

If private equity investors cannot foresee that a company will be mature enough to go public or sell to the third party towards the end of the funds’ life, they are

¹² <https://www.investeurope.eu/research/about-research/glossary/>, retrieved on 5.04.2017.

unlikely to invest in the business in the first place¹³. According to A. Schwienbacher, the effect of board representation on the exit choice is not significant¹⁴.

An exit may be full or partial¹⁵:

- A full exit for an IPO involves a sale of all of the venture capitalists' holdings within one year of the IPO; a partial exit involves the sale of only part of the venture capitalists' holdings within that period.
- A full acquisition exit involves the sale of the entire firm for cash; in a partial acquisition exit, the venture capitalist receives (often illiquid) shares in the acquirer firm instead of cash.
- In the case of a secondary sale or a buyback exit (in which the entrepreneur buys out the venture capitalist), a partial exit entails the sale of only part of the venture capitalists' holdings.
- A partial write-off involves a write down of the investment on its books.

In exiting their investments, VCs sometimes make a full exit (disposing of their entire interest in the investee firm), and sometimes make a partial exit (retaining at least part of their interest). The study conducted by D. J. Cumming and J.G. MacIntosh investigates the determinants of the choice between a full and a partial exit¹⁶. According to them, the key factor in driving this choice is the degree of information asymmetry between the selling VC and the purchaser(s) of the VC's investment. If the information asymmetry is high, then the VC can maximize the overall proceeds of disposition by initially effecting a partial exit, because ownership retention constitutes a credible signal that the quality of the investee firm is high.

Because every investee firm is different, a development plan to achieve a successful exit takes into consideration a number of macroeconomic and microeconomic factors. Some of them, especially those related to macroeconomic trends (the economic cycle and anticipated growth rates, the nature of the industry, the cycle of financial markets, the costs of borrowing, and so on), are outside of the venture capitalist's sphere of influence.

Still there are numbers of those factors which are subject to control of VC (business development, business expansion, and achievement of milestones and operational

¹³ P.A. Gompers, J.A. Lerner, *The Venture Capital Cycle*, The MIT Press, Cambridge, 1999; P. A Gompers, J.A. Lerner, *The Venture Capital Revolution*, "Journal of Economic Perspectives" Spring 2001, Vol. 15, No. 2, pp. 145–168.

¹⁴ A. Schwienbacher, *An Empirical Analysis of Venture Capital Exits in Europe and the United States*, Working paper, University of Amsterdam, January 2005, pp. 1–38.

¹⁵ D.J. Cumming, J.G. MacIntosh, *A Cross-Country Comparison of Full and Partial Venture Capital Exit Strategies*, "Journal of Banking and Finance" 2003, Vol. 27, pp. 511–548.

¹⁶ D.J. Cumming, J.G. MacIntosh, *A Cross-Country Comparison of Full and Partial Venture Capital Exit Strategies*, "Journal of Banking and Finance" 2003, Vol. 27, pp. 511–548.

goals, trends in profitability and sales, a competent and strong management team). For instance, to alleviate the costs associated with the IPO decision, firms often build their reputation by obtaining different types of quality certifications to signal their true value to the market. Some popular certification strategies include¹⁷:

- employing a reputable auditor;
- associating with a venture capitalist with an established track record;
- hiring a well-known underwriter;
- attracting a strong institutional affiliation;
- recruiting a good quality management team.

Before venture capitalists invest, they plan for exit. This means that they select portfolio companies according to the preferred type of exits. On the other hand, there may be demand for specific modes of exits depending on the type of portfolio companies.

The ability to control the exit is crucial to the venture capitalist's business model of short-term funding of nascent business opportunities. The exit¹⁸:

First, allows venture capitalists to reallocate funds and the nonfinancial contributions that accompany them to early stage companies.

Second, it allows fund investors to evaluate the quality of their venture capitalists and, if necessary, to reallocate their funds away from venture capital toward other investment vehicles or from less successful venture capitalists to more successful venture capitalists.

Finally, the credible threat of exit by venture capitalists may work to minimize the temptation toward self-dealing by the entrepreneurs who manage the venture-backed companies.

3. Initial Public Offering

An initial public offering (IPO) is a process of selling shares to members of the public for the first time. The decision to go public is one of the most critical decisions in the lifecycle of a firm.

¹⁷ V.B. Marisettya, M.G. Subrahmanyam, *Group affiliation and the performance of IPOs in the Indian stock market*, "Journal of Financial Markets" 2010, No. 13, pp. 196–223.

¹⁸ D.G. Smith, *The Exit Structure of Venture Capital*, "UCLA Law Review" 2005, Vol. 53, No. 315, pp. 316–356, University of Wisconsin Legal Studies Research Paper No. 1005.

Two types of shares can be sold at an IPO¹⁹: the primary equity (new shares sold to investors) and the secondary equity (shares owned by the original investors). Some IPOs consist of all primary equity with the original investors retaining their shares. Other ones are all secondary equity with no money raised for the company. Many IPOs appear as a combination of these two possibilities.

Typically, the VC will retain its shares at the date of the public offering, then selling shares into the market in the months or years following the IPO. However, the VC usually sells a small fraction of its shares at the time of the IPO. Alternatively, following the IPO, the VC may dispose of its investment by making a dividend of investee firm shares to the fund's owners²⁰.

The precise details of the process are long, tedious and complicated. The IPO process consists of the following stages²¹:

- Forming the IPO team;
- Preparing the company;
- Assembling the team;
- Signing a letter of intent with the underwriters;
- Beginning of the quiet period;
- Holding the organizational meeting;
- Preparing a preliminary registration statement (the first draft prospectus);
- Conducting the due diligence process – concurrently with the preparation of the preliminary registration statement;
- Filing the preliminary registration document with the SEC for examination;
- Preparing an amended registration statement;
- Distributing the preliminary prospectus (“red herring”);
- Marketing (“road shows”);
- Holding the due diligence meeting;
- Pricing, signing the underwriting agreement and having the registration statement declared effective;
- Selling the shares to the public and closing;
- Trading, stabilization and exercise of the underwrites’ option (“green shoe” option).

The decision of going public is not easy, as the process is very comprehensive and complex. Hence, a lot of considerations should be taken into account:

¹⁹ T. Jenkinson, A. Ljungqvist, *Going Public. The Theory and Evidence on How Companies Raise Equity Finance*, Clarendon Press, Oxford 1996, p.15.

²⁰ D. J. Cumming, J.G. MacIntosh, *A Cross-Country Comparison of Full and Partial Venture Capital Exit Strategies*, “Journal of Banking and Finance” 2003, Vol. 27, pp. 511–548.

²¹ O. Fuerst, U. Geiger, *From Concept to Wall Street*, “Financial Times Prentice Hall” 2003, p. 247.

First, the business needs to identify the date when it wishes to float and then work backwards several months to identify the time when the whole process should start, which means that a great deal of planning is required.

Second, the effort that is required for preparation will take much of the attention of directors in the months prior to the event.

Third, putting the company's shares on the public market now involves continuing regulatory burdens that are costly and heavy.

Forth, the sanctions that the market regulators may impose on the management and venture shareholders of the business that is considering the listing may involve shares being 'locked up' to prevent the market being swamped, so they will still be subject to detailed regulation.

Fifth, venture investors may be reluctant to give some of the warranties that are required to enable the listing to proceed smoothly.

Several advantages and disadvantages of the exit through an IPO could be indicated.

Following numerous research, S. Povaly indicates many advantages²²:

- Potential for the highest price (as investors buying public shares in a company are prepared to pay a premium for liquidity higher than the control premium paid by purchasers in an acquisition exit;
- Favored by the management as the executives retain more managerial freedom and flexibility with a well-diversified shareholder base rather than with a large majority owner;
- Share participations or stock-option schemes can be offered as a complementary and highly effective form of employee incentives;
- Other stakeholders' incentives such as customers, suppliers or strategic partners can be invited to acquire shares in the business to solidify commercial relationships;
- Publicity, reputation and image – IPOs are highly publicized processes so that the companies can benefit from it;
- Provoking M&A bids by potential M&A buyers as a credible IPO process signals a high quality to them; lower due diligence requirements in the interest of a quick transaction process could be a result;
- Retaining future upside potential – IPOs do not enable full immediate exits; however, a private equity investor is able to retain a stake in the business, sharing potential profits of future growth of the business;
- Source of funds for future investments or acquisitions when issuing primary shares while exiting (other exits do not provide new financing to the company).

²² S. Povaly, *Private Equity Exits Divestment Process Management for Leveraged Buyouts*, Springer 2007, p. 252

He emphasizes the disadvantages of exit via an IPO as well²³:

- High transaction costs in comparison to other types of exit;
- Extensive preparation and high standards required, intense execution processes;
- Only a partial immediate exit because of lockup conditions; a continued shareholding in a public company carries the risk of still having to monitor it;
- Risk of illiquid stock markets; to be able to sell substantial blocks of shares at attractive price levels, sufficient liquidity in the stock is necessary;
- Need to convince a large number of investors about the quality and future outlook of the business;
- High, often short-term-oriented, performance pressure due to continuous expectations by institutional investors can over time alter a previously longer-term-oriented management style to a strive for short-term goals, and thus limiting the management's flexibility in pursuing strategic objectives;
- Downturns in the company's stock prices can have a negative impact on the business, such as a loss of reputation with customers, suppliers and employees;
- High and comprehensive disclosure of commercially sensitive information, such as the divisional cost structure or operational data that might be used by competitors to the detriment of the company;
- Substantial risk attached to the process of withdrawal; companies that cancel IPOs might have severe problems accessing public capital markets again, as investors may be reluctant to re-consider an investment, presuming the company has withdrawn an IPO due to a fundamental business problem;
- Only for sizeable companies with an attractive projected growth profile as apart from the requirement of the company's business plan to credibly demonstrate a growth pattern and the ability to generate attractive returns for expansion capital, IPO exits typically require a minimum issue size, as otherwise institutional investors are unlikely to commit to transactions.

“The 2011 Global Venture Capital Survey” conducted jointly by Deloitte & Touche LLP and the National Venture Capital Association in the group of global venture capitalists indicates factors that create a healthy and vibrant IPO market (see the Table below).

²³ S. Povaly, *Private Equity Exits Divestment Process Management for Leveraged Buyouts*, Springer 2007, p. 252.

Table 3. Top 3 factors that create a healthy and vibrant IPO market

Factors	Brazil	Canada	China	France	Germany	India	Israel	UK	US
The competitive investment banking community for an IPO	44	14	22	14	50	29	40	24	30
Healthy investor appetite for equity in public companies	94	77	75	93	92	90	70	84	81
Freely available capital	19	32	44	18	17	19	20	43	25
Ability to move capital out of a country	6	0	17	0	0	14	10	0	3
Economic stability	69	45	58	43	25	52	40	68	52
Adequate stock analyst coverage	19	36	14	46	17	52	10	32	33
Companies with leading edge technologies	19	50	28	36	67	0	40	24	27
Companies that appeal to the general public and mainstream media	6	23	14	29	33	38	50	16	19
Easier reporting for newly public companies	25	23	28	21	0	5	20	8	30

Source: *Global Trends in Venture Capital: State of the IPO Market*, Deloitte, NVCA, June 22, 2011.

According to the survey²⁴:

- Over 80 percent of global venture capitalists believe that current IPO activity levels in their home countries are too low;
- Venture capitalists believe higher returns generated by IPOs are critical in providing superior returns to limited partners and growth capital to developing portfolio companies;

The costs of going public are rather high and they involve two types of cost²⁵:

- Direct costs of an issue, such as underwriting fees, legal expenses, accountancy, audit fees and costs of management time that is less quantifiable;
- Indirect costs associated with the initial underpricing that constitutes a transfer of wealth from the original owners of the company to the new shareholders.

With respect to the effects of exit routes, the A. Schwiembacher indicates that the likelihood of going public is affected by the number of financing rounds, the investment duration and reporting requirements of the investee to the venture capitalist²⁶.

²⁴ The study was conducted among venture capitalists in the following countries: Brazil, Canada, China, France, Germany, India, Israel, the United Kingdom and the United States. They received 347 responses from general partners with assets under management ranging from less than \$ 100 million to greater than \$ 1 billion. Multiple responses from the same firm were encouraged as the survey was a general measurement of the state of global investing from general partners, not attitudes of specific firms. The survey was conducted during February and March 2011. More information: *Global Trends in Venture Capital: State of the IPO Market*, Deloitte, NVCA, June 22, 2011.

²⁵ T. Jenkinson, A. Ljungqvist, *Going Public. The Theory and Evidence on How Companies Raise Equity Finance*, Clarendon Press, Oxford 1996, p.14.

²⁶ A. Schwiembacher, *An Empirical Analysis of Venture Capital Exits in Europe and the United States*, Working paper, University of Amsterdam January 2005, pp. 1–38.

Furthermore, the research conducted by J. Ritter confirms that venture-backed companies in the US yield higher first-day rate of return than the others during their IPOs (see the Table below).

Table 4. First-day return of IPOs from 1980–2013²⁷

Type of company	Number of IPOs	Average First-day Return
VC-backed	2846	27.4%
Non VC-backed	5009	12.7%
Non VC and non Buyout	3986	13.6%
All	7855	18.0%

Source: J.R. Ritter, *Initial Public Offerings: VC-Backed IPO Statistics through 2015*, January 6, 2016, p. 12, <https://site.warrington.ufl.edu/ritter/files/2016/02/Initial-Public-Offerings-VC-backed-IPO-Statistics-Through-2015-2016-01-06.pdf/> (retrieved on 5.04.2017).

S. Povaly indicates the research done by Bienz in 2004, which shows IRRs for IPOs (58%) higher than for acquisition exits (18%). The study only distinguishes between acquisition exits and IPOs and shows that highly profitable companies, which need limited oversight, will go public, while less profitable companies, which require more control, will be sold²⁸.

The decision to pursue an IPO is relatively more dependent on the current stock market conditions, the portfolio company's future profitability and opportunities for growth. According to the findings of A. Hyttinen, the decision to exit through an IPO is more sensitive than the decision to exit via a trade sale²⁹. That is why PE funds carefully consider the nature of the portfolio companies' activity, having decided the mode of exits in the sustained business model.

P. Gompers and J. Lerner, examining the relationship of public capital market conditions and the decision to go public, found that private equity investors take firms public during the times of market peaks and rely on private financing (such as trade sales, etc.) when public equity market valuations are lower. They concluded that experienced investors are more proficient regarding the timing of IPOs. The public

²⁷ Growth capital-backed IPOs are classified as VC-backed in this table.

²⁸ S. Povaly, *Private Equity Exits Divestment Process Management for Leveraged Buyouts*, Springer 2007, p. 171.

²⁹ A. Hyttinen, *How Important Are Exits for Venture Capital Finance? Evidence from Finland*, [in:] *Venture Capital, Entrepreneurship, and Public Policy*, V. Kannianen and Ch. Keuschnigg (Eds.), MIT 2005, pp. 127–149.

stock markets' appetite and receptiveness to new issues varies dramatically, which strongly influences the valuation of a potential IPO exit³⁰.

B.S. Black and R.J. Gilson studied the link between the venture capital market and argued that a well-developed stock market that permits venture capitalists to exit through an IPO is critical to the existence of an active and well-performing venture capital market. They highlight the necessity of liquid stock markets.³¹ In comparison to this research, B.H. Hall concludes that in order to provide an exit strategy for early stage investors of the VC sector there is required a thick market in small and new firm stocks (such as NASDAQ or EASDAQ)³².

Many studies focused on the exit of a VC from the financed firm especially on IPOs which have known, during these last ten years, cycles with strong agitation³³. In the United States, there was observed a strong growth in the IPOs industry until 2000. The initial public offering constitute the best means of exit for VCs, since it enables them to make profit from the enthusiasm of the investors toward these technological companies, in particular during hot periods. That was the case in 1999. Then the market largely dropped and is known as a so called 'cold period', which is characterized by a deceleration of the number of IPOs and a weak underpricing of the offer prices. The renewal of the market in increasing the number of venture-backed IPOs was observed in 2014 (see table 5 below).

Table 5. Number of Venture-Backed IPOs versus All IPOs in the US (2000-2015)³⁴

Year	Number of all IPOs	Number of venture-backed IPOs
1995	578	183
1996	883	253
1997	638	140
1998	466	77
1999	578	275
2000	629	238

³⁰ P.A. Gompers, J.A. Lerner, *The Venture Capital Cycle*, The MIT Press, Cambridge 1999; J. Lerner, *Venture Capitalists and the Decision to Go Public*, "Journal of Financial Economics" 1994, Vol. 35, No. 3, pp. 293–316.

³¹ B.S. Black, R.J. Gilson, *Does Venture Capital Require an Active Stock Market?* "Journal of Applied Corporate Finance", Winter 1999, Vol. 11 No 4, pp. 34–48.

³² B.H. Hall, *The Financing of Research and Development*, "Oxford Review of Economic Policy" 2002, Vol. 18, No. 1, pp. 35–51.

³³ D. Trabelsi, *Venture Capital and Timing of IPO*, Université Paris 1 – Panthéon – Sorbonne, September 2007, p. 2.

³⁴ According to this data IPO counts reflect IPOs on US stock exchanges and markets. Venture-backed IPOs are those with at least one US-domiciled venture fund investor.

Year	Number of all IPOs	Number of venture-backed IPOs
2001	119	37
2002	114	24
2003	75	26
2004	239	81
2005	214	59
2006	219	67
2007	267	90
2008	73	7
2009	59	13
2010	154	67
2011	168	50
2012	140	48
2013	182	81
2014	273	117
2015	183	77

Source: *NVCA Yearbook*, 2016, p. 63., <https://nvca.org/> (retrieved on 8.04.2017).

4. Underpricing Venture-Backed Companies and Control after the Exit by an IPO

Firms may time their IPO in order to take so called “windows opportunity”, meaning the periods of market buoyancy during which companies have, on average, an incentive to issue new shares as they are substantially overvalued among other firms in their industry³⁵. Apart from that, companies may decide to go public when they are able to display positive growth opportunities and optimistic valuations. Underpricing is primarily the result of intentional actions and an IPO strategy element that allows investors to gain positive returns. Then debut is considered to be carried out successfully, and the company seems to be promising and perspective³⁶. But if the market does not understand that earnings growth tends to mean revert, an IPO will be over-valued³⁷.

³⁵ T. Loughran, J.R. Ritter, *The New Issue Puzzle*, “The Journal of Finance” 1995, Vol. 50, No. 1, pp. 23–51.

³⁶ D. Podedworna-Tarnowska, *Niedowartościowanie w procesie IPO*, “Prace Naukowe Wyższej Szkoły Bankowej w Gdańsku” 2013, Vol. 27, pp. 129–141.

³⁷ S. Paleari, S. Vismara, *Over-optimism when pricing IPOs*, *Managerial Finance* 2007, Vol. 33, No. 6, pp. 352–367.

J. Ritter indicates underpricing as an indirect cost of going public. He argues that both components – direct costs (investment banking fees) and indirect costs (underpricing) account for around 21.2% for firm commitment offers and around 31.87% for best efforts³⁸.

P.M. Lee and S. Wahal find evidence for higher underpricing for venture-backed IPOs. According to them venture capital-backed firms face lower costs when doing an IPO than non-venture-backed firms. They put forward the theory suggesting that VC firms look forward to creating a reputation in the market which helps them in generating profits in the future. According to their findings, to achieve this purpose, venture capitalists are ready to incur the losses due to underpricing. This helps them to bring their portfolio companies public in the future and thus generate higher management fees and more funds³⁹.

Underpricing occurs when the issues are offered to the public at a price which is lower than its intrinsic value. IPOs then get listed in the market with a significant premium to the issue price, due to which investors earn an abnormally high return on the day of listing⁴⁰. In the process of an IPO, the adequacy of the valuation to a company's offer for the investors is visible on the first day of the company's listings⁴¹.

With regard to the cost of IPOs, J.S. Ang and J.C. Brau demonstrate that more transparent firms pay lower issuance costs, which they divide into four components: initial underpricing, underwriting fees, legal and administrative fees, and overallotment costs. They also find that firms pay higher costs in all the components of the issuance cost, if they have to pay more in any one component⁴².

P.A. Gompers argues that young venture capital firms take actions that signal their ability to potential investors. According to his findings, young venture capital firms bring companies public earlier than older venture capital firms in an effort to establish their reputation and raise capital for new funds. What is more, companies financed by young venture capital firms are nearly two years younger and more underpriced when they go public than the companies backed by older venture capital firms. These so-called rushing companies to the initial public offering market impose costs

³⁸ J.R. Ritter, *The Costs of Going Public*, "Journal of Financial Economics", December 1987, Vol. 19, No. 2, pp. 269–281.

³⁹ P.M. Lee and S. Wahal, *Grandstanding, Certification and the Underpricing of Venture Capital Backed IPOs*, "Journal of Financial Economics" 2004, Vol. 73, No. 2, pp. 375–407.

⁴⁰ N.R. Abraham, A. Joseph, *Underpricing of Venture Capital IPOs: A Journey Through History*, "International Journal of Management Research and Business Strategy", October 2015, Vol. 4, No. 4, pp. 83–92.

⁴¹ D. Podedworna-Tarnowska, *Company Valuation within the IPO Process*, [in:] *Business Valuation. A Basic Approach*, M. Panfil, A. Szablewski (Eds.), Poltext, Warszawa 2012, pp. 227–251.

⁴² J.S. Ang, J.C. Brau, *Firm Transparency and the Costs of Going Public*, "Journal of Financial Research", Spring 2002, Vol. 25, No. 1, pp. 1–17.

on the venture firm: a shorter duration of board representation is associated with a greater degree of underpricing and a lower percentage equity stake for the venture capitalist. With regard to the exit timing, he identifies a fund's sequence number as a potentially important factor in the exit decision, with first-time funds having an incentive to take companies public too early⁴³.

V. Mogilevsky, Z. Murgulov argue that private equity backed IPO firms tend to be larger, more profitable and are underwritten by investment banks that have a proportionally greater share of the underwriting market. Their results indicate that, on average, private equity backed IPOs experience a significantly lower level of underpricing than venture capital backed or non-sponsored IPOs. The authors posit that the presence of a private equity firm as a client divesting through an IPO induces the investment bank to reduce the expected underpricing, because private equity firms tend to be continuing and lucrative clients of investment banks⁴⁴.

W. Megginson and K.A. Weiss confirm the finding that the underpricing of venture capital-backed initial public offerings is significantly lower than the underpricing of non-venture initial public offerings. They also explain that private equity and venture capital firms are in a position to certify the quality of offerings as they repeatedly bring firms to the public market and cannot afford to offer overpriced issues to keep the established reputation. They support this with another finding – venture capitalists are able to attract higher quality and more experienced underwriters and auditors than other listings. They claim that the quality certification by a venture capital firm reduces the information asymmetry between the issuing firm and the underwriters and auditors, which facilitates a reduction in the overall costs of going public. They also show that the underwriters of venture-backed firms have a significantly greater share of the IPO market than the underwriters of comparable non-venture offerings. They argue as well that venture capitalists also retain a majority of their equity after the initial public offering, which serves as a commitment device⁴⁵.

Ch. Barry, C. Muscarella, H. Peavy, M. Vetsuppens argue that the typical venture-backed offering is not yet profitable at the time it goes public. Finally, venture-backed initial public offerings have less of a positive return on their first trading day. The authors suggest that this implies that investors need less discount to purchase these shares (that is, the offerings are less “underpriced”), because the

⁴³ P.A. Gompers, *Grandstanding in the venture capital industry*, “Journal of Financial Economics” 1996, No. 42, pp. 133–156.

⁴⁴ V. Mogilevsky, Z. Murgulov, *Underpricing of private equity backed, venture capital backed and non-sponsored IPOs*, “Investment Management and Financial Innovations” 2012, Volume 9, No. 3, pp. 47–59.

⁴⁵ W. Megginson, K.A. Weiss, *Venture Capitalist Certification in Initial Public Offerings*, “Journal of Finance”, July 1991, Vol. 46, No. 3, pp. 879–903.

venture capitalist has monitored the quality of the offering. They also documented that venture capitalists hold significant equity stakes in the firms they take public (on average all venture investors hold 34% stake immediately prior to the initial public offering, and control about one-third of the board seats). They continue to hold their equity positions in the year after the initial public offering⁴⁶.

A. Brav and P.A. Gompers also found that venture capital-backed IPOs are more underpriced and thus outperform other issues (based on the US market)⁴⁷. The same results were found by S.A. Franzke, conducting an analysis on the basis of the German market. She showed that venture capital-backed IPOs are more underpriced than other IPOs. It is interesting that she found that the involvement of a reputable venture capitalist leads to a higher underpricing. She stresses that the underpricing behavior has to be regarded in the context of venture capitalists only selling about 20% of their pre-IPO equity stake at the time of the IPO, which makes their exit strategy following the IPOs crucial⁴⁸.

At a single country level, despite their higher concentration in technology sectors, companies going public on secondary markets are as often venture-backed, as companies on the main markets. exchange-regulated markets seem to be perceived as a valid alternative to venture funding, allowing firms to forego mezzanine financing before the listing. Some young firms may view the secondary market as a sort of 'public venture market' to finance their growth projects. Obviously, the strength of these patterns depends a great deal on a country's specificities⁴⁹. For instance, the proportion of VC-backed IPOs is larger on the London Stock Exchange than on any other market⁵⁰. To take another example, companies in Italy are typically more mature when they decide to go public⁵¹.

P.A. Gompers and J. Lerner show that even after the expiry of the lock-up period, private equity firms do not sell their stock but rather distribute shares to their own investors, typically the limited partners in the funds. Their empirical evidence suggests

⁴⁶ Ch. Barry, C. Muscarella, H. Peavy, M. Vetsuypens, *The role of venture capital in the creation of public companies: evidence from the going-public process*, "Journal of Financial Economics" 1990, Vol. 27, pp. 447–476.

⁴⁷ A. Brav, P.A. Gompers, *Myth or reality? The long-run underperformance of initial public offering: evidence from venture and non-venture-backed companies*, "Journal of Finances" 1997, Vol. 4, No. 52, pp. 1791–1820.

⁴⁸ S.A. Franzke, *Underpricing of Venture-Backed and Non-Venture-Backed IPOs: Germany's Neuer Market*, CFS Working Paper, 2001, No. 2001/01.

⁴⁹ S. Vismara, S. Paleari, J.R. Ritter, *Europe's Second Markets for Small Companies*, European Financial Management, June 2012, Vol. 18, Issue 3, pp. 352–388.

⁵⁰ R. Jelic, M. Wright, *Exits, performance, and late stage private equity: The case of UK management buy-outs*, "European Financial Management", June 2011, Vol. 17, No. 3, pp. 560–593.

⁵¹ S. Vismara, S. Paleari, J.R. Ritter, *Europe's Second Markets for Small Companies*, "European Financial Management", June 2012, Vol. 18, Issue 3, pp. 352–388.

that share prices drop by 2% in the days following the distribution, which is due to outside investors' reaction to announcements of secondary stock sales by limited partners, even though the distribution has not been announced⁵².

The ability to control an exit is crucial to the venture capitalist's business model of short-term funding of nascent business opportunities, because⁵³:

First, it allows venture capitalists to reallocate funds and the nonfinancial contributions that accompany them to early stage companies.

Second, it allows fund investors to evaluate the quality of their venture capitalists and, if necessary, to reallocate their funds away from venture capital toward other investment vehicles or from less successful venture capitalists to more successful venture capitalists.

Finally, the credible threat of exit by venture capitalists may work to minimize the temptation toward self-dealing by the entrepreneurs who manage the venture-backed companies.

5. The Comparison of Most Common Types of Exit in the USA, Europe and Poland

At the beginning of its existence, the venture capital industry grew slowly. The market was rather geographically concentrated. The flow of money into the venture capital industry in the US between 1946 and 1977 never exceeded a few hundred million dollars annually. Also, the amount of the venture capital funds was rather limited. The deep stagnation of this market was observed at the beginning of the 1970s and was due to a sharp rise in the capital gains tax that increased from 25 to 49%⁵⁴. For comparison, in 1969, the record year, the newly formed venture capital partnership raised \$171 million, while in 1974–75 the members of the US Venture Capital Association raised only \$74 million⁵⁵.

The venture capital market in the US grew dramatically in the early 1980s, as investment opportunities increased, like the emergence of new technologies in the economy or possibility for the pension funds to invest in venture capital that was limited before 1979. During that time, some introduction of tax-related issues was

⁵² P.A. Gompers, J. Lerner, *What Drives Venture Fundraising?* Brookings Papers on Economic Activity-Microeconomics 1998, pp. 149–92.

⁵³ D.G. Smith, *The Exit Structure of Venture Capital*, "UCLA Law Review" 2005, No. 315, Vol. 53 pp. 316–356, University of Wisconsin Legal Studies Research Paper No. 1005.

⁵⁴ *Handbook of Research on Venture Capital*, H. Landström (Ed.), Edward Elgar Publishing Limited, Cheltenham 2007, p. 11.

⁵⁵ H. Cowie, *Venture Capital in Europe*, Federal Trust for Education and Research 1999, p. 32.

undertaken. Previously restrictive fiscal policies were reversed and the maximum capital gain tax rate was reduced successively from 49 to 28%. The stock options became taxable when the relevant shares were sold rather than having the rights connected with the options exercised. These factors caused the venture capital market in the US to plummet again.

The fundraising and investment environments in the venture capital ecosystem remained strong in 2015 and the capital invested reached its highest mark since 2000. The exit environment for venture-backed companies, on the other hand, was unable to maintain the pace from 2014, but was on par with 2013⁵⁶.

Table 6. Main indicators on VC investments in the USA (2007-2015)

Indicators	2007	2008	2009	2010	2011	2012	2013	2014	2015
GDP (in \$ billion)	14,798.37	14,718.3	14,320.11	14,628.17	14,833.68	15,126.28	15,348.04	15,691.18	16,088.25
Total funds raised (in \$ billion)	34.92	36.18	12.01	19.57	23.31	24.42	20.64	35.35	35.17
Total investment in the country (in \$ billion)	31.06	29.11	21.52	25.75	36.22	32.57	35.86	58.85	73.35
Total divestment in the country (in \$ billion)	40.79	18.15	15.69	30.28	36.90	53.94	36.24	81.74	50.37

Source: the author's own study based on *Venture Monitor*, NVCA Pitch Book, 4Q 2016, http://nvca.org/wp-content/uploads/2017/01/4Q_2016_PitchBook_NVCA_Venture_Monitor.pdf/ (retrieved on 8.04.2017) and The Statistics Portal <https://www.statista.com/statistics/280260/venture-capital-fund-raising-by-holding-companies-in-the-usa/> (retrieved on 8.04.2016).

The most common type of exit in the US is not an IPO. For example, for every dollar of venture capital invested in the US from 1970 to 2010, \$6.27 of revenue was generated in 2010. But on the other hand, although the investor has high hopes for any company getting funded, only one in six ever goes public and one in three is acquired⁵⁷.

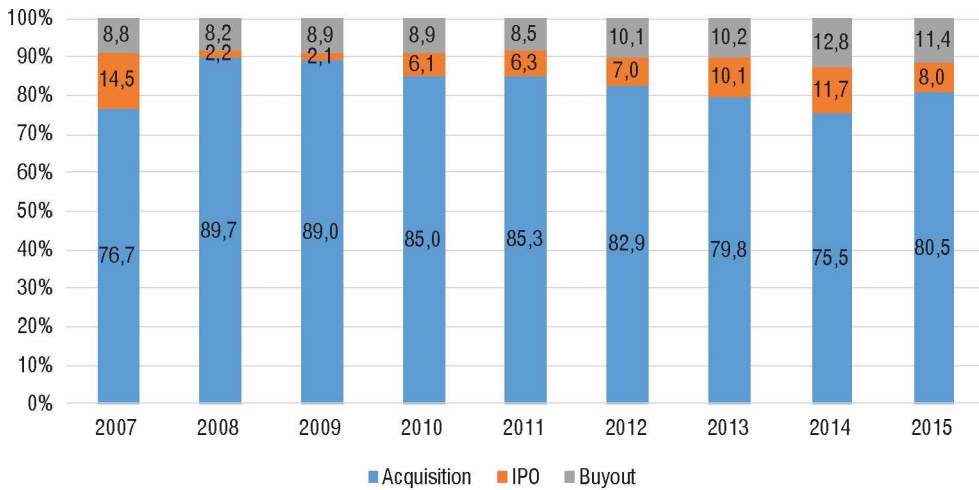
For a long time, venture capital was regarded as an American phenomenon. Although there were some individual and rather isolated investment initiatives, in general venture capital did not exist outside the US during the 1970s. The development of the European venture capital market took place mainly in the UK. It had over 20 venture capital funds at the end of the 1970s, with a total investment

⁵⁶ NVCA Yearbook, 2016, p. 9.

⁵⁷ *Venture Impact, The Economic Importance of Venture Capital Backed Companies to the U.S. Economy*, NVCA, p. 2.

of £20 million. After a decade, the industry grew significantly, investing more than £1300 million into 1297 venture funds. In terms of growth, the European market outperformed the US venture industry. It was connected with the introduction of the secondary markets in many European countries. Historically, the secondary markets in Europe have been successful in hot periods and have collapsed in cold periods⁵⁸.

Figure 3. Exit routes by the number of divested companies in the USA in 2007–2015 (%)



Source: the author’s own study based on NVCA *Venture Monitor*, NVCA Pitch Book, 4Q 2016, http://nvca.org/wp-content/uploads/2017/01/4Q_2016_PitchBook_NVCA_Venture_Monitor.pdf/ (retrieved on 8.04.2017).

Venture capital was in Europe for a long time the business of rich families (family offices), corporations, public finances (directly or indirectly), banks (directly or through a captive structure) and personal connections. Hence, depending on the national specificities, some sources of financing dominate others, e.g. corporate venturing and family offices in Switzerland, public companies and corporations in France, banks and corporations in Germany, family offices and personal connections in Italy, family offices and corporations in Scandinavia⁵⁹.

In 2015 total fundraising reached €47.6bn, nearly matching the level of 2014. The number of funds raised (274) decreased by 15% compared to 2014, but is still above the levels of 2012 and 2013. The European private equity and venture capital raised in the past three years was 70% more than between the years 2010 and 2012.

⁵⁸ S. Vismara, S. Paleari, J.R. Ritter, *Europe’s Second Markets for Small Companies*, “European Financial Management”, June 2012, Vol. 18, Issue 3, pp. 352–388.

⁵⁹ C. Demaria, *Introduction to Private Equity*, Wiley, 2010, p 51.

Over a third of the total amount invested in European companies was attributed to cross-border investments⁶⁰.

Table 7. Main indicators on PE investments in Europe (2007-2015)

Indicators	2007	2008	2009	2010	2011	2012	2013	2014	2015
GDP (€ billion)	13,693.60	13,823.73	13,022.44	13,680.06	14,182.18	14,514.21	14,626.73	14,989.80	15,685.50
Total funds raised (in € billion)	79.59	80.47	18.91	21.80	41.60	24.58	54.40	47.97	47.57
Total investment in the region (in € billion)	0.43	0.64	0.28	0.65	0.68	0.47	0.38	0.25	0.80
Total divestment in the region (in € billion)	0.14	0.07	0.03	0.08	0.18	0.05	0.28	0.53	0.75

Source: the author's own study based on *European Private Equity Activity Data 2007–2015*, <https://www.investeurope.eu/research/invest-europe-publications/#1/> (retrieved on 8.04.2017).

Almost 2,500 European companies were exited in 2015, representing former equity investments (divestments at cost) of €40.5bn. This amount matches the level of 2014, which was until then the highest reported exit volume to date for the European private equity. The most prominent exit routes by amount were a trade sale – four out of ten companies followed these exit routes. More than 50 companies exited by an IPO in the years 2014–2015 (see the Figure below)⁶¹.

Poland is one of the emerging markets in which there has been growing interest from the worldwide investment community in recent years. This happened since the Polish economy transformed from a socialist economy to a market economy, and that is why enterprises became more competitive and relying on external financing.

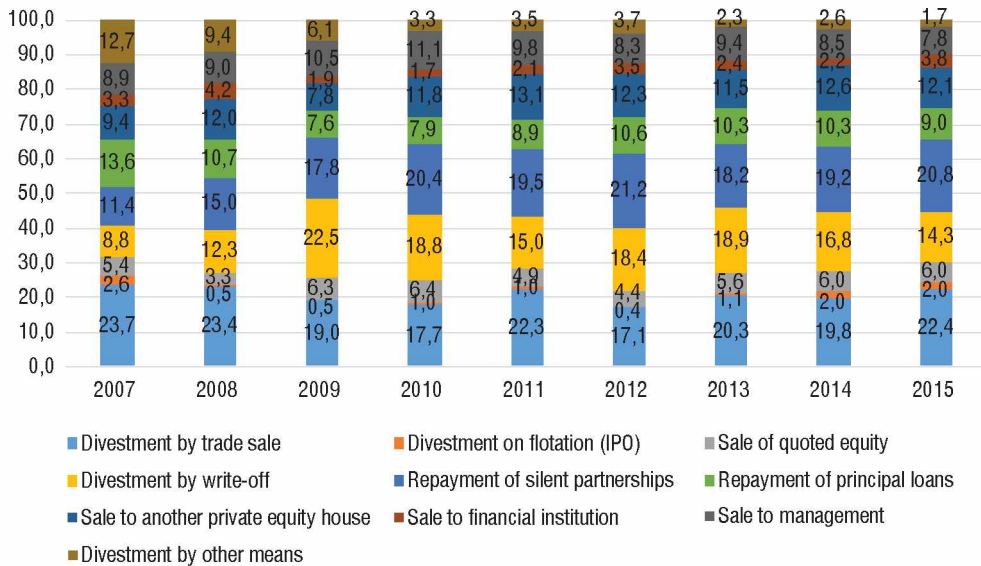
The private equity sector in Poland started to grow in 1990. Nowadays, Poland is one of the most developed private equity industry in Central and Eastern Europe and over the last twenty years it has become one of the world leaders in terms of private equity returns. What is more, the private equity industry in Poland is one

⁶⁰ 2015 *European Private Equity Activity Statistics on Fundraising, Investments & Divestments*, p. 4. <https://www.investeurope.eu/media/476271/2015-european-private-equity-activity.pdf> (retrieved on 8.04.2017).

⁶¹ 2015 *European Private Equity Activity Statistics on Fundraising, Investments & Divestments*, p. 4. <https://www.investeurope.eu/media/476271/2015-european-private-equity-activity.pdf> (retrieved on 8.04.2017).

of the most developed across all emerging market countries. Below the overview of the market is presented.

Figure 4. Exit routes by the number of divested companies in Europe 2007–2015 (%)⁶²



Source: the author’s own study based on *European Private Equity Activity Data 2007–2015*, <https://www.investeurope.eu/research/invest-europe-publications/#i/> (retrieved on 8.04.2017).

Deal sourcing in Poland has evolved in the last two decades. The competition was not as strong as in developed countries and there were a lot of investment opportunities in the 90s that came from privatization as the result of the transformation of the Polish economy. Nowadays, the competition between VCs is not as limited as it was at the beginning of the private equity market in Poland.

The crisis also influenced the PE sector, so this market decreased in 2009. Then after a renewal in the years 2010–2012, it dropped again in 2013. Capital turbulences on the financial market and high uncertainty regarding safety of investments caused the decrease not only in the amount of funds raised and the invested capital in the PE sector. It had an impact on the willingness to exit the portfolio companies during that time.

Furthermore, in 2015 the share of the Polish in the total value of investments in the CEE countries amounted to 53%⁶³.

⁶² Industry statistics – by the country of a private equity firm.

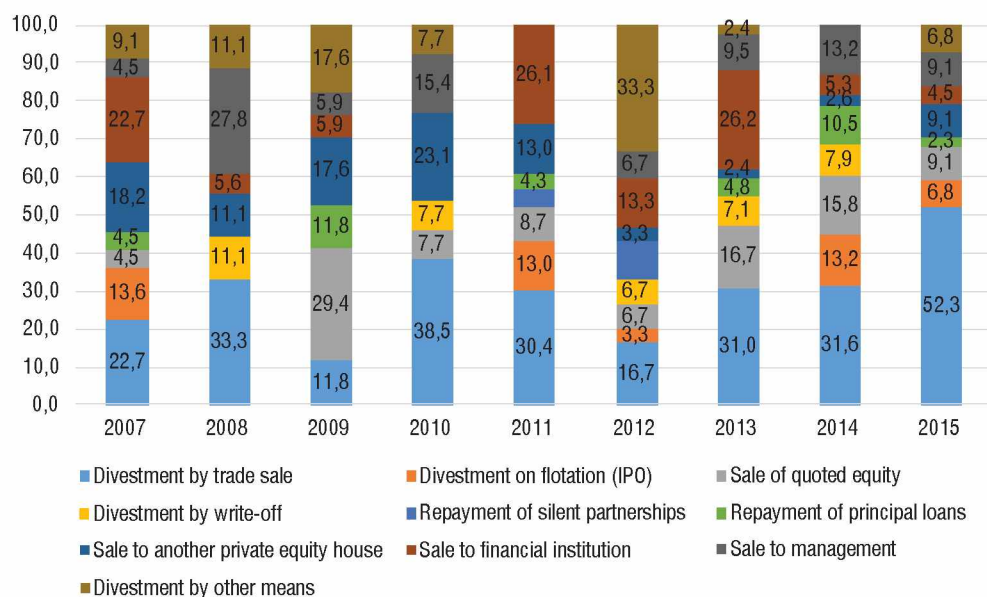
⁶³ *Rynek private equity w Polsce 2016. Trendy i szanse rozwoju*, KPMG, PSIK, http://www.psi.org.pl/pliki/psik/Raporty/Raport%20KPMG_Rynek%20private%20equity%20w%20Polsce%202016.pdf (retrieved on 8.04.2017), p. 6.

Table 8. Main indicators on PE investments in Poland (2007–2015)

Indicators	2007	2008	2009	2010	2011	2012	2013	2014	2015
GDP (€ billion)	313.14	360.36	313.17	361.21	379.52	389.79	394.78	410.01	428.18
Total funds raised (in € billion)	0.82	0.76	0.15	0.11	0.44	0.49	0.26	0.13	0.16
Total investment in the country (in € billion)	0.43	0.64	0.27	0.65	0.68	0.47	0.38	0.25	0.80
Total divestment in the country (in € billion)	0.14	0.07	0.03	0.08	0.18	0.05	0.28	0.53	0.75

Source: the author's own study based on *European Private Equity Activity Data 2007–2015*, <https://www.investeurope.eu/research/invest-europe-publications/#1/> (retrieved on 8.04.2017).

In Poland, the exit by the venture capitalist through an IPO on the Warsaw Stock Exchange is still unavailable as the Polish capital market is still narrow. In the years 2008–2010 and in 2013 there were no VC exits by an IPO. In Poland venture capital funds exit principally by a trade sale (see the Figure below).

Figure 5. Exit routes by the number of divested companies in Poland 2007–2015 (%)⁶⁴

Source: the author's own study based on *European Private Equity Activity Data 2007–2015*, <https://www.investeurope.eu/research/invest-europe-publications/#1/> (retrieved on 8.04.2017).

⁶⁴ Industry statistics – by the country of a private equity firm.

Although there are numerous similarities between the US and Europe, there are also important differences. For instance, the replacement of the former management is easier in the US than in Europe, as it may increase managerial efficiency, which positively affects the probability of going public (and negatively affects a liquidation). The liquidity of the VC market is still higher in the US⁶⁵.

Conclusion

A key characteristic of private equity finance is that investors hold their investments only for a limited period of time. Their exit type as a way of cashing out on their investment in a portfolio company is a consequence of the exit strategy, which means the plan for generating profits for the owners and investors of a company. Typically, the options of exits are to make an initial public offering (IPO), merge, or be acquired. However, the strategy containing the choice of the right type of exit has to take into account several trends and circumstances changing the industry environment.

According to Cumming and McIntosh, in the circumstances of high information asymmetries, the exit type preferences from a value maximization standpoint would be ranked as follows: buybacks, trade sales, secondary buyouts and finally IPOs⁶⁶. Information asymmetries can be mitigated by investment duration. Thus, companies characterized by high information asymmetries are divested through IPOs and are held the longest in the portfolio, while those sold via buybacks are kept the shortest. Following this theory, write-offs would be held even shorter than buy-backs.

While an IPO is the most spectacular and visible form of exit, it is not the most common, as historically it was in the US, especially before 2000. Initial public offerings as so called the gold standard in venture capital success, have been decreasing significantly over the past years. Sales to larger companies in the industry (trade sales) are only a second-best solution, and such sales alone are not sufficient to sustain the venture capital model⁶⁷. Nowadays, most companies are sold through a merger or acquisition. Furthermore, the liquidity of a portfolio company and the path to this stage is uncertain and considerably longer. Nowadays, in the US an acquisition is the

⁶⁵ See other differences in: A. Schwienbacher, *An Empirical Analysis of Venture Capital Exits in Europe and in the United States*, Working paper, University of Amsterdam, January 2005, pp. 1–38.

⁶⁶ S. Povaly, *Private Equity Exits, Divestment Process Management for Leveraged Buyouts*, Springer, 2007, p. 140.

⁶⁷ D.M. Ibrahim, *The New Exit in Venture Capital*, *Vanderbilt Law Review*, January 2012, Vol. 65, No. 1, pp. 1–47.

most significant way of exit for venture-backed and private equity-backed companies. Both in Europe and in Poland the statistical data shows the same. Furthermore, in this region mainly a trade sale is used as a type of exit. This conclusion is confirmed by the statistical figures presented by the EVCA and NVCA, which show that for the last few years an IPO has not been a favorite type of the exit route for private equity and venture capital funds. Hence, it can be stressed that an IPO does not represent a sensible option for all portfolio companies.

As indicated in this article, although there are numerous similarities between the US and Europe, significant differences still remain, especially in terms of contracting and monitoring. Furthermore, younger European and US VC firms exhibit much fewer differences than their older participants. This is the first evidence suggesting the convergence of both markets⁶⁸.

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