Investment Funds as Financing Alternative to Revive Local Industry

Ioana Pop-Radu[1], Mircea-Iosif Rus[2]

Abstract: The paper is oriented toward identifying the benefits offered by investment funds as financing alternatives to those entities in need for funding, thus in financing their growth. The research is developed as a case study being carried out for private equity investments within the Romanian market. This alternative investment vehicle presents the most comprehensive range of operations carried out by investment funds and their example can expose both benefits and compromises. Methodologically, the analysis covers all stages of investment funds related to demarcation of the target entity, from selection, evaluation, implementation, monitoring until the multiplication of investment while liquidation is in place.

Keywords: investment funds; alternative funding; private equity;

JEL Classification: E22; G23; O11; O16

1. Introduction

Mutual fund investments topic is attractive for the latter researches as this domain (dynamic, market size and its growth) involves a wide area of studies, industries and countries. It is enhancing a great significance for both academic literature and global capital market, as complex connections are involved between capital allocation, financing decisions and economy.

Our approach gains relevance as it provides relevant alternatives in boosting the economy thourgh this investment vehicles – by funding companies and simultaneously - by supporting economic growth.

The latter development of capital markets, as well the developments of financial innovations have led to many institutions and financial instruments improving the

[1] PhD, Babes Bolyai University of Cluj-Napoca, Faculty of Economics and Business Administration, Cluj-Napoca, Romania, Address: Universitatii Str. 7-9, Cluj-Napoca 400084, Romania, Tel.: 0264 405 300, Corresponding author: ioana19radu@yahoo.com.

[2] PhD, Babes Bolyai University of Cluj-Napoca, Faculty of Economics and Business Administration, Cluj-Napoca, Romania, Address: Universitatii Str. 7-9, Cluj-Napoca 400084, Romania, Tel.: 0264 405 300.

financial intermediation system. Consequently, the actors involved in capital allocation have perfected a complex circuit in brokering the supply of financial investments (i.e. equity holders - investors) and demand for capital (i.e. users of capital - entrepreneurs in need of capital). As a result, this circuit of raising capital has been organized and concentrated in investment funds vehicles.

Given the pursued role of investment funds, we'll analyze them from the two ways:

• attracting capital funds i.e. establishment of the fund itself by selling investment units to investors - as shown in Figure 1;

• placement of accumulated funds in various securities on the financial market – i.e. financing other companies - as shown in Figure 2.

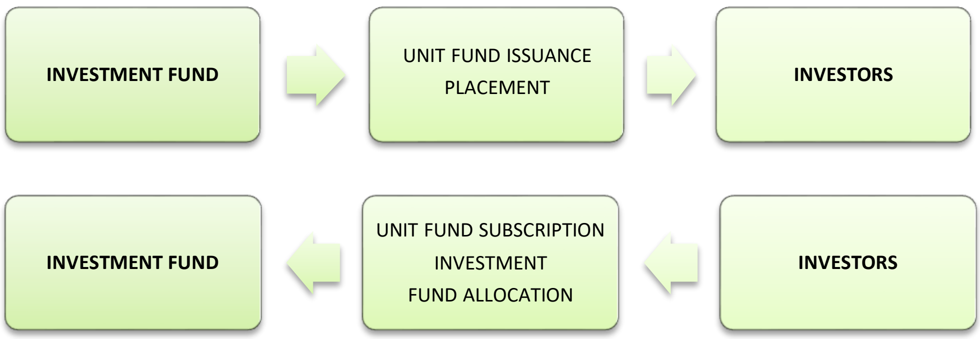

Figure 1. Fund initialization scheme

Source: Author's own processing

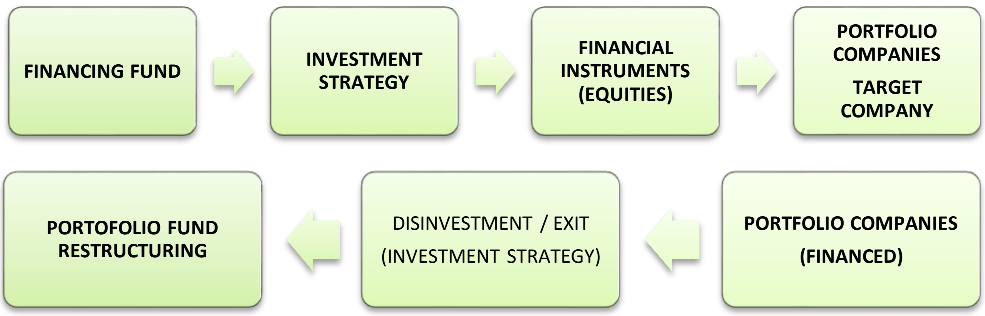

Figure 2. Fund investing scheme

Source: Author's own processing

On account of the first circuit (in which these investment funds are operating in the market), it is concluded that investment funds operate within three specific actions:

- issuing fund units in order to attract investment capital - action that involves raising funds from investors on account of subscriptions for the issued units;

- performing strategic investment allocations- the capital accumulation is placed according to a clearly defined investment strategy in various investment vehicles;

- c) investment multiplication through the redemption of fund units at the time of exit.

The process of gradual migration of household savings from bank deposits classic was largely directed to investment funds use, which recorded gradually a higher growth rate of the total attracted assets. This situation can be explained mainly on account of lower interest rates on bank deposits, higher disposable incomes, increasing financial education, the development of capital market, but also on behalf of the advantages offered (e.g. better diversification of risk, cost savings, professional management etc.) and higher returns on investments.

Investment funds became debt financiers by the fact that, by their significance, they have a certain percentage of the portfolio placed in money market instruments issued by the state. Here, a particular importance rises over the money market funds functionality, which, as per their organization is considered to have the bulk of capital (80%) allocated on medium and short period monetary instruments, such as government securities, treasury bills, bank deposits, certificates of deposit and bonds.

2. Mutual Funds (Private Equity) Financing Scheme

There is a rebound effect between the partners involved in this financing mechanism while involving investment funds. This connection is best described by Luckoff (2010) figure, below presented.

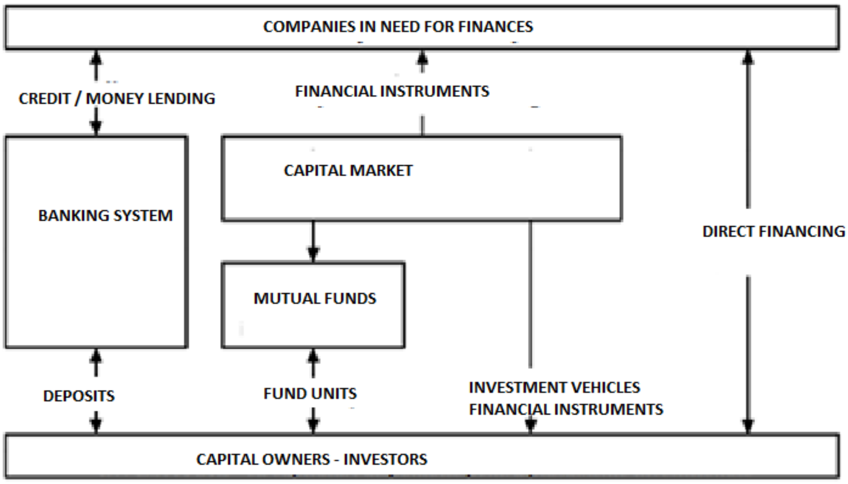

Figure 3. Financing cycle

Source: Author's own processing using (Luckoff 2010)

In other words, we found that following investing and financing cycle are emerging on a two-way relationship. Both traded funds and target companies may influence investors' expected performance.

For a better representation of investment funds financing cycle our analysis will be spreaded within *private equity market*. As a source of external financing, private equity funds foreshadows a partnership between the investment fund and the beneficial of the invested capital through a financing contract that will be based on either an issue of shares or bonds. Consequently, private equity capital intervention takes the form of a investment parnership by purchasing securities issued by those companies in need of capital funding.

From a macroeconomic perspective, EVCA[1] and Frontier Economics have identified the business benefits of private equity funds based on three indicators briefly presented below:

- Main activities: attracting funds and investing them to support companies;
- Outcomes: intermediate effects on investors, companies, sectors and the economy;
- Impacts: long-term improvements in companies, sectors and the economy.

[1] EVCA stands for European Venture Capital Association.

Based on all transmission channels, private equity industry supports economic growth by simultaneously following the investee companies, raising funds or closely following the markets. Figure 4 depicts all transmission channels.

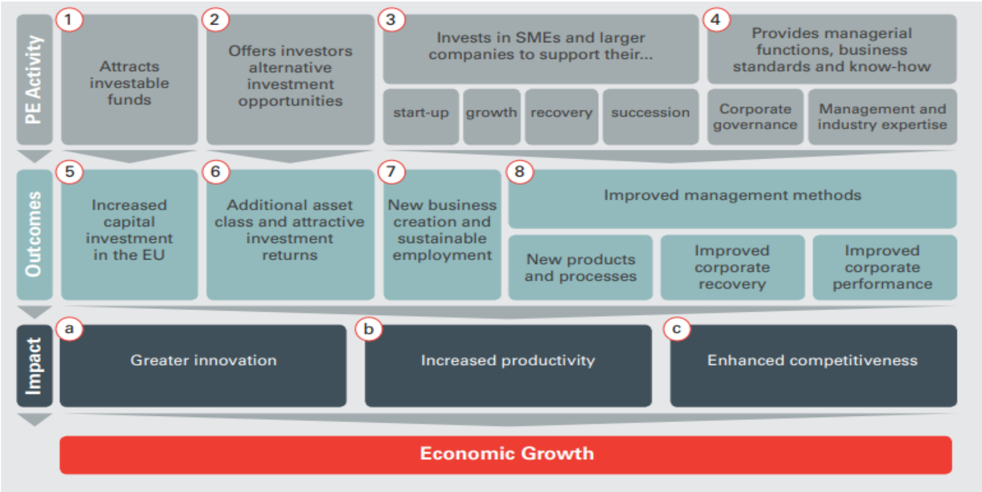

Figure 4. Interconnections between private equity funds and economic growth

Source: Frontier Economics, 2013, p. 15

Summarizing, the potential impact of private equity investments may be defined by:

- supporting and promoting innovation as long as the investments support an excess of 80% of the budgets for research and development and innovation, all being around 40% of the capital raised from risk capital financing;
- increasing productivity by implementing new technologies, products or services. New developments and innovation implementation in production and management become effective solutions to use limited resources for multiplying effects;
- increasing competitiveness as a direct result of the competitive advantages arising from implementation of new technologies.

3. Case Study

3.1. Private Equity Financing in Romania

In Romania, private equity financing alternative began to develop only after 2000, being a young sector but with an extremely high growing potential. Even if this market is at an early stage development, it has already registered examples that proved to be profitable and able to develop the European market wide (Vasilescu, Giurcă & Simion, 2009).

Eyeing the Romanian market, international players such as Advent International (holds the largest investments in Romania with investments of hundreds of millions of Euros in companies like Brewery Holdings, Vodafone, Euromedia, Terapia and Dufa), AIG, GED Enterprise Investors, Innova Capital Oresa Ventures have not underestimated the market's potential and succeded to ensure earnings of tens of millions of Euros and multiplications up to 126 times (e.g. the case of Flanco and Flamingo merging within Oresa investments financing).

In a simplified approach these funds have accessed Romanian market and have multiplied their initial investments up to 5 times (Radu 2010b) as shown in Table 1.

Table 1. Summary of main private equity investments in Romanian market and their results

ADVENT INTERNATIONAL

Financing entity	*Sector*	*Strategy*	*Investing amount*	*Multiplied amount*	*Take over partner*	*Investing period*	*Multiplying coefficient*
Dufa	Chemical industry	*Buyout*	(2004) 18 mil EUR	(2008) 50 mil EUR	Bengross	4-5 y	2.78x
Terapia Cluj	Pharma	*Takeover*	(2003) 49,5 mil USD	(2005) 324 mil USD	Ranbaxy India	2-3 y	6.5x
Mobifon Connex	Telecom services	*Capital growth*	(1997) 85 mil USD	(2004) 2,5 -3 mld USD	Telesystem International Wireless Vodafone	8-9 y	29.4x

AIG Investments

Financing entity	*Sector*	*Strategy*	*Investing amount*	*Multiplied amount*	*Take over partner*	*Investing period*	*Multiplying coefficient*
Astral Telecom	Telecom services	*Buyout*	(mai 2007) 80 mil USD	(2009) 1,6 mld EUR	France Telecom, Deutche Telecom	2-3 y	20x

GED Capital Investments

Financing entity	*Sector*	*Strategy*	*Investing amount*	*Multiplied amount*	*Take over partner*	*Investing period*	*Multiplying coefficient*
SICOMED	Pharma	*Management replacement*	(2000) 6,8 mil EUR	(2005) 41,6 mil EUR	Zentiva	5-6 y	6.11x

ORESA Investments

Financing entity	*Sector*	*Strategy*	*Investing amount*	*Multiplied amount*	*Take over partner*	*Investing period*	*Multiplying coeficient*
FLANCO FLAMINGO	Distribution	*Partial exit*	(1997) 300.000EUR	(2006) 38 mil EUR		9-10 y	126x
LA FANTANA	Distribution	*Buyout*	(2001) 3 mil EUR	(2007) 35 -40 mil EUR	Innova Capital (secondary buyout)	6-7 y	11.67x

Source: Author's own processing

Generally, these foreign investment companies have invested in domestic companies belonging to the same sectors within the most relevant examples are the followings: for telecommunications (eg. Mobifon Connex tradeoff to Vodafone, Astral Telecom sale to Orange, Digital Cable Systems takeover by RDS RCS), for financial services (we have the case of Intercapital Invest, Kiwi Finance, Libra Bank, Credisson), for chemicals and pharmaceuticals (Terapia Cluj takeover by Ranbaxy, Sicomed - Zentiva case, Labormed-Shreea, Lupin, Dr Reddy's Laboratories), the industry of consumer goods (Bere Miercurea Ciuc - Brewery Holdings, as well as Vel Pitar, La Fantana, Oriflame), for electrical and electronic distribution (Flanco - Flamingo, Domo), in tourism services (Happy tours, Continental Hotels), paint industry (Policolor, Dufa), etc.

As an external funding solution, private equity funding has become a considered financing alternative while the bank loans conditions have been restrictive (Galeteanu 2009). With short-term interest rates of 13.1% and 11.8% (for 3 months EUR interest rates) and of 7.7% and 9.7% (for 10 years long term rates), 2008-2009 period surprised a weaker economic activity for the global market due to a lack of liquidity. Moreover, capital market listing has become barely viable source of financing starting from February 2015 through Aero quotation for small and medium companies. Until then, private equity funding was available to support companies to cover their illiquidity issues.

According SEEPEA, the fastest private equity investments growing was recorded in 2007 when investment rose by over 400% after one year's growth rate has exceeded only 60% of the local market. As a fact, the Romanian companies have captured the private equity funds attractiveness, being amounted at 156 million EUR and an average funding of 12 million RON for each targeted entity (Table 2)

Table 2. Evolution of private equity funds in Romania

Indicators	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Private equity (PE) investments in Romanian companies (thousand EUR)	156050	122584	82865	80338	48075	24276	48450
PE investments growth (Δ%)		-21.45	-32.40	-3.05	-40.16	-49.50	99.58
No of funded companies	13	20	17	11	9	8	10
Start-up	1	2	1	0	0	0	1
Growth	3	10	12	10	8	7	6
Buyouts	9	8	4	1	1	1	3
Medium investment/company (thousand EUR)	12003	6129.2	4874	7303	5341	3034.5	4845

Source: Author's own calculations using EVCA and SEEPEA statistics

Among the most attractive areas for private equity investments, energy, pharmaceuticals, telecommunications, financial services and retail trade provide the highest attractiveness, all 5 areas accumulating 50 % of the new invested amounts throughout the period 2007-2013 (Chart 1).

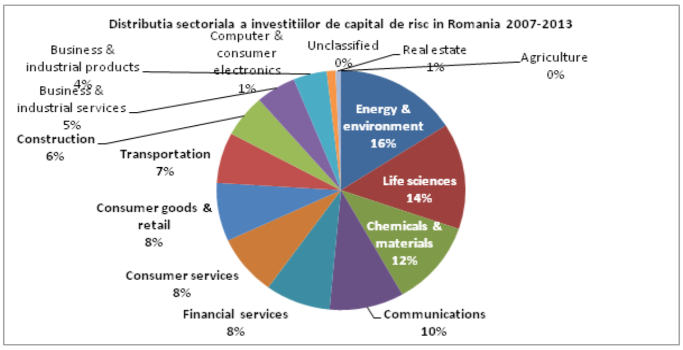

Chart 1. Sectorial distribution of the private equity investments in Romania

Source: Author's own calculations using EVCA și SEEPEA statistics

The best exit results were related to amounts invested in Romanian companies. More exactly, it was registered within the Healthcare sector, with significantly multiplied final amounts. At the same time, the same sector generated a maximum exit value of EUR 14.965 thousand EUR (2009), becoming the most attractive domain for private equity capital portfolio investments.

3.2. Data. Methodology. Results

Data considered are real and exemplifies the case of a local pharmaceutical company, namely SC SICOMED SA, which benefited three capital inflows from investment funds side and whose business was restructured under Zentiva name. This example has become a particular one defining best how private equity funds provide financing and add value to an entity. For example, following funds involvement, Zentiva new merged entity announced a turnover of 11 times higher after Sicomed was acquired. However, the takeover's success was not fully accompanied for all levels - it has been marked also by series of compromises that have included various restructuring strategies. Sicomed-Zentiva case has become a pillar among the major investment transactions during period 1997 and 2005 as it has followed a standard scheme on financing through private equity funds implication from investing to divesting/exit. Consequently, we'll proceed to analyze the financing scheme through three stages: at the time of investing, during funding period and at the time of exit. To ensure a pertinent analysis we report to same set of indicators during the three reporting stages e.g. turnover changes, net profit evolution and employment rate dynamics, which correspond to time period before 2000, during 2000-2005 and after fund's exit, once the new entity of Sicomed-Zentiva has been consolidated.

Before being a target company, Sicomed company had a 10 years vintage on the market and having one of the highest liquidity rates on the Romanian stock market. It has been traded on the Romanian capital market starting with 1998 and due to its international success on European pharmaceutical market for a wide range of products has been firstly financed by Venoma Holding[1] in 2000 with an placement of 6.8 million EUR through its fund GED Capital. With new investments, Venoma Holding had reached to owe up to 50.08% of the Sicomed (2004). At the time of targeting, Sicomed has been the market leader by quoting a 5.1% of the national market and maintained its stock undervaluated. With the capital infusion and speculating the stock valuation, Venoma Holding had invested another 10 million USD to restructure the managerial team, to improve the production gear along with new operational flows.

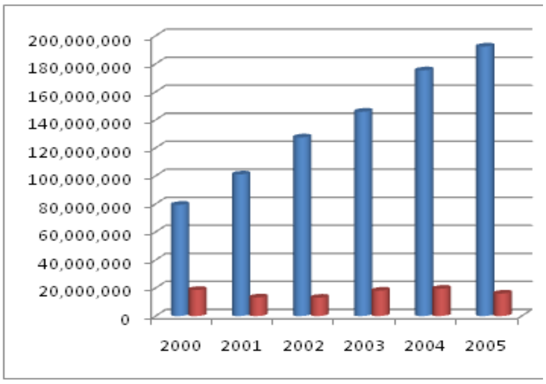

Chart 2. Turnover and net profit evolution during private equity financing

Source: author's own calculations

[1] Venoma Holding is defined by two private equity funds managed by GED Capital Development and Global Finance.

Note: Turnover marked in blue and net profit marked in dark red.

During fund's financing (2000-2005), Sicomed has registered growth in both assets and liabilities and hence has maintained liquidity and its solvability at optimum rates. Although the total number of employees has been significantly reduced from 2000 to 918 employees the financial results are much improved. While the total turnover has been 11 times multiplied during these 6 years and the profit has been maintained at the same level, the compromise made with employee's disengagement proved to be the opportunity charge. Starting with 2006, Sicomed had a total turnover of 63 million EUR, Venoma Holding sold through a public buyout its participation to a Czech pharmaceutical group i.e. Zentiva grup. Consequently, the new created entity, i.e. Sicomed-Zentiva has consolidated its market share to 25%.

At the time of exit (2005), Sicomed-Zentiva entity has obtained a revive defined by new and wider market, new distribution, new portfolio of products, increased competition, modern technologies, new production capacities, new research objectives and etc. Once restructured and launched on a new development path, the initial compromise has been slightly remitted and new employees have been involved in the new projects (new 200 jobs). Hence, the employment rates are pretty volatile these days as technology moves a step forward.

After exit, Sicomed-Zentiva followed same path in consolidating its market position and developing new products and accepted since 2009 other private equity funds to finance their operations (i.e. pension funds and ING International Romanian equity fund).

Another compromise accepted during these times has been the name changing from Sicomed-Zentiva to Zentiva only. The former national pharmaceutical enterprise has been removed from its naming but its identity cannot be erased. Nowadays the pharmaceutical sector keeps in consolidating the market position internationally and since 2009 Zentiva is part of Sanofi Avensis Europe group by taking over 96.8% of its capital.

3.3. Research Limits

We acknowledge that this research is restricted to local market and its results cannot be extended to other markets, but it provides a comprehensive and useful guidance material to anyone interested in finance and mutual funds investments. At the same time, the theme is attractive to all specialists and this research is foreshadowing a detailed case study of Romanian pharmaceutical sector as an example in establishing the advantages and/or disadvantages of a mutual fund investment scheme.

4. Final Remarks

Last 6 years demonstrated that Romanian capital market has joined European competition by reducing the fragmentation of the market from regulatory institutions unification of entities active in the capital market under the Financial Supervisory Authority (abr. ASF –i.e. Autoritatea de Supraveghere Financiara). At the same time, adapting national legislation to the European legislative framework has allowed the removal of discriminatory barriers between EU states, allowing access and authorization of foreign investment vehicles on the local market, while outsourcing national funds in the foreign market.

In addition, we found that the industry investment fund in Romania has registered a sustained rate of growth (both in the number of funds active in the market and the value of total assets managed by them), without being strongly affected by the contagion of latter economic crisis. Thus, despite the inconveniences arising on the global stock market in 2008, Romanian mutual funds recorded increases of over 86% up versus 2005 status, mainly due to rising capital inflows into equity and diversified funds.

Consequently, Romanian investment fund market enhances a proof of resistance to latter market shake and effectively, while banking system has been self-contained and restrictive, fund investments have become an available financing alternative.

Given that the stock market will keep liquidity levels at least at the scores obtained in 2012, the next period appears to be the dynamic for the investment funds market. Alike, attracting funding will provide support for new investments and portfolio investors will step up their assets allocations within the domestic market (Radu & Nistor 2010). Thus, the background to achieve a constant demand for investment funds allocations, the funding mechanism has to prefigure benefits for both funded companies and as well for investment fund's investors.

5. References

Arsani, A. (2015). Despre oportunitățile de investiții în România. *Piața financiară*, Martie 2015, pp. 74-75.

Cãtãlina, S. & Ioana, R. (2012). The Attractiveness of Harmonized Investment Funds Evidence on Romanian Investment Fund Market. *Ovidius University Annals, Economic Sciences Series*, 12(1), pp. 1660-1665.

Couch, Robert & Wu, Wei (2012). Private investment and public equity returns. *Journal of Economics and Business*, 64, issue 2, pp. 160-184.

Falat–Kilijanska, Ilona (2012). Private Equity and the competitiveness of Polish entreprises. *Oeconomia Copernicana*, 3, issue 1, pp. 89-114.

Galeteanu, N. (2009). *In lipsa creditelor, companiile se pot imprumuta la fondurile de private equity*. 25 Feb 2009.

Hernán, Herrera-Echeverri, Guillermo; Salazar-Duque, Juan & Jerry, Haar (2017). Private Equity and Devaluation in Emerging Countries. *Global Economy Journal*, 17, issue 1.

Johan, Sofia A. (2012). Institutional investment in private equity. Ch. 3, p. iii-iii in , Handbook of Research on Venture Capital: Volume 2, Edward Elgar Publishing, https://EconPapers.repec.org/RePEc:elg:eechap:13985_3.

Luckoff, P. (2010). *Mutual fund performance and Performance Persistance*. The impact of fund flows and manager changes. 1st Edn. Germany: Gabler Verlag,.

Moise, O. (2015). Capitalul caută mereu alternative profitabile. *Piața financiară*, Martie 2015, pp. 66-67.

Pontarollo, Enzo & Casè, Marco (2007). Private Equity Investments and the Italian Industry. *L'industria*, issue 4, pp. 679-702.

Vasilescu, Giurcă L & Simion, S. (2009). Facilitatea accesului întreprinderilor mici și mijlocii inovative la fondurile de capital de risc. *Revista de Finanţe Publice şi Contabilitate*, no. 1, pp. 22-26.

Vasilescu, L.G. & Popa, A. (2011). Fondurile cu capital de risc – alteranativă de dezvoltare și inovare pentru firme. *Analele Universității Constantin Brancusi din Targu Jiu, Seria Economie*, no. 1, pp. 204-213.

Xu, Xiaoqing Eleanor (2008). Global Perspectives on Venture Capital and Private Equity. ch. 8, pp. 187-209 in *Advances In International Investments Traditional and Alternative Approaches*, World Scientific Publishing Co. Pte. Ltd.