Research on Financial Risk Management of Private Equity Fund in Exit Stage

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Abstract: In recent years, China's private equity investment funds have developed rapidly, especially in the national policy of encouraging innovation and entrepreneurship.Under the circumstances, private equity investment funds have become an important financing channel for small and medium-sized venture capital enterprises. In external supervision and legal construction. On the other hand, in recent years, the supervision system of China's private equity investment industry has become increasingly perfect, which has ensured private equity investment banks.Orderly and standardized development of the industry. In the internal management of fund management companies, in order to enable private equity investment funds to Steady operation, healthy operation, and enhanced anti-risk ability, the fund management company, as the fund manager, operates in the fund.And risk management also need to be improved. As the most critical stage of fund operation-"exit stage"The success of "segment" is particularly important, which is directly related to the income of the fund and the development of the fund management company.

Keywords: Private Equity Fund; Exit Stage; Risk Management

Introduction

The exit stage is the last link in the investment process of private equity funds. In this link, whether the fund can successfully exit is related to the success or failure of fund investment. Since the reform and opening up, China's private equity funds have experienced nearly 40 years of development, and the industry is constantly maturing. By 2019, China's private equity investment market has achieved an adjustment process from quantitative change to qualitative change, and private equity investment institutions have played an important role in the development of many industries in China. In 2020, the growth rate of private equity investment declined, but after the domestic epidemic was under control, it gradually showed an upward trend. Among them, in 2020, there were 3,328 investment cases in the Price to Earning Ratio, PE) market, with an investment amount of 679.574 billion yuan. In terms of exit cases, only 2019 investment cases can be successfully exited, with a successful exit rate of 60.67%. This also reflects that in the process of private equity investment, the exit link is very important and there are great risks.

1. Exit Path and Financial Risk of Private Equity Fund

Exit Path of Private Equity Funds Private equity funds generally go through four stages: raising, investment, management and exit during the operation of investment projects（Qian Yanzhen 2022）. As the last stage, the exit is the key to whether the private equity fund can make a profit. China's private equity funds mainly take the following paths in the exit stage.

Initial public offering. InitialPublic Offering, IPO), as an important way for private equity funds to withdraw, mainly converts the invested equity into liquid stocks in the secondary market through IPO, and then after the lock-up period expires, puts all the stocks held in the secondary market for sale, so as to gain capital appreciation. This exit method is more profitable.

Listing for transfer. This exit method is mainly used for over-the-counter trading, and is suitable for small and medium-sized enterprises with growth potential. The main listing transfer platforms are the New Third Board and the Fourth Board. This method can provide a platform for equity trading for enterprises that are not listed on the main board or small and medium-sized board.

1.1 Financial risks of private equity funds in the withdrawal stage

The main purpose of private equity fund investment is to realize capital appreciation. However, in the withdrawal stage, some financial problems such as management expenses and investment income are often involved. If the financial risks are not properly identified in the withdrawal stage, (Li Longfei 2019)it will induce business risks, which is not conducive to the withdrawal of private equity funds. Specifically, the financial risks in the fund withdrawal stage can be divided into the following categories:

1.1.1 Liquidity risk

Private equity funds mainly invest in the equity of unlisted companies or the non-public trading equity of listed companies. The value of equity investment is closely related to the development of enterprises, which also determines the poor liquidity of equity(Ji Xiaohui 2021). If the private equity fund fails to withdraw successfully in time during the withdrawal stage of fund investment, the price of equity and other assets may fluctuate, and the uncertainty of investment income will also increase. At the same time, the invested funds will generally be locked for a long time, and the daily maintenance of fund projects will also require a certain management fee, which will further aggravate the liquidity risk of the fund.

1.1.2 Exit income risk

From the perspective of fund withdrawal income, IPO and selling methods have higher income, but there is great uncertainty about whether investment enterprises can realize IPO. However, the way of equity sale requires both parties to negotiate the price of equity and evaluate its value to calculate the investment income. If the exit income is high, the operation and management of all aspects of the fund can still be effectively guaranteed; On the contrary, if the exit income is low, or even can't make up for various expenses, the risk of exit income will increase.

1.1.3 Re-financing risk

Whether the private equity fund established in the early stage can successfully withdraw will have a certain impact on the fund establishment in the later stage and the fund-raising ability of equity fund companies. If the withdrawal of the previous fund fails, the financial situation of the whole institution will deteriorate, and the credit degree of the institution in the market will be greatly reduced, thus affecting investors' investment confidence in the newly established fund and increasing the risk of re-raising.

2. A Financial risks faced by private equity fund companies in the exit stage

2.1 Introduction of private equity fund companies

Private Equity Fund Company was established in 2013 with a registered capital of 400 million yuan. Its main business is investment and financing management and capital operation. The company is committed to finding valuable enterprises and projects, and providing necessary financial services for enterprise development through capital advantages.

2.2 The fund valuation system is not perfect.

At present, most of the private equity funds set up by Company A are limited partnerships, and their investment projects are basically available-for-sale financial assets and transactional financial assets. Those enterprise projects that have been listed or listed on the New Third Board can be registered according to the transactional financial assets, and the changes in asset value generated by them can be counted as the fair value change loss. For unlisted enterprises, their projects are generally registered as marketable financial assets. However, for Company A, most of the currently invested projects are such unlisted or unlisted enterprise projects. The possibility of IPO of such projects is not great, and most of them are withdrawn by means of share repurchase or transfer. Because of the asymmetric information between the two parties, the valuation of the project is not accurate enough, and the fund cannot be reasonably valued at the withdrawal stage, which makes it difficult to withdraw. The low valuation is not enough to make up for various expenses of the fund, etc., both of which will lead to the failure of withdrawal.

2.3 Information asymmetry with the invested enterprise

Asymmetric information is an important factor that causes the financial risk of A private equity fund in the withdrawal stage. At present, A private equity fund basically adopts pure financial investment mode, and its shareholding ratio in the invested unit is as high as 20%. At the same time, a private equity fund, as an investment institution, does not actually participate in the operation and management of investment enterprises. This leads to a certain information asymmetry between A private equity fund and managers of invested enterprises. Then, how or at what stage A private equity fund withdraws, on the one hand, it needs to rely on its own experience in project investment to make decisions; On the other hand, it is necessary to rely on the relevant financial information of the invested company as an aid(Xia Yan. 2015).

3. Suggestions on perfecting financial risk control in fund withdrawal stage

To sum up, the financial risks of A private equity fund in the withdrawal stage mainly exist in fund valuation, risk control and information asymmetry, etc. Therefore, in order to ensure the successful withdrawal of A private equity fund, this paper tries to put forward some suggestions to deal with the risks from the following aspects.

3.1 Establish and improve the fund valuation system

At present, the biggest problem faced by a private equity fund in the exit stage is: It's a fund valuation issue. As most of the invested enterprises are unlisted companies, the information of these companies is mainly disclosed to the public through voluntary disclosure. As a result, A private equity fund is uncertain about its information, and accurate valuation becomes a difficult problem in the exit stage. Therefore, in order to ensure the scientificity of fund valuation, it is necessary to improve the fund valuation system.

3.2 Establish a risk management system. Improve the internal risk prevention and control organizational structure.

A Private equity fund should set up four risk control lines in accordance with the relevant provisions of risk prevention and control, combined with the business characteristics of invested enterprises and the main characteristics of industry risks.

The first line of risk defense is to implement full-staff risk management in fund investment institutions, check all the risks in the institutions one by one, clarify the specific responsibilities of each position, and ensure that a risk management pattern of mutual checks and balances can be formed.

4. Conclusion

As an important participant in the capital market, private equity funds inject vitality into the development of the capital market. At the same time, the internal management and supervision system of private equity funds is not perfect, and there are still some deficiencies in the exit stage. Therefore, relevant departments] need to focus on the problems existing in the current private equity fund activities and further improve the relevant legal system. Private equity fund itself should strengthen internal control from the perspective of risk prevention, reduce the risk in the exit stage, and ensure that private equity investment is more reliable and efficient.

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