THE ROLE OF EQUITY STAKES AND INDUSTRY EXPERTISE IN MITIGATING THE RISK OF FINANCIAL DISTRESS. ARE PRIVATE EQUITY SPONSORS REALLY BETTER THAN OTHER TYPES OF OWNERS?

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Abstract

We study whether Private Equity acquirers (sponsors) are long-term oriented with their Leveraged Buyout (LBO) European targets. These temporary acquisitions aim to restore the target’s value and to provide a capital gain to the sponsor. The performance-based reputation of the sponsor could incentivize the latter to value capture at the expense of the target rather than value creation. Since LBOs are highly-levered transactions and sponsors are active investors, we study how corporate governance mechanisms, namely equity stakes and enhanced industry expertise, affect the target’s risk of financial distress (Altman’s Z-score; O-score; Zmijewski-Score). Studying a 2013-2016 sample of 307 firms (targets and non-LBO firms), with a linear regression we find that sponsors, compared to other types of ownership, make a better use of equity stakes and industry experts to improve strategic planning and ultimately to mitigate the risk of financial distress of the target; however, results do not completely exclude that sponsors use these corporate governance mechanisms also for value capture, especially by opportunistic uses of assets rather than an inefficient use of leverage. These findings are useful to targets, investors in PE-LBO funds, and regulators.