Ilona Falat – Kilijanska[1]

THE HISTORY OF PRIVATE EQUITY MARKET. THE STORY BASED ON USA, GREAT BRITAIN, GERMANY AND POLAND CASES

SUMMARY

The objective of this article is to show the history of private equity investments, which is quite long and interesting. Despite its European roots, however, the private equity market grew fastest and most strongly in the United States. The need for capital necessary to support innovation on a larger scale emerged in the nineteenth century together with the industrial revolution in Europe's fastest developing countries like Great Britain or Germany. Later, in 1990, after the political and economic transformation, private equity funds appeared in Polish market and in other CEE countries.

The article is based mainly on British and American literature and the data used for its purposes come from annual reports and statistical materials of numerous national private equity associations (e.g. Invest Europe, BVCA, NVCA, PSIK), international organisations' publications (e.g. EBRD), reports and studies prepared by consulting companies and online resources.

Several research methods were used in the study: the descriptive method, the comparative analysis method, the critical analysis method and the synthesis of conclusions method.

Keywords: *private equity investments, entrepreneurship development, sources of capital.*

JEL: *G24, G32, O16.*

1. INTRODUCTION

The biggest barrier to the development of any business entity, and thus a barrier to being innovative and competitive, often consists in insufficient financial resources. One of the alternative ways of financing economic activity is the use of private equity capital. Private equity capital is used for the purposes of developing or introducing

1 Ph.D.; Department of Finance; Wroclaw University of Economics Adress: ul. Komandorska 118-120, 53-345 Wroclaw, Poland, email: i.falat-kilijanska@ue.wroc.pl

new technology, product development, enlarging the product range and improving production quality, raising the amounts of investments in the company's trademark, construction (or expansion) of distribution channels, as well as increasing the expenditure aimed at improving the company image, employing highly-skilled workers or financing the changes in the organisational structure. Private equity funds activity in developed countries shows them to be an important part of economic development, as by financing ventures considered to be too risky for others, they contribute to the increase in the number of enterprises, positively affect their competitiveness, create many jobs and are an important participant in the capital market. Intel, IBM, Microsoft, Apple, Google are only few example of private equity backed firms. So, such names show the role of the private equity investment.

The objective of this article is to show the history of private equity investments, which is quite long and interesting. Despite its European roots, however, the private equity market grew fastest and most strongly in the United States. The need for capital necessary to support innovation on a larger scale emerged in the nineteenth century together with the industrial revolution in Europe's fastest developing countries like Great Britain or Germany. Later, in 1990, after the political and economic transformation, private equity funds appeared in Polish market and in other CEE countries.

The article is based mainly on British and American literature and the data used for its purposes come from annual reports and statistical materials of numerous national private equity associations (e.g. Invest Europe, BVCA, NVCA, PSIK), international organisations' publications (e.g. EBRD), reports and studies prepared by consulting companies and online resources.

Several research methods were used in the study: the descriptive method, the comparative analysis method, the critical analysis method and the synthesis of conclusions method.

2. Private equity and venture capital – definitions

The private equity and venture capital terms are defined differently in literature. The feature that helps to distinguish them is the author's country of origin. Continental Europe, the Great Britain and the United States represent different approaches to private equity and venture capital investments. Although private equity investment is a concept broader than venture capital and the two may mean investments of very different character, these terms are often used interchangeably. In **continental Europe** private equity means those investments in the private equity market that are aimed at obtaining profit through capital gain. It is the purchase of shares of unlisted companies. Most frequently, private equity funds are invested in mature companies pursuing new development opportunities and showing high growth potential**.** Venture capital is a specific type of private equity investments. This term is used to emphasise investments in early-stage companies (seed or start-up), ones employed to launch or expand such companies. Another feature that distinguishes venture capital from private equity is the investment amount. The term 'venture capital' is used to refer to less capital intensive projects. Venture capital investments are intended for companies from the SME sector (small and medium-sized enterprises), as opposed to the capital market, which in principle is a source of capital for larger businesses.[2] In all European publications, the two terms are treated as synonymous and used interchangeably.

In **Great Britain**, venture capital and private equity markets are perceived as two separate segments. In one of its publications – entitled "A Guide to Venture Capital" – the British Venture Capital Association (BVCA) defines venture capital as long-term capital invested in the shares of unlisted companies, which will allow those companies to finance their development and achieve market success. It is pointed out, however, that the term 'venture capital' is in Great Britain and continental Europe very frequently used interchangeably with the term 'private equity'.[3] Still, some market participants reserve the term 'private equity' for management buy-outs and leveraged transactions solely.[4] Nevertheless, in its latest publications, the Association makes a clear distinction between the venture capital market and the private equity market. The term 'private equity investment' is used to refer to management buy-outs only (MBO, MBI), while other types of investment, from early life-cycle stages of enterprises to their development stage, are the proper venture capital.[5] Despite BVCA's definitional distinction between the two terms, most of the data on the private equity and venture capital markets published in Great Britain present them as one single market, which hinders analysis and comparison of data, e.g. with that of U.S.

In **the U.S. market**, there is a clear line drawn between venture capital and private equity. Venture capital is used to refer to investments in projects that are in their early stages (early stage investments), i.e. in the so-called seed and start-up stages. Other types of investment – from expansion to leveraged buy-outs and management buy-outs – form the private equity market there. The National Venture Capital Association (NVCA) defines 'venture capital' as the funds provided by specialised managers

2 Based on Glossary, Invest Europe, www.investeurope.eu.

3 Pellin, J. "The Guide to Venture Capital", BVCA – British Venture Capital Association, London 1994, p. 1.

4 To distinguish between 'private equity' and 'venture capital', the British Venture Capital Association (BVCA) expanded its mission to represent the British venture capital and private equity sector.

5 "BVCA Performance Measurement Survey 2002", BVCA and PricewaterhouseCoopers.

who, along with the financial resources, invest in the company their experience and knowledge. Investments are made in young companies with huge growth potential; venture capital funds are often a source of financing an idea or companies starting their corporate "life". A professionally managed venture capital firm usually takes the form of a private company or a closed-end fund, whose founders are private or public pension funds, financial institutions, public entities, foundations, businesses, domestic and foreign natural persons.[6]

Polish definitions of private equity and venture capital are somewhere in-between the European and the U.S. approaches. Private equity type investments include venture capital ones, but usually only the term 'venture capital' is used to refer to investments in entities not listed on the market. Similar definitions of private equity and venture capital are provided by the Polish Private Equity and Venture Capital Association. According to the Association, private equity are investments in the private equity market (i.e. purchase of shares in unlisted companies), aimed at achieving profit through capital gain. They are usually of a medium- or long-term nature, and the investor is engaged in the management of the company being invested in. Private equity investments are obtained for the purposes of new product or technology development, increasing working capital, improving the balance or other major expenditures. Private equity is also helpful in resolving issues related to inheritance and other owner changes as well as in management buy-out. Venture capital, on the other hand, is a type of private equity that refers to investments in companies in their early life-cycle stages, ones employed to launching or expanding a company.[7] This definition includes some features of both the American and the European approaches.

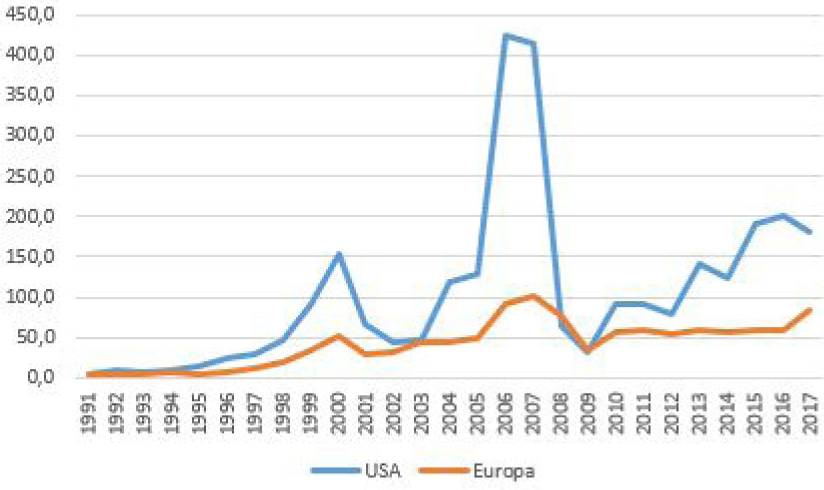
3. The history of private equity market

The history of private equity financing is quite long. In late eighteenth century, during the reign of Wilhelm I, there appeared in Great Britain first investments bearing the features of private equity investment. Then entrepreneurs were seeking rich individuals willing to invest in new, risky projects. An analysis of historical statistical data clearly indicated the dominance of two private equity markets: the USA and Europe (and here the most significant is the Great Britain – see fig.2) (fig. 1).

6 Based on "*What is Venture Capital*?", NVCA, www.nvca.org.

7 PSIK, www.psik.org.pl

Figure 1. A comparison of the value of private equity investment in Europe and the investments in the United States from 1991-2017 (in billion dollars)



Source: Author's own work on the basis of https://www.statista.com/statistics/277501/venture-capital-amount-invested-in-the-united-states-since-1995/, https://pitchbook.com/news/articles/2017-was-an-down-year-for-take-private-buyouts, NVCA 2018 Yearbook Final, https://www.investeurope.eu/media/711867/invest-europe-2017-european-private-equity-activity.pdf

Despite its European roots, however, the private equity market grew fastest and most strongly in the **United States**. Two segments developed there – buy-out transactions (buy-outs), i.e. a European equivalent of private equity, and investment in young and highly innovative projects, i.e. venture capital. The development of the U.S. market will be presented in accordance with the terminology adopted there. In chronological order, venture capital investment appeared first, and it was only in the eighties of the twentieth century that private equity investment came to exist. Its founding fathers were wealthy individual investors, who – at the turn of the twenties and thirties of the twentieth century – invested their capital in emerging companies that in their opinion had good chances of expanding rapidly. It was then that such companies as Xerox or Eastern Airlines were founded to later become well-known international corporations. Those individual investors were soon joined by banks, which invested their capital surpluses in shares of companies. In 1911, a group of bankers funded the merger of three small companies that later came to form the global corporation known as IBM. The year 1946 was a true turning point in the history of venture capital and private equity funds, as it was the year the first private equity fund was established – American Research and Development (ARD). Its originator was R. E. Flanders, the president of the Federal Reserve Bank of Boston. Flanders was worried about the state of the U.S. economy after World War II. More and more signs of slump and stagnation were visible. Flanders noticed that the main reason for this situation was the lack of new, thriving businesses, and that they were prevented from growing dynamically due to, above all, different legal solutions, which virtually made it impossible for them to acquire financing for their operations from public sources, e.g. investment funds.[8] The reason was that the investment law, existing since 1940, at the time, allowed funds to invest up to only 5% of the value of their assets in securities of new enterprises. Flanders decided to act towards favourable changes in the legal system. He quickly received support from a Harvard University professor, G. Doriot, who had been dealing with the issue of new, fast-growing companies for many years. Flanders and Doriot, along with some of their colleagues, founded the American Research and Development (ARD). They were convinced that with the emergence of small private businesses, financing scientific research may be possible without the use of public funds – research that would lead to rapid technological developments in the U.S. economy and an increase in its dynamism. The first step was the introduction of various technological inventions created at the Massachusetts Institute of Technology (MIT) during the Second World War into the business world. ARD was joined by well-known lawyers and financiers, which resulted in the creation of a strong lobby able to influence the opinions of the business environment representatives. The initial plan of the founders of ARD was for the fund to be equipped with a capital of five million dollars. For that time period, it was a quite large amount, and thus very difficult to collect, all the more so that it was meant to be committed to a completely innovative project, and that the fund's prospectus was in large part devoted to presenting the impact of its investment on the economy, while offering absolutely no mention of the prospective earnings for investors. The fund was to start its operations when at least three million dollars had been acquired. Ultimately, they managed to obtain 3.5 million dollars. The main donors were institutional investors – who provided 1.8 million dollars – and directors and managers of ARD, whose share was 45%. The other shareholders were three universities (including Harvard University and MIT). The first of ARD's investments was in the High Voltage Engineering Corporation (HVE), a company founded by five MIT physicists and engineers. HVE was also the first company to be introduced by ARD on the New York Stock Exchange. The next investment objectives of ARD were six newly established companies and two already running ones. The first few years of the fund's existence were extremely difficult. The financial needs of the fund's portfolio companies were huge and constantly growing. This resulted in liquidity problems, in both the fund and the shareholding companies. The accompanying low rate of return was making it virtually impossible to obtain additional investors. Rising costs of

8 Based on Bygrave ,W.D., Timmons, J.A. "*Venture Capital At the Crossroads*", Mc Graw-Hill Professional, Boston 1992.

consultancy services and problems in assessing the value of investments in new companies proved to be an additional burden. Help came from ARD's founders themselves, who up until then had not been personally involved in the activities of the fund. They provided the companies that the fund had invested in with their managerial and technical assistance. Most of the companies were close to bankruptcy, and the primary task of ARD, as Doriot would say, was to "watch, push, worry, and spread hope." ARD's financial situation began improving in 1951. Up until that time, despite very good reviews in business press, it had managed to obtain merely 57% of the intended five million dollars, which led to discontinuation of financial support from the shareholding companies. In 1951, most of the ten companies in ARD's portfolio finally generated some profit, which greatly improved the liquidity of both the companies and the fund itself. Despite the improvement, the price per ARD's share fell. The year 1954 saw a radical change in the strategy of ARD – more attention was now paid to profitability and dividend pay-outs. But it was the fund's investment of 1957 in Digital Equipment Corporation (DEC) that turned out to be a true milestone, both in ARD's activity and the entire history of American private equity and venture capital. DEC, a company engaged in producing mini computers, was hugely successful, and its purchase proved to be the most fortunate investment of ARD since its creation – by 1971 ARD's market value rose by 5000%. This result set the standard for the required rate of return for the entire U.S. private equity and venture capital market of the 1970s and 1980s. ARD's shares in DEC were valued at 355 million dollars, and a year later they were sold to TEXTRON Inc. at an even higher price. The investment in DEC proved that the essence of private equity and venture capital consists, as Doriot and Flanders had earlier claimed, in providing active assistance to start-up companies, whose innovativeness will in turn contribute to dynamic development of the entire economy. The success of DEC, as well as that of ARD's subsequent investments, contributed to a significant increase in the interest in private equity investment. By the end of 1960s, ARD alone managed to obtain additional eight million dollars. Moreover, investors changed also their attitude to private equity and venture capital investment. Since that time they were prepared for a long time horizon and low liquidity of investments during the first few years. The founders of ARD contributed also to a change in the federal government's approach to this type of investment. Due to lobbying activity, the federal government activated the mobilisation of capital for venture capital investment, and this in turn gave rise to many new business entities. One of the factors strengthening the U.S. private equity and venture capital market was the creation in 1958 of the Small Business Investment Company (SBIC)[9] by the Small Business Administration (SBA). The SBIC

9 Small Business Administration is a government agency aimed at supporting small private business.

had one, clearly specified task – establishing licensed funds regulated by the government, which were to be used for starting new businesses. Despite the fact that the SBIC was administered by the SBA, the management of its capital was handed over to a private entity. The structure of the capital acquired by the SBIC for investment was significantly different than that of ARD's. SBIC benefited from great legal privileges, which meant that for every dollar invested by the SBIC, the federal government granted a preferential loan in the amount of four dollars. Thus, the SBIC's investments were funded by foreign capital mostly, while ARD's from equity capital obtained from shareholders exclusively. Easier access to capital resulted in a growing number of companies licensed by the SBIC. In 1965 there were 585 of them, and in the seventies the number exceeded 700. Unfortunately, it soon became clear that the *SBIC*'s soft approach to the debt amounts of the enterprises (which belonged to the group of high-risk projects) and the associated costs of the federal debt servicing have led to serious disruptions in the banking sector. Eventually, by the end of 1967, as many as 232 companies owned by the SBIC were classified as problematic. For that reason, the creation of the SBIC cannot exactly be called a success. Lack of competence in managing the organisation as well as numerous embezzlement cases forced the government to amend the legislation, which resulted in a reduction in the number of companies licensed by the SBIC to 250. Problems with the SBIC heavily tarnished the good image of venture capital investment, so laboriously built by ARD. Additionally, the economic situation of the seventies was not exactly conducive to the development of the U.S. venture capital either. The oil crisis and the economic recession caused by it led to a collapse in the venture capital market. As always in times of recession, there occurred a sharp decline in investor interest in the capital market, and consequently a loss of confidence in the private equity and venture capital investment. Investors were deterred by the long-term nature of private equity and venture capital investment as well as by low liquidity and relatively low return on investment in relation to the level of risk. The unfavourable situation lasted until 1977, when a search for alternative ways of investing began. In this way MBOs and LBOs were discovered. ARD's results, however, gave rise to more concern over whether companies engaged in private equity and venture capital activity should even be listed on the stock exchange. These doubts were caused by the fact that, due to making all information about listed companies public, including that on companies operating in high-risk conditions, there appeared considerable room for speculation, which in the long run destabilised the situation of the company itself. Breaking the tie between the long-term investment-oriented capital and short-term ratings proved to be yet another problem. Discussions on organisational changes in companies dealing with private equity investment were initiated, leading to the creation of a new private equity business structure – i.e. partnership – which continues to function successfully even today. The end of the seventies brought about a renewed debate on the impact of private equity investment on the economy. Supporters of private equity – entrepreneurs, Members of Congress and the administration of then –President Jimmy Carter – began a debate on the need to introduce legislative changes that would revive the private equity market. Following the views and opinions of Flanders and Doriot, who indicated the lack of liberalisation of regulations concerning the stock exchange and no changes in the tax system as the main barriers to market development, five new, breakthrough acts were prepared, under which, inter alia, the tax rate on capital gains was reduced (originally from 49.5% to 28%, and in 1981 to 20%) and pension funds were allowed to invest in private equity and venture capital projects. The effects of these regulations were soon apparent. Within few years, the value of private equity and venture capital increased several-fold. The eighties of the twentieth century, apart from a revival of these two segments of the market, brought about tremendous growth of U.S. entrepreneurship. Many new companies were established, while those already existing became stronger, the number of mergers and acquisitions increased, and the public offerings market was stimulated.

The history of the **European** private equity market is much shorter than that of the U.S. market, even though it is actually Europe where this type of investment originated from. The need for capital necessary to support innovation on a larger scale emerged in the nineteenth century together with the industrial revolution in Europe's fastest developing countries. The main capital providers were wealthy individuals or families and banks. And it was the banks that created the first ever group of institutional investors to finance innovative projects. Due to the high probability of failure of investments in promising companies, bankers began to separate the activity associated with project financing from their core business by establishing subsidiary companies. First such company – in its nature similar to today's institutions investing in companies – was established in Belgium in 1822 by *Société Générale*.[10] A true investment boom took place in the seventies (Great Britain) and eighties (Germany, France, the Netherlands and Sweden) of the 20th century. Currently, in Great Britain alone there is around 260 active private equity funds, investing billions pounds in primarily British companies every year.[11] The development of the European market was not as spectacular as that of U.S.A.'s (see fig.1). The main reason for that was the lack of uniformity in legal and tax solutions in European countries. It was not until the late nineties that several initiatives to promote the development of the pri-

10 Freyer, W. *"Die Kapitalbeteilligungsgesellschaft als Instrument der Wirtschaftspolitik,"* Frankfurt, 1981, p. 31, in Węcławski, J. *"Venture capital. Nowy instrument finansowania przedsiębiorstw,"* Warsaw, 1997, p. 12.

11 BVCA Report on Investment Activity 2017, https://www.bvca.co.uk/Portals/0/Documents/Research/Industry%20Activity/BVCA-RIA-2017.pdf?ver=2018-07-05-190000-180&timestamp=1530813602675.

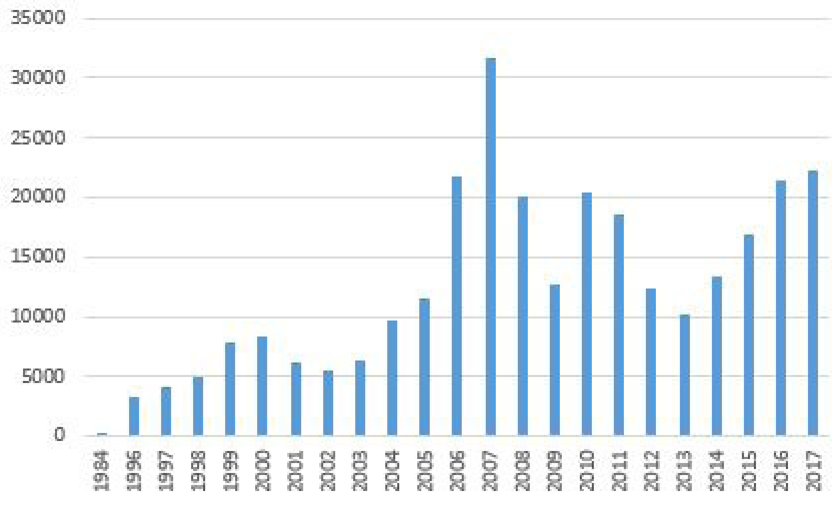
vate equity market were established in the structures of the European Union (e.g. the White Paper of 1995 and 2001, the Action Plan *and* Lisbon Strategy). A great diversity of investment cultures and traditions present in European countries turned out to be yet another obstacle, as it significantly affects the ways of financing investment projects. There can be two investment models found in Europe: the Anglo-Saxon model and the Continental European model. The Anglo-Saxon model is represented by Great Britain primarily, but also by France and the Netherlands. These countries have a highly developed capital market, due to which they are set to finance investment projects with equity capital, and this in turn promotes the development of private equity. Germans and Italians, on the other hand, have a traditional approach to economic development of a country – debt securities. However, over the last decades there has been a radical change in these countries, and increasingly more attention is now being paid to the possibilities offered by the capital market.

The largest share of the European private equity market, as was mentioned before, belongs to **Great Britain** with over 20 billion pounds annual investment (fig. 2). It is also the oldest private equity market among European markets. The Industrial & Commercial Finance Corporation – the first British organisation engaged in venture capital investment – was established shortly after the end of World War II in 1945. Its purpose was to finance the operations of small and medium-sized enterprises facing difficulty in obtaining an amount of capital that would enable their development. The Industrial & Commercial Finance Corporation was initiated the British government, and the parties involved included British clearing banks, with the Bank of England in the forefront. In 1974, the organisation merged with Finance Corporation Industry, thus giving rise to Finance for Corporation Industry, which since 1982 has been operating under the name of Investors in Industry (3i).[12] In the period from 1945 to 1980, 3i was one of the few organised institutions providing funds for venture capital investments in Great Britain. The British market began its rapid development in late 1970s, that is several years faster than the rest of the European market. For comparison, in 1952 there were only two venture capital organisations in the UK, in 1979 – 23, and two years later the number rose to 44. Numerous legal and tax initiatives, especially from the eighties and the first half of the nineties, designed to support the activities of private equity funds, achieved the intended purpose and contributed to a very dynamic development of the British market. As a result of growth in both the value of private equity capital and the level and number of investments, in 1983 the British Venture Capital Association was established. The aim of the Association is to promote the *venture capital* and private equity sectors. The Association's constitution specifies several areas of its operation: creating educational programmes for its members, lobbying for the improvement of legal and tax conditions for the venture

12 *3i Research,* www.3i.com.

capital and private equity business in Great Britain, conducting public relations activities designed to create a positive image of venture capital and private equity investors, and collecting data on the sector as well as analysing and publishing it.[13] The state of the British private equity and venture capital market has undoubtedly been greatly influenced by government initiatives. Up until the time of Margaret Thatcher, the market was practically non-existent, although venture capital investments did take place. They were associated, however, with OTC investments in new projects with innovative technological solutions only. They were therefore narrow-range, consistently with the definition of the U.S. venture capital. Market development in imitation of the U.S. model, however, did not arouse much interest, as British scientists did not want to follow the same path as their American colleagues and did not establish own business entities *en masse*. Investors claim it was under the conservative rule of Margaret Thatcher that the economy and the entire private equity sector were stimulated. [14]

Figure 2. The value of British private equity worldwide investment between 1984-2017(in million pounds)



Source: Author's own work on the basis of BVCA's reports, www.bvca.uk

13 www.bvca.co.uk,

14 Born in 1925, Margaret Thatcher was the Prime Minister of Great Britain in the years 1975-1990. She was the first woman prime minister in British history. Thatcher held power for three terms. Her programme, based on the principles of liberalism, conservatism and monetarism, received a special name – "Thatcherism". Her steely attitude, for example towards striking miners, gained her the nickname 'Iron Lady'. After the introduction of a tax reform in 1990, Thatcher began to lose popularity, which in November of the same year led to her resignation (www.ue.sarr.com.pl/postacie/thatcher.html).

The first **German** company dealing with private equity investment was established in 1965 – *Deutsche Beteiligungsgesellschaft mbH* (known better under the abbreviated name of DBG) was founded by Deutsche Bank. In 1984, shares of 12 companies from DBG's portfolio, equivalent to EUR 21 million, were taken over by the newly established *Deutsche Beteiligung AG Unternehmensbeteiligungsgesellschaft,* and DBG was to manage the company's assets.[15] A year later, the company was introduced on the Frankfurt and Düsseldorf Stock Exchanges[16]. In 1996 the value of DBG's investments exceeded EUR 500 million. Throughout the first half of the eighties, the development of the private equity sector in Germany was very slow. The second half of the decade, however, brought about a considerable revival, which in 1988 resulted in the formation of *Bundesverband Deutscher Kapitalbeteiligungsgesellschaften* (BVK), an organisation that bands together German entities from the private equity sector. A year later *Deutscher Venture Capital Verband* (DVCV) was created, into which BVK was incorporated. Currently, BVK's ordinary members amount to about 200 private equity companies, and supporting members count 100.[17] Researchers of the German market indicate that the reason behind the slower and less spectacular development of the market than in, for example, Great Britain, France or the Netherlands may lie in the cultural, structural and social conditions.[18] Initially, German entrepreneurs had a negative attitude towards financing their businesses with the use of private equity. What they saw in a potential financial investor was a considerable threat to their position. They were reluctant about the requirement to present a wide range of information, both financial and strategic, to an external investor. They also differed in their approach to the purpose of running a company: in their view the purpose of a company is to generate cash surpluses that enable you to finance further development of the business, and not the maximisation of profits that are to be paid in the form of dividend. Over time, the hostility was neutralised by quite a large success of private equity investment in other markets. It was the economic development of Germany and, consequently, a high demand of enterprises for investment capital that proved to be the strengthening factor. The twilight of the eighties brought about also a dynamic growth of small and medium-sized enterprises established at the end of World War II, and with it came the need for change of ownership in most of them. Most of the new owners were from managerial background, and private equity funds turned out to be ideal for management buy-out transactions.

15 www.deutsche-beteiligung.de.

16 DBG is the largest private equity fund manager in Germany. Its investment territory is not limited to Germany, and the larger part, i.e. EUR 400 million, has been invested in German-speaking countries. It is present in Poland and other countries of Central and Eastern Europe.

17 https://www.bvkap.de/en/bvk/who-we-are.

18 Based on Abbot, S., Hay, M. „*Investing for the Future. New Firm Funding in Germany, Japan, the UK and the USA*", Pittman Publishing Ltd., London 1995, p. 68.

The **Polish** private equity market has existed since 1990, when – thanks to the aid programme for Central Europe adopted by the Bush administration – the Polish-American Enterprise Fund (PAEF) was created, holding 240 million dollars.[19] Paradoxically, the biggest role in the development of the Polish private equity market did not belong to Polish but to international financial institutions. In the early days, when the Polish economy was transforming, the key donors of somewhat private equity-like capital (Development Capital type) were the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC). During the first few years, EBRD invested 250 million dollars in, inter alia, the construction of a Banking Centre in Warsaw, Huta Szkła "Sandomierz" (glass works), the Fiat Auto Poland factory, Wielkopolski Bank Kredytowy, Bank Przemysłowo-Handlowy, or Netia. EBRD's financial commitment in Poland between the years 1991-2010 amounted to 4.329 billion euros, which gave Poland an 8.52% share in the total investment amount of the institution. Within the studied period, EBRD participated in the financing of some 220 Polish projects, as a creditor, shareholder or guarantor. For comparison, at the same time, EBRD provided its financial assistance in 103 Czech projects, for a total amount of 1.1 billion euros, and 164 Hungarian projects – 2.5 billion euros.[20] Greater nominal commitment of EBRD was observed only in Romania: 311 projects and 5.6 billion euros, and in the Russian market: 714 projects in the amount of 21.4 billion euros.[21] The International Finance Corporation, in turn, together with other strategic investors allocated over 354 million dollars for investments in such Polish companies as Huta Szkła "Sandomierz" (glass works), Huta Lucchini, the International Bank of Poland, or FM Bank (the first Polish microfinance bank focused on the sector of micro- and small enterprises). In addition to the role of capital donor for Polish companies, EBRD played also a large role in the development of the Polish private equity market, being a co-founder of leading Polish funds, e.g. funds from the Enterprise Investors group, Renaissance, Pioneer Poland Fund, Caresbac, Innova 98, Argus Capital, Environmental Investments Partners, AIG New Europe Fund. The bank's founding function was not limited to the first years of the "new" Polish economy; in 2002, thanks to EBRD's co-financing, the first Polish fund specialising in mezzanine financing was established – Accession Mezzanine Capital LP, which, by 2007, was provided by EBRD with almost 24 million euros.[22]

19 Currently, by creating and managing eight venture capital and private equity funds, it constitutes the largest investment company in Poland - Enterprise Investors, which manages 2 ,5 billion euros (www.ei.com.pl) as at July 2018).

20 In 2007, EBRD ended the investments supporting the transformation of the Czech economy, concluding that it had already reached a mature level of development.

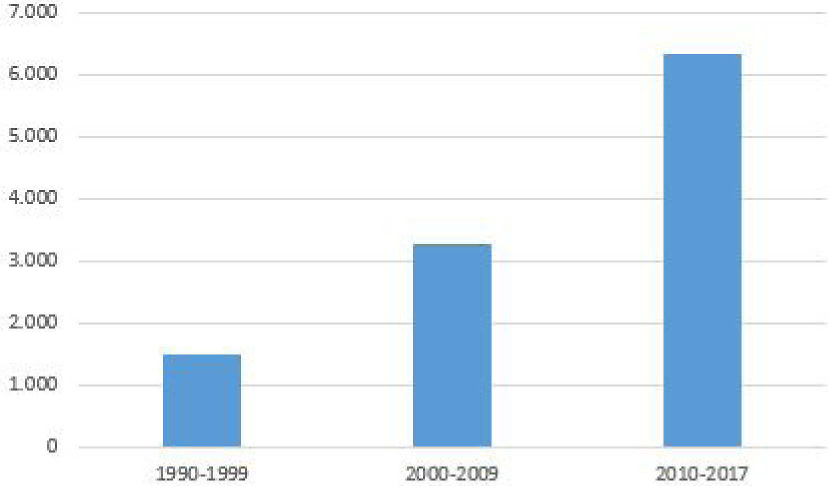
21 The European Bank for Reconstruction and Development, internet materials, www.ebrd.org.

22 Mezzanine financing is a hybrid of debt and equity capital financing, e.g. the purchase of bonds convertible into shares of the company issuing them.

Moreover, EBRD fully financed the activities of two other funds – Nova Polonia Natexis II (in 2006) and AVALLON (in 2007), specialising in MBOs. Between the years 1991-2010, EBRD invested in the development of the Polish private equity market over 478 million euros, i.e. 11% of all funds contributed in Poland. Another important element of EBRD's activity is promoting private equity investments, and not only in Poland but throughout the entire Central and Eastern Europe region. In the case of the Czech private equity market, EBRD invested over 129 million in about 30 private equity funds, i.e. 12% of the total capital committed by EBRD in the transformation of the Czech economy; and in the case of Hungary – 167 million euros in 35 funds, i.e. 7% of all investments of the bank. By sponsoring a number of private equity funds, EBRD realises the adopted policy, whose main aim consists in the belief that private equity funds with appropriate investment strategies constitute the best source of financing of post-communist economies by investing in companies undergoing restructuring and privatisation. The activities of the EBRD and other international institutions have undoubtedly contributed to the flourish of the Polish private equity market, which dominates in the Central and Eastern Europe region.

The beginnings of the Polish private equity market are bound, as mentioned earlier, with the establishment of the Polish-American Enterprise Fund. The Fund was part of a broader aid scheme directed to the countries of Central and Eastern Europe, the so-called SEED Act. The concept of this type of assistance (through the use of structures typical for the private sector) for post-communist countries had come to life a little earlier, that is, in the days of the Ronald Reagan administration. Despite its governmental origin, the Fund operated on a commercial basis. The same aid scheme gave rise to the creation of the Hungarian-American Enterprise Fund, the Czech-American Enterprise Fund and the Romanian-American Enterprise Fund. The management of the Polish-American Enterprise Fund was handed over to *Enterprise Investors*. At the same time, the Danish Investment Fund for Central and Eastern Europe – IQ – began to operate, also fully equipped with government capital (approx. DKK 900 million). The investment activities of the Fund were aimed at financing of the joint projects of Poland and Denmark exclusively (mainly joint ventures). The years 1992-1993 brought about the introduction of many new players into the Polish market. There emerged both depend and independent organisations, all of a commercial nature. For the purpose of financing Polish projects, consortia of funds were now being created, e.g. Huta Szkła "Jarosław" (glass works) was jointly invested in by the New Europe East Investment Fund associated with the Californian fund management group Capital Research, the Owens Illinois corporation and PAEF. The year 1992 was when the creation of the segment of large funds began, together with the establishment of the Polish Private Equity Fund I&II (PPFK for Polish: Polski Prywatny Fundusz Kapitałowy I&II) and UNP-Holdings. The PPFK's shareholders were: the Polish-American Enterprise Fund (USD 50 million), EBRD (USD 50 million), Creditanstalt (USD 7 million), and several U.S. pension funds (USD 44 million). UNP-Holdings was owned by several institutions involved in investment banking.[23] Due to the then state of the Polish economy, its lack of stability, the primary source of projects to be financed by the already existing funds was consisted in the privatisation of state enterprises. In 1993, the Polish economy accelerated greatly – inflation began falling rapidly, domestic product dynamics were growing, and foreign investment was increasing. All this boosted Poland's investment attractiveness. Evidence to that was the year 1994, which can be considered a record in terms of growth of the commercial funds segment. Almost simultaneously a number of funds emerged, equipped with huge capital (fig. 3). This was an important moment in the history of the Polish private equity market.

Figure 3. Private equity funds' investments in Poland in the years 1990-2017 (in million euros)



Source: Author's own work based on PSIK reports, www.psik.org.pl.

Competition among the funds began increasing, types of investments were becoming more and more diverse, entrepreneurs were getting interested in the concepts of venture capital and private equity. In total, the Polish market grew by more than 210 million dollars in one year.[24] The year 1994 can also be considered a breakthrough in terms of emergence of the first funds established by banks. These funds, however, were not as commercial in nature as other funds. Bank funds came to exist with the

23 But the real founder of UNP was actually a Canadian entrepreneur, G. Bonar, who created it in 1989; and it has been present in Poland since 1992.

24 No data on the amount of the initial capital of White Eagle Industries.

use of aid funds of the Know-How Fund, and their investment portfolio consisted of entities acquired in the process of recovering portfolios and converting companies' "bad debts" into shares. [25] Also in 1994, trans-regional funds began to emerge in Poland on a wider scale. The first one was the East European Development Fund, which had already made its first investment in 1992 in Żywiec S.A. but did not increase its investment activity until two years later, when it enriched its portfolio with such companies as: Pudliszki, Wedel and BPH. The next trans-regional funds interested in investing in Central and Eastern Europe were: Advent Private Equity Fund – Central Europe,[26] European Renaissance Capital, Alliance Scan East Fund, New Europe east Investment Fund, and since 1996 also East Europe Food Fund. The years 1995-1999 brought a number of changes in the Polish private equity market, mainly among small, quasi-commercial funds based on public capital. The experience gained by Enterprise Investors through managing the Polish-American Enterprise Fund and *PPFK I&II*, led in 1995 to the launch of another fund – the Polish Enterprise Fund, and a year later – the Polish Enterprise Fund IV. And a somewhat curious event was the emergence of trans-regional funds with heavily specialised investment profiles. Their investments were focused on three sectors: the Internet, TMT and new technologies. The biggest player among the trans-regional funds of that time turned out to be Advent Central and Eastern Europe I&II, which allocated almost 50% of its funds to investments in Poland (about USD 90 million). There also appeared in the market: BMP/CEEV, Techologieholding, Environmetal Investment Partners, DBG Osteureuropa, Riverside Central Europe. And in 2000-2001: Lloyd's Internet Investment Fund, Softbank Emerging Markets oraz Raiffeisen CEE Private Equity Fund.

In 2002, to prove that the Polish private equity market had reached a proper level of development and embedded itself in the landscape of Polish investments for good, the Polish Private Equity Association (PSIK for Polish: Polskie Stowarzyszenie Inwestorów Kapitałowych) was established. The Association brings together representatives of companies managing private equity funds (so-called ordinary members) as well as consulting companies, law firms and banks cooperating with the private equity sector (so-called supporting members). Initially, the Association's list included 129 ordinary members, while at present there are 55 companies that manage private equity funds and 74 supporting members. Its primary tasks are to promote the Polish private equity market and support its development through conducting educational activities targeted to both entrepreneurs and fund representatives, exchanging experiences between PSIK members, collecting and analysing data on Polish private

25 The process took place on the basis of the Act on the Financial Restructuring of Enterprises and Banks of 1993.

26 The fund became a shareholder in Poland Investment Fund. Simultaneously, it also invested independently.

equity investments, informing the members about various initiatives aimed at modifying the legal conditions of their operations, and ensuring that members observe the relevant ethical and professional standards[27]. All members of the Polish Private Equity Association operate in accordance with the adopted Code of Conduct. Moreover, they are obliged to adhere to the Code of the European Venture Capital Association (now is changed onto the Invest Europe). It is estimated that there are about 60 fund management companies constantly present in the Polish market (some of which are not PSIK members), predominantly private equity funds. In Poland they invested over 7 billion euros by the end of 2017, thus injecting capital in about 1 200 Polish companies.[28]

4. CONCLUSIONS AND RECOMMENDATIONS

An analysis of historical statistical data shows the dominance of two national private equity markets: the USA and Great Britain. The United States and Great Britain examples also show what a strong impact the state's actions have on the private equity market's condition. Significant in this case are not only legislative solutions regarding the private equity market's operation, but also the direct participation of public funds in investments.

The history of the global private equity market shows that funds' investments have impact also on the state of a given country's economy. Companies using private equity increase employment, and thus reduce the level of unemployment. They attach more attention to the educational level of employees, allowing the economy to be more knowledge-based and enabling the introduction of a wider variety of new technological solutions, making the economy more competitive. It is therefore worth to create good system conditions that would enable the private equity market to develop, bring greater availability of capital and lead to not transferring abroad the profits generated by the funds.

27 On the basis of the Charter and Code of Conduct of the Polish Private Equity Association, www.psik.org.pl.

28 On the basis of data published on the website of the Polish Private Equity Association, https://psik.org.pl.

REFERENCES

1. 2017 European Private Equity Activity, [online]. Available at: **www.investeurope.eu**, [Accessed on July 30, 2018].
2. 2017 was an down year for take private buyouts, [online]. Available at: **www.pitchbook.com**, [Accessed on July 30, 2018].
3. 3i Research, [online]. Available at: **www.3i.com**, [Accessed on July 29, 2018].
4. Abbot, S., Hay, M., 1995, Investing for the Future. New Firm Funding in Germany, Japan, the UK and the USA, Pittman Publishing Ltd., London.
5. BVCA Performance Measurement Survey 2002, BVCA and Pricewaterhouse-Coopers
6. BVCA Report on Investment Activity 2017, [online]. Available at: **www.bvca.co.uk**, [Accessed on July 29, 2018].
7. Bygrave ,W.D., Timmons, J.A., 1992, Venture Capital At the Crossroads, Mc Graw-Hill Professional, Boston.
8. Charter and Code of Conduct of the Polish Private Equity Association, [online]. Available at: **www.psik.org.pl**, [Accessed on June 15, 2018].
9. Glossary, EVCA, [online]. Available at: **www.investeurope.eu**, [Accessed on July 29, 2018].
10. NVCA 2018 Yearbook Final, [online]. Available at: **www.nvca.org**, [Accessed on July 29, 2018].
11. Pellin, J., 1994, The Guide to Venture Capital, BVCA – British Venture Capital Association, London.
12. Rocznik 2002, PSIK, Warsaw 2003, [online]. Available at: **www.psik.org.pl**, [Accessed on April 20, 2008].
13. Rocznik 2003, PSIK, Warsaw 2004, [online]. Available at: **www.psik.org.pl**, [Accessed on April 20, 2008].
14. Rocznik 2004, PSIK, Warsaw 2005, [online]. Available at: **www.psik.org.pl**, [Accessed on April 20, 2008].
15. Rocznik 2005, PSIK, Warsaw 2006, [online]. Available at: **www.psik.org.pl**, [Accessed on April 20, 2008].
16. Rocznik 2006, PSIK, Warsaw 2007, [online]. Available at: **www.psik.org.pl**, [Accessed on April 20, 2008].
17. Rocznik 2007, PSIK, Warsaw 2008, [online]. Available at: **www.psik.org.pl**, [Accessed on April 20, 2008].

18. Rocznik 2008, PSIK, Warsaw 2009, [online]. Available at: **www.psik.org.pl**, [Accessed on September 12, 2011].

19. Rocznik 2009, PSIK, Warsaw 2010, [online]. Available at: **www.psik.org.pl**, [Accessed on September 12, 2011].

20. Venture capital amount invested in the United States since 1995, [online]. Available at: **www.statista.com**, [Accessed on July 29, 2018].

21. Węcławski, J., 1997, Venture capital. Nowy instrument finansowania przedsiębiorstw, Warsaw.

22. What is Venture Capital?, NVCA, [online]. Available at: **www.nvca.org**, [Accessed on July 29, 2018].

HISTORIJA PRIVATNOG TRŽIŠTA DIONICA. PRIČA ZASNOVANA NA SLUČAJEVIMA SJEDINJENIH AMERIČKIH DRŽAVA, VELIKE BRITANIJE, NJEMAČKE I POLJSKE

SAŽETAK

Cilj ovog članka jeste historijski prikazati investicije privatnog kapitala, smatrajući ih interesantnim u dugom razdoblju. Pored činjenice da tržište privatnog kapitala potiče iz Europe, ono je brže i snažnije raslo u Sjedinjenim Američkim Državama. Potreba za kapitalom koji bi podržao inovacije na višoj razini javila se u devetnaestom stoljeću, zajedno s industrijskom revolucijom u najbrže rastućim državama Europe u razvoju, poput Velike Britanije i Njemačke. U kasnijem razdoblju, 90-tih godina ovog stoljeća, nakon političke i ekonomske transformacije, dolazi do nastanka fondova privatnog kapitala na Poljskom tržištu, kao i tržištima ostalih zemalja Centralne Europe.

Članak prevashodno obrađuje Britansku i Američku literaturu, kao i podatke korištene iz godišnjih izvještaja i statističkog materijala brojnih nacionalnih udruženja privatnog kapitala (poput Invest Europe, BVCA, NVCA, PSIK), publikacija međunarodnih organizacija (npr. EBRD), izvještaja i studija sačinjenih od strane konsultantskih kuća, kao i izvora sa weba.

Studija obuhvata primjenu nekoliko metoda: deskriptivne metode, metode komparativne analize, metode kritičke analize i metode sintetiziranja zaključaka.

Ključne riječi: *privatna ulaganja, razvoj poduzetništva, izvori kapitala.*

JEL: *G24, G32, O16.*