

Private Equity, Buy-outs, Leverage and Failure

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Abstract

We study the determinants of failure, defined as entering the bankruptcy process, in a unique dataset comprising the population of over 10 million company-year observations of private firms in the UK over the period 1995-2009, of which over 140,000 had failed. We focus on the role of leverage, whether the firm involved a management buyout or management buy-ins, and whether the buy-out/buy-in was private equity backed. Estimating discrete time macro dependent duration models and controlling for a range of financial and non-financial factors, companies with higher leverage, whether a buyout or not, are significantly more likely to fail. Importantly, we find that controlling for firm specific characteristics, including proxies for operational risk, financial risk and governance, buyouts have a higher failure rate than non-buyouts with MBIs having a higher failure rate than MBOs. We find that private equity backed buyouts are not more prone to failure than other buyouts. Indeed there is evidence that MBOs and private equity backed deals completed post 2003 are not riskier than the population of non buyouts. . We suggest that private equity companies both target better prospects and are in a better position to adjust capital structure over the cycle and, therefore, manage insolvency risk.