DOKUZ EYLÜL UNIVERSITY
GRADUATE SCHOOL OF SOCIAL SCIENCES
DEPARTMENT OF BUSINESS ADMINISTRATION
ACCOUNTING AND FINANCE PROGRAM
MASTER'S THESIS

PRIVATE EQUITY; COULD IT BE THE RIGHT FINANCIAL SOLUTION FOR SMALL & MEDIUM SIZE ENTERPISES IN TURKEY?

Selim Cemil GÖKÇEN

Supervisor
Prof. Dr. Çağnur BALSARI

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THESIS APPROVAL PAGE

DECLARATION

I hereby declare that this master's thesis/non-thesis master's term project titled as "Private Equity; Could it be the right financial solution for small & medium size enterprises in Turkey?" has been written by myself in accordance with the academic rules and ethical conduct. I also declare that all materials benefited in this thesis consist of the mentioned resourses in the reference list. I verify all these with my honour.

Date

…/…/…….

Selim Cemil GÖKÇEN

Signature

ABSTRACT

Master's Thesis

Private Equity: Could it be the Right Financial Solution for Small & Medium Size Enterprises in Turkey?

Selim Cemil GÖKÇEN

Dokuz Eylül University

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Department of Business Administration

Accounting Finance Program

By 1980's, companies all around the world have been introduced by the new alternative borrowing and lending options. Rather than classical credit instruments by commercial banks, it has been called as Private Equity funds assumed under Merger and Acquisitions. As an alternative to bank credits with its great expansion from 1980s to financial crises in 2008 and by partnering or by acquiring the company as whole, Private Equity funds can be assumed as a Professional Management technique buying the target company while it has lower valuation and sell it back with long-term and sustainable profit after six years average by adding value added products and services.

Turkish economic activity is covered by Small & Medium Size Enterprises by %99. The main problem for SME's in Turkiye is their financial needs. Existing and classic banking credit tools do not supply sufficient financial resources to SME's in Turkiye. As a result of this resources problem, SME's in Turkiye try to find alternative ways to solve financial problems such as finding new financial partner, partially or whole sale of company.

Like all other examples in the world, the main purpose of Private Equity funds investing to Turkish Market is to gain by selling the target companies expensive which were acquired cheaper and after creating value added products and

services. Mostly backed by international finance institutions, Private Equity funds and its partners evaluates and calculates all returns in foreign Exchange rather than local currency, Turkish Lira. For this important reason, it is vital for every Private Equity fund investing in Turkiye to invest on companies generating foreign exchange or export revenue.

Turkish Lira has been in devaluation situation since September 2013 after a ten-year strong term between 2002 – 2013. This devaluation process has made all investment in Turkiye so fragile against foreign exchange while Private Equity funds pay all payments in U.S Dollar or Avro to its limited and general partners.

Assuming Turkish SMEs as "attractive companies" in terms of foreign Exchange is not convenient not only because of higher U.S Dollar parity against Turkish Lira but also for chronic problems in Turkish legislation on partnership.

On several meetings with Private Equity managers in Turkiye, it was claimed that target companies not offering and not creating value added products and services, companies not promising long term and sustainable growth, companies not generating export revenues have no chance to get any investment from a Private Equity fund.

Keywords: Private Equity, Mergers and Acquisitions, Small & Medium Size Enterprises (SMEs), financial problems of SMEs, value creating, financial resources, sustainable growth.

ÖZET

Yüksek Lisans Tezi

Özel Sermaye Fonları: Türkiye'deki Kobilerin Finansman Sorunu İçin Bir Çözüm Olabilir mi?

Selim Cemil GÖKÇEN

Dokuz Eylül Üniversitesi

Sosyal Bilimler Enstitüsü

İngilizce İşletme Anabilim Dalı

Muhasebe Finansman Programı

Dünyada 1980'ler ile şirketlere yönelik alternatif finansman bulma yöntemleri gelişmeye başlamıştır. Temel bankacılık ve kredi işlemleri dışında gelişen bu uygulama şirket alım satım işlemleri adı altında ortaya çıkan özel sermaye fonlarıdır. 1980 sonrası artan, 2008 finansal krizine kadar ciddi gelişme gösteren özel sermaye fonları, banka kredisine alternatif olarak şirketlere belirli oranda ortak olmak ya da şirketin tümünü satın almak sureti ile şirketi çok daha katma değerli ürün ve hizmet üretir, uzun vadeli ve sürdürülebilir kar eden bir yapıya getiren ve ortalama 6 yıl sonra firmayı daha pahalı halde satan bir fon olarak düşünülebilir.

Türkiye'de ekonominin temel taşı olan KOBi'ler, Türkiye'deki şirketlerin %99'unu kapsamaktadır. Kobilere ilişkin en temel sorun, finansman ihtiyaçlarıdır. Bankacılık sistemi ve mevcut kredi araçları ile finansman sorunlarını gideremeyen Kobiler, alternatif ortak arayışı ve parçalı ya da tüm işletme satışı ile mevcut finansman sorunlarını çözmeye çalışmaktadırlar.

Tüm dünyadaki örnekleri ile benzer olarak özel sermaye fonlarının özellikle 2002 sonrası ülkemize girişi ve burada şirket alımı yapmalarının arkasındaki ana neden aldıkları şirketleri çok daha katma değerli ürün & hizmet üretir hale getirerek, daha pahalıya satmaktır. Söz konusu yabancı sermayeli fonların tüm yatırımlarını, getiri ve kar paylarını Türk lirası dışında yabancı paralar cinsinden

takip etmesi nedeni ile yatırım yaptıkları şirketlerin döviz cinsinden gelir etmesi hayati bir önem taşımaktadır.

2002 – 2013 döneminde görece yatay olarak seyreden Amerikan doları Türk lirası paritesinin 2013 Eylül dönemi ile başlayan yükselişi nedeni ile Türk Lirası yaklaşık 10 yıldır ABD doları karşısında değer kaybetmekte, bu durum yurt dışı ortaklarından aldıklarını katı paylarına ait kar paylarını yabancı para cinsinden kar payı ödeyen Özel Sermaye fonlarının, ülkemizdeki tüm yatırımlarını değerini dolar bazında düşürmektedir.

Döviz kuru ve dönemsel ortaklığa dayalı yasal mevzuat altyapısının kronik sorunlarının olduğu bir ortamda Kobilerin, sadece döviz bazında "ucuz" şirket olduklarından dolayı özel sermaye fonlarının radarına girmesini beklemek mümkün değildir.

Türkiye'de bu alanda yatırım yapan özel sermaye fonlarının yöneticileri ile yapılan tüm görüşmelerde katma değerli ürün hizmet sunamayan, gelecek dönemde yüksek büyüme vadetmeyen, döviz bazında ihracat geliri sunamayan hiçbir şirketin, dolar bazında düşük şirket değerlemesi nedeniyle yatırım almasının imkânsız olduğu ifade edilmiştir.

Anahtar Kelimeler: Özel Sermaye Fonları, Küçük ve Orta Büyüklükteki İşletmeler (Kobiler), Kobilerin sorunları, Şirket Birleşme ve Satın almaları, uzun dönemli ve sürdürülebilir büyüme, değer yaratan ürün ve hizmetler.

PRIVATE EQUITY; COULD IT BE THE RIGHT FINANCIAL SOLUTION FOR SMALL & MEDIUM SIZE ENTERPISES IN TURKEY?

CONTENTS

ABBREVIATIONS

AMD	Asset Medical Design Inc
BIST	Borsa Istanbul
BIST 100	Borsa Istanbul Index of 100 public companies traded
BV	Book Value
CDS	Credit Default Swap
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COC	Cash on Cash Return
DCF	Discounted Cash Flow
ESIAD	Ege Sanayici Is Adamlari Dernegi
EBITDA	Earnings before interest, taxes, depreciation, and amortization
EU	European Union
EV	Enterprise Value
FINTECH	Financial Technology
FED	Federal Reserve
FX	Foreign Exchange
GDP	Gross Domestic Product
GP	General Partners of PE fund
IFC	International Finance Corporation
IPO	Initial Public Offering

IRR	Internal Rate of Return
IVCI	Istanbul Venture Capital Initiative
LBO	Leveraged Buyout
LP	Limited Partners of PE fund
M&A	Merger & Acquisitions
MBO	Management Buyout
MSCI Index	Index captures large and mid-cap representation across 15 Developed Markets (DM) countries in Europe or Japan
NATO	The North Atlantic Treaty Organization
NAV	Net Assets Value
PE	Private Equity
RECAP	Recapitalization
SME	Small & Medium Enterprises
SPAC	Special Purpose Acquisition Company
TRY	Turkish Lira
TTGV	Technology Development Foundation of Turkiye
U.K	United Kingdom
USD	American Dollar
U.S	United States

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INTRODUCTION

The main motivation behind this thesis is to examine whether Private Equity funds transactions, shortly PE investments, are a real and suitable solution to the financing problems of SMEs in Turkiye. Financial problems of SME's in Turkiye can be classified in four main types: problems in obtaining loans, problems arising from lack of equity / working capital, problems in obtaining funds from the capital market and problems arising from inadequacies in financial management. (Kutlu & Demirci, 2007: 190) PE deals have increased their popularity in all developed economies since 1960 as an alternative to classic banking and credit activities. Global PE companies, who have increased their assets and sources to find and to invest on new companies, have diverted their investment scope from developed to developing economies or emerging markets since 2000s (Klonowski, 2012: 4). The main reason for increasing PE activities is the globalization and open market conditions after 1990 (Klonowski, 2012: 5).

Turkiye has been an important and net borrower for all fund suppliers including PE funds because of its lack of sufficient financial resources to source its economic activities. After 1980 Turkiye has started its privatization activities but especially by 2003 Turkiye has accelerated privatization and minimized its public activities in economy (Ministry of Treasury and Finance, 2021: 1). Private sector has been the main player in Turkish Economy. This situation has increased the importance of Small and Medium Enterprises (SMEs) in Turkish economy, by the end of 2020 %99,80 of total entities (which means 3.2 million SMEs in Turkiye) are SMEs and they employ the %73,8 of total Turkish Employees, SMEs in Turkiye has a turnover of 5.8 trillion TRY (%64,5 of total turnover in Turkiye) and $101.9 billion of exports (TOBB, 2020: 1).

The term "Small and Medium Enterprises, simply SMEs" are defined in Turkish Commercial Law. According to its legislation, SMEs are the entities hiring number of employees less than 250 and having annual net sales revenue or annual financial balance sheet, not more than 250 million Turkish Liras (KOSGEB, 2022). Under these limitations, Turkish legislation classifies SMEs into 3 groups due to the number of employees hired and the net sales revenue or annual financial balance sheet (KOSGEB, 2022). Table 1 shows the classification on SMEs in Turkish Legislation (TOBB, TOBB Division of SME Research and Consultancy Center, 2022).

Table 1: Classification on SMEs in Turkish Legislation

Criteria	Micro-Sized Enterprise	Small-Sized Enterprise	Medium-Sized Enterprise
# of Employees	<10	<50	<250
Annual Net Sales Income	< TRY 5 million	< TRY 50 million	< TRY 250 million
Annual Financial Balance Sheet	< TRY 5 million	< TRY 50 million	< TRY 250 million

Source: Created by the author due to Turkish Trade Legislation by March 18, 2022

Today Small and Medium Enterprises in Turkiye have different kind of problems which are classified as financial and non-financial problems. Examples of important financial problems SMEs in Turkiye are insufficient working capital, lack in equity, limited budget, limited financial sources for research & development and long-term investment plans, inadequate sources problems due to macroeconomic instability, higher interest rates and in-stabilized foreign currency (Duran, 2013: 38). Besides these important financial problems, SMEs in Turkiye have some important non-financial problems in professional management related to tight family business rules, hiring skilled stuff, marketing, and network problems (Zengin, 2010: 64). The main reason for financial and non-financial problems in Turkish SMEs is the general economic situation that is unpredictable even in the short run. The unpredictable economic situation in Turkiye creates a business environment for SME facing higher interest rates, working under insufficient lending, and borrowing activities from classical banking and crediting activities in Turkiye. Because of these insufficient financial sources, Turkish SMEs seek alternative ways to obtain more financial sources for financing their expanding activities.

Objective of this thesis is to find out if Private Equity investments will be a real alternative solution for both financial and non-financial problems of Small and Medium Size Enterprises in Turkiye. In this two-sided equation, one party, SMEs in Turkiye, seeks alternative resources or partners to solve its financial problems, while the other party, PE fund operating in Turkiye, tries to become a partner or the new owner of promising companies with its financial resources.

While checking the availability of the right match between SMEs in Turkiye and PE funds operated in Turkiye, Chapter one presents the literature search by defining private equity, its structure and types with some real examples from Turkiye. Chapter two explains the configuration of private equity with main drives behind it, how to compare performance of PE funds in theory. In this chapter there is detailed information about the progress of a PE transaction. In Chapter three, real findings about Private Equity investments in Turkiye have been explained by making interviews with Turkish PE fund manager. At the last part of thesis, in Conclusion, real findings by interviewing different PE fund managers and theorical information gathered about global PE environment were compared by asking PE investments will rehabilitate the financial and non-financial problems of Turkish SMEs.

CHAPTER ONE

LITERATURE REVIEW

PRIVATE EQUITY; DEFINITION, STRUCTURE, TYPES

In this chapter, there will be the definition of Private Equity (PE) along with the types of variations of PE.

1.1. THE DEFINITION AND STRUCTURE OF PRIVATE EQUITY

Private Equity is an alternative fundraising equity financial method for the companies seeking extra finance for increasing their equity rather than getting credit or loan in order to expand their business activities or to make investments for future business expansions. In basic term, PE is based on selling some part of company ownership in order to source new financial resources for accelerating the growth. In a PE deal company seeking a new and an extra equity finance is called “target company” and the company or the fund supplying this new financial source is called “Private Equity Company or PE company”.

Besides these main two participants, there may be some other participants in a PE transaction such as regulatory institutions and intermediary institutions. Example of public regulators are Capital Market Board of Turkiye (www.cmb.gov.tr) and Competition Authority of Turkiye (www.rekabetgov.tr/en).

In PE acquisitions, the term “deal or transaction” refers to the realized or executed acquiring activity between the PE company and the target company.

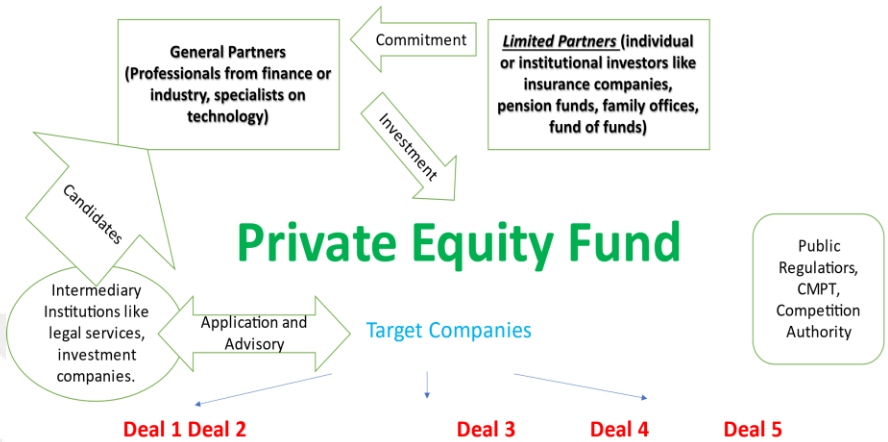
In a basic structure, Private Equity is a limited liability company or fund which is established by the general partners who are the finance or industry professionals or former investment bankers. General partners run the PE company, evaluate the countries and market, seek, and evaluate different opportunities on target companies, and realize the PE deals. In order to show their good interest and belief on each PE deals, general partners commit and supply between % 2 - % 5 of each investment by themselves. The rest of the main funds for each investment are committed and supplied by limited partners. Limited partners may be the individual or the institutional investors, family offices, fund or fund of funds seeking relatively higher yields compared to benchmark yield options. Example of institutional investors are pension funds (Robertsen, 2019), insurance companies, hedge funds or assets management companies such as Ak Asset Management Company or Is Private Equity Company which offer PE funds to their clients as an alternative investment option compared to classic financial instruments. Some PE funds backed by a conglomerate, or a bank which may not need limited partners because of excess available financial sources led by the main owner company. As an example, Is Private Equity, one of the first PE companies in Turkiye, is a subsidiary of Turkiye Is Bankasi, is a public private equity company and traded in Borsa Istanbul Stock Exhange, BIST. Meanwhile there are also PE companies operating in Turkiye which are not backed by any financial conglomerates, such as Taxim Capital, Turkven, Pera Capital.

As stated before, there are also intermediary institutions and public regulations in a PE structure. Some target companies seeking a PE deal may apply and connect with PE companies directly. But in most cases, it has been seen that target companies apply to intermediary companies first for getting professional advisory such as consulting, valuation, presentation before connecting with a PE company. In Turkiye, some examples of intermediary institutions are Unlu & Co, Is Investment, Ak Investment, Pragma, Credia Partners, 3seas Capital Partners, Alp Acar, Dome Group and 4Big Audit Companies.

As the last participants, government and regulatory institutions may be part of PE structure. Some PE deals need government approval for many reasons. The industry or the target company may be too strategic for the government, or it changes the competition by making monopoly or duopoly. In Turkiye, some PE deals must be approved by Competition Authority or Capital Markets Board of Turkiye.

Figure 1 below shows the basic structure with different parts in a PE structure.

Figure 1: Example of a Basic Private Equity Structure



Source: Created by the author.

Also, in Table 2, the main founders of a PE structure are shown with their basic characteristics.

Table 2: Main Founders and Partners of a Private Equity Company

	General Partner	Limited Partners
Partners	Industry and finance professionals, acting such as fund managers	Individual and Institutional Investors
Example	Former CEOs, CFOs, Investment Bankers	Ultra-High Network Individual Investors, Family Offices, Pension Funds, Insurance companies
Commitment	% 2 - % 5 of each fund	% 98 - 95 of each fund
Main Purpose	As a private equity fund manager, establishing funds' strategies, Allocating the funds to suitable target companies fitting these strategies, increasing the number of deals, increasing the number of Limited Partners, realizing the deal, manage port-transaction process, find exit strategies	Distribute the risk among different industry deals for long term and stable higher yield, do not deal with running the target companies
Investment period	5 to 7 years	5 to 7 years

Source: Created by the author.

As it was stated before, private equity is a type of acquisition and acquired company here is called the Target Company.

Target companies can be any companies seeking new and extra finance for different purposes. Examples of different motives driven by a target company are shown in Table 3.

Table 3: Main motives behind Target Companies seeking PE deals.

	Target Companies Reasons to sell some portion of their stock
Reasons	Growth, Difficulties for getting long term credits because of high interest rates, family reasons, high competition, reaching new marketing & sales channels, new technologies

Source: Created by the author.

Target companies have different reasons for seeking PE opportunities. Growth is the main reason for most PE deals. By making a PE acquisition, the target company can share the risk of growth and expansion operations with the PE company. Also, some target companies may not have sufficient financial evidence or financial records for obtaining long-term bank load. Banks may find it relatively risky to finance target companies not able to show past financial records for long-term credit. PE investors' risk appetite here can solve this dilemma. Future high potential return can be an attractive reason for PE funds to get this risk and target company can find long-term finance to growth.

There are some non-financial reasons for target companies thinking about a potential PE acquisition. Family-owned or family-operated companies are one of the main company structures in the world. Operated by members of the same family, a company can be managed in a cost-effective and fully controlled way under the long-term business experience of the family. But in some family companies might be interested in Private Equity deal because the lack of interest of the new generations may be expected to manage the company as the prior generation have. Besides the new generations lack of interest on the family business, some companies have not the next generations. Reluctant new generations and no next generations in the family operated business is another reason for PE acquisitions demanded by the target companies.

Increasing the effectiveness and competition position are not easy for small and medium size companies. Corporate governance, rehabilitation of the cost structure, professional management, professional supply chain management are the essential elements of an effective business model. Rather than supplying extra finance for a target company, a PE fund guides a target company how to increase their effectiveness in cost structure, how to increase their revenue and profit margins, how to find new sales channels, new export markets or how to increase the effectiveness of purchasing channels. Besides financial and managerial support, some PE companies also control the budget by appointing a new and professional CFO.

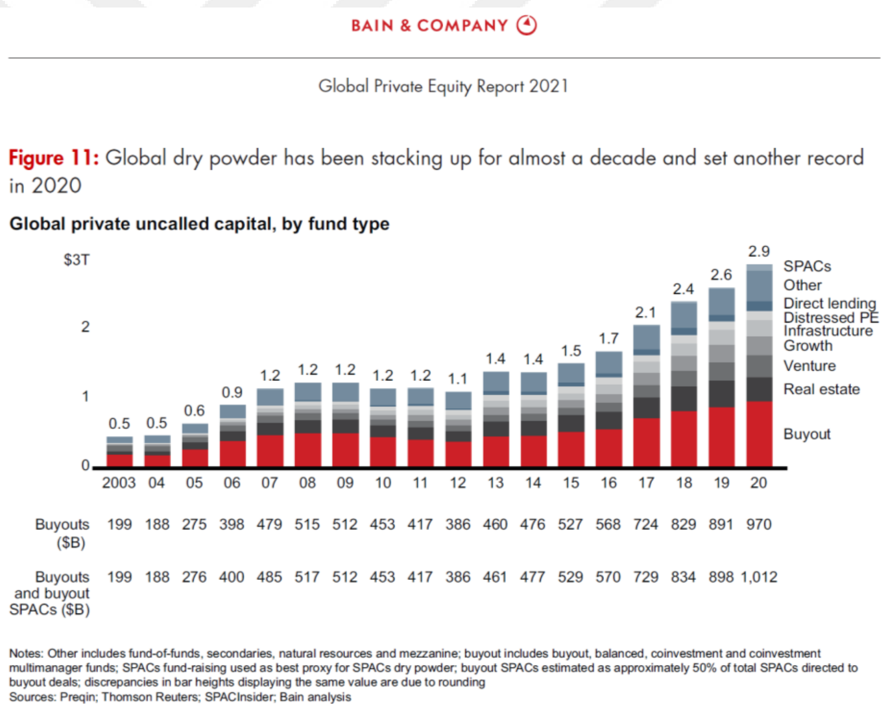
Technological needs, improvements, requirements are assumed as the last reason why some target companies are thinking about a potential PE acquisition. Most technological and industrial investments, research and development expenses may exceed target companies' financial capabilities. Also, research and development investment need a longer duration to generate sales revenue and cash. Besides its longer time to realize financial returns from R&D activities contain risk of failure which means R&D expenses waste some portion of target companies' limited budget. In order to start some technological investments and to reduce the risk of failure, some target companies may seek a new partner through PE investments rather than getting long term credit load from a bank. By this way a target company having limited financial capabilities shares the failure's risk of a new project with PE fund which may supply the know-how and the experiences with the target company.

Today the accumulated financial capital is very intense in North America, U.K and EU Countries where PE activities are so popular and common. In the next sections, it will be shown that lending and borrowing capabilities are especially important for PE activities. Investors who have dry power are willing to borrow and to invest most of their capital in potential target companies. Some form of PE deals may not need borrowing, but the huge buyout activities need not only borrowing but also some leverage support from financial institutes.

Despite the Covid 19 pandemic and its global economic conclusions, by end of 2020, PE assets have been more than $ 2.9 trillion all around the world and in all fund types. (Bain & Company, 2022: 12) As shown in Figure 2 (Bain & Company, 2022: 13), has reached $ 2.9 trillion in 2020 even though the decrease in number of global deals.

By the next section, different types of Private Equity will be explained.

Figure 2: Global fund rising number under different types of Private Equity deals.



Source: (Bain & Company, Inc, 2022)

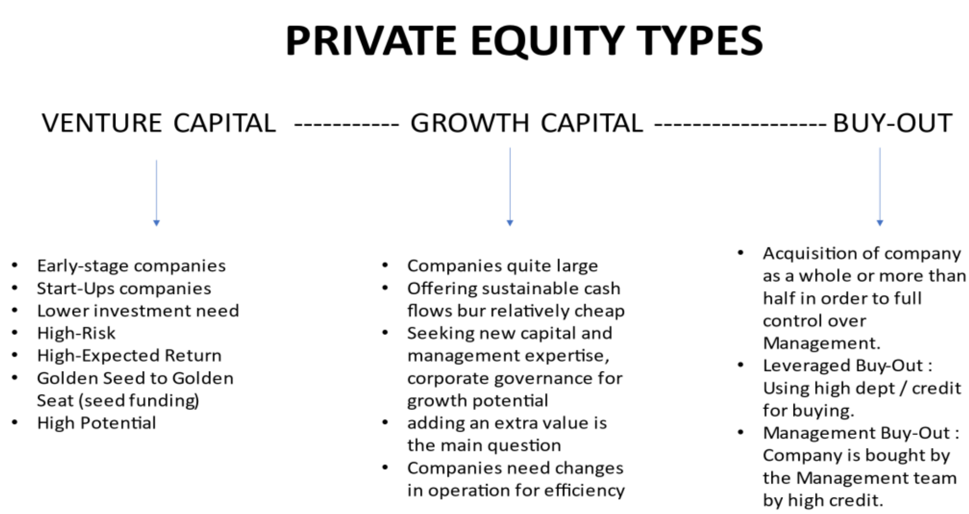
1.2. TYPES OF PRIVATE EQUITY AND EXAMPLES FROM TURKIYE

As described in section 1.1, Private Equity (Kıldokum, 2011: 3) is an alternative financing model assumed under Merger and Acquisitions (M&A) activities. Merging refers to combination or to consolidation of two firms under a newly established firm

(Majaski, 2021: 1). The term acquisition or takeover refers to buying or purchasing a company by another company. The portion of the stake bought can be in any part due to the expectations of the acquiring company, the buyer. There are different types of acquisition such as Public Privatizations, Initial Purchase Offer, Private Equity, Special Purpose Acquisition Companies, shortly SPACs or direct sale. In Turkiye, since 1980, mostly after 2005, there are examples of privatizations in finance, public telecom, air or seaports and infrastructure, mining, and petroleum & chemical industries. Even privatizations are the extreme examples of private equity, privatizations and public buy-out are not in the scope of this thesis.

Private Equity is one type of Acquisition and can be divided into 3 sub-basic forms due to the life cycle and size of the target company. Figure 3 shows sub-variance of Private Equity.

Figure 3: Types of Private Equity



Source: (Kıldokum, 2011)

The first type of Private Equity is called venture capital, also called angel investment. These early-stage Private Equity investments are made by an angel investor or by a venture capitalist where the investor acknowledges the high risk for higher returns.

Venture capitalists prefer investing to start-ups and newly established companies in the early ages with a small portion of stake such as between % 10 - % 40. The target companies here are the new start-ups which need extra finance for survive in the business life, today most examples of venture capital or angel investing are seen in financial intelligence, fintech, technology, smart phone applications and software businesses. Technology and mobile services were popular venture capital sector targets in 2019, whereas PE investments were divided between several industries, such as e-commerce, pharmaceuticals, food and beverage, and technology (Üçer, Uzun, & Erturgut, 2021: 2). In Turkiye by 2019, attracting venture investors in 2019 with an average deal size of USD 900,000 (Üçer, Uzun, & Erturgut, 2021: 2). The risk structure of early-stage start-ups is relatively higher than established companies due to undetermined conditions and situations which are relatively higher than mature companies. Because the target companies have just started to business, they may not have adequate business experience for expanding activities, non-sustainable income for compensating start-up cost, and profits due to lower financial resources. On the other hand, these higher risk target companies offer a higher return for venture capitalists in which they can join the companies with relatively lower valuation. The main aim for the investor here is to buy some portion of a target start-up company with cheaper price and to sell it to another investor after a while when the target company produces higher return and generates profit. The exit strategy here is eighter a direct sell or an IPO. The other name of this strategy is called Golden Seed to Golden Seat (Gal, 2009: 1); which means after a waiting period, the seed you sewed will bring you a seat or chair in the board of director which is called golden seat. Angel investing brings some social benefits by promoting entrepreneurship. The main examples of Venture Capital or Angel Investing are seed in high-tech companies. High-Tech companies bring technological improvement facilitating the daily life such as video sharing, taxi, food take-away, supermarket shops, ticket or hotel booking. In parallel with the developments in internet and smart phone applications, especially in the U.S, those venture capitalists invested golden seeds to smart phones application software companies. Important examples of angel investors in the U.S are Jess Clavier, David Lee, Jeff Bezos (Boitnott, 2014: 1). Contrast to U.S, the progress of angel investing is still very low in Turkiye. Examples well-known induvial Turkish angel investors are Nevzat Aydin (Yemeksepeti, BanaBi), Nazim Salur (BiTaksi, Getir), Serkan Borançılı (BiTaksi, ModaCruz, Insider, Denebunu), Alphan Manas (Agrovisio), Emre Kurttepeli (MyNet) (Kurupara, 2014: 1). Beyond individual angel investors, there are some important Turkish initiatives where some experienced angel investors come together such as Galata Business Angels, Şirket Ortağım, Keiretsu Forum Türkiye, Telos Angels İstanbul, İstanbul Startup Angels (iyzico Marketing Team, 2019: 1). Some critical things in angel investing are unpredictability in growth and free cash flows for future, which emerge a risk where the ordinary investors may not get. If we examine the most well-known angel investors, it is easily seen that most of the angel investors are former successful entrepreneurs who have faced difficulties in establishing highly risky business. As an example, for unpredictable and overvalued companies, the Blue-Chip companies' crises in the U.S have shown that valuations based on future expected cash flows did not work in small-cap high-tech companies. Because every application, web page or service they supply might not have been preferred, consumed, or bought by the public. So, based on future, possible, undetermined cash flows cannot be used in valuation in venture capitals.

The second form of Private Equity is Growth Capital. Rather than early, unpredictable start-up companies, the growth capital investors invest on companies quite larger than start-ups, generating relatively stable income and net profit, carrying fixed assets, having predictable free cash flows and need extra finance to future growth. In this type of Private Equity transactions, PE companies do not only buy some stakes in the target company but also give some management expertise, such as financial planning by appointing a new Chief Financial Officer (Mutlu, 2020), effective human resources planning, cost cutting, increasing efficiency and productivity, opening new sales and distribution channels. This is the main difference between Venture Capital and Growth Capital. In venture capital, there is no management support, but in Growth Capital, the PE companies offer better management expertise. The main aim of the PE company in a Growth Capital transaction is to re-sell the stake either to a new investor or investors with an IPO or direct sale or buy-out.

A combined example of venture capital and growth capital PE transaction in Turkey is Asset Medical Design Company. Asset Medical Design Inc. (AMD) was founded in 2009 as a Turkish Small Medium Enterprise with a registered capital 106.250 usd when USD / TRY parity was nearly 1,61 in order to produce needle-free injection valves (Ven Valves), which has never produced in Turkiye for vaccine and syringe industry. AMD has focused on infection control and safety of healthcare professionals. The core business of Assets Medical, producing needless vaccine valves in Turkiye, has been assumed attractive by the venture capital fund of Technology Development Foundation of Turkiye (TTGV) established Teknoloji Yatırım Inc. By the end of 2009, Assets Medical got an early-stage venture capital investment from TTGV as its first PE transaction (ÜNLÜ THE CLUB, 2017: 1). This small equity capital was used to start production and enabled AMD to export its products to EU countries. After establishing the company, and starting the production and export activities, TTGV venture Capital has achieved its targets and preferred making an exit by partly selling some of its stake to a larger investor, Pera Capital. In 2016, TTGV sold some part of its stake in Assets Medical to Pera Capital (ÜNLÜ THE CLUB, 2017: 1) which could supply more business experience as well as human resources for growth. Figure 4 below will show the PE stages of Assets Medical.

Figure 4: An example of Venture and Growth Capital from Turkiye, Assets Medical Inc

Asset Medical Inc Private Equity Timetable

1. Assets Medical Inc was founded as a SME with 160.000 usd registred capital in 2009 with the idea of producing needle-free injection valves first time in Turkey.
2. Shortly after the establishment, the idea of Asset Medikal was assumed as attracted by an early-stage venture capital fund from TTGV and TTGV made an ventural capital investment on Asset Medical in 2009.
3. With the capital Support of TTGV, Assets Medical increased the Production capacity and started export of %30 of its Production to EU countries. Asset Medikal's founding partner, Füsun Ünal Tüysüz, was given the Best Women Entrepreneur award in 2012.
4. The scope of venture capital is to help the target company to establish the Business and to survive it, not to growth it. In order to look for a new PE deal, Assets Medical made an exclusive deal with Unlu & Co to find possible Growth Capital PE deal opportunites.
5. In order to finace its new projects and growth activities, Pera Capital has acquired 45 percent of the shares of Asset Medikal from its founders and TTGV in 2016.

It is quite clear that main motives in venture capital and growth capital are different as shown in Assets Medical Inc case (ÜNLÜ THE CLUB, 2017). Venture capital funds seek investment opportunities early-stage companies just or about to start the business, to survive with a unique and creating a value-added business idea. In Asset Medical case the creative and extra value-added business idea was to produce needle-free injection valves (Ven Valves) in Turkiye, because till 2009, these needle-free injection valves were imported to Turkiye, never produced locally. These early-stage risky activities may not suit the main purpose of growth capital funds. This conflict in interest prevents Growth Capital funds dealing with an early-stage risky target company. So rather than seeking investment opportunities in this early stage & having relatively higher risk profile target companies, Growth Capital funds seek more mature companies by funding their growth activities.

Both in Venture Capital and Growth Capital PE activities, Private Equity companies prefer not involving daily operational management activities by taking only the minority stake. Rather than involving daily operations, PE companies leave the management function to the main partner but support the company by implementing value creating company policies and by hiring professional managers in important departments of the company, such as CFO in finance. In Turkiye, PE companies such as Is Girisim Sermayesi, and Ak Fund Management prefer appointing a professional and well experienced Chief Financial Officer. This newly appointed CFO controls the budget and reports to PE companies regularly (Mutlu, 2020: 2). On a phone conversation with Ak Asset Management PE fund manager Mr. Kerem Mutlu, he explained the main reason to appoint a new and a professional, independent CFO to the acquired target company; Budget control is the main battlefield with the existing owners and new PE partner.

In 2020, we have seen many examples of Venture Capital and Growth Capital PE activities even though difficult Pandemic conditions. Besides pandemic situation with 2020 and even though the problems in supply chain, increased commodity price, 2021 has been a good year for mergers and acquisitions activities in Turkiye. According to KPMG, the estimated number of M&A activities in Turkiye by the end of 2021 is 15,5 billion U.S Dollars (REUTERS, 2021: 1). Figure 5 (Deloitte Turkiye, 2021: 24) below shows some of the PE deals in Turkiye by end of 2020. Stake acquisitions less than %50 are the examples of Venture Capital and Growth Capital examples. In line 147, we see Mediterra Capital a PE company investing on mid-cap and SME companies with their motto “We are the "trusted partner" for mid-market and SME companies in Turkiye, catalyzing them to become industry leaders with global management practices” (Mediterra Capital Management, 2023: 1). Mediterra company has bought a minatory stake %13 stake of Pidem (Bloomberg Turkiye, 2020: 1) and majority stakes %51 of Dürümle (Mediterra Capital, 2020) & %76 of Paycore (Mediterra Capital Limited, 2021). Pidem is an example of both Venture Capital and Growth Capital where the target company seeks an PE investment for the reason of increasing the number of branches in shopping malls or crowded places in main cities in Turkiye. The renting and renovation costs are relatively high for a new start-up company, and this acquisition (PE deal) helps the target company to finance this cost. It was so certain that Pidem's main reason for seeking private equity investment is to find a partner to finance its growth activities.

Figure 5: Some PE deals in Turkiye by the end of 2020

Annual Turkish M&A Review 2020

#	Acquirer	Origin	Target	Sector	Stake (%)	Deal Value (US$ million)
144	Maxis	Turkey	PCI Checklist	Technology	N/D	0,2
145	Maxis, Albaraka Startup Fund, Private Investors	Turkey	Denebunu.com	Internet & Mobile Services	N/D	0,9
146	MB Holding Company	Oman	Turquoise Yacht Industry	Manufacturing	40%	N/D
147	Mediterra Capital	Turkey	Paycore	Financial Services	76%	N/D
148	Mediterra Capital	Turkey	Pidem	Restaurants & Hospitality	13%	N/D
149	Mediterra Capital	Turkey	Dürümle	Restaurants & Hospitality	51%	N/D
150	Meritus Upravljanje	Croatia	Customer Management Center	Internet & Mobile Services	100%	N/D
151	Michael Moritz, Revo Capital, Private Investor	USA, Turkey, Brazil	Getir	E Commerce	N/D	38,0
152	Micro Focus International	UK	ATAR Labs	Technology	100%	N/D
153	Mitsuba Corporation	Japan	Mitsuba Teklas Turkey Otomotiv	Manufacturing	20%	N/D
154	MLP Saglik Hizmetleri	Turkey	Medisis Hospital	Healthcare	100%	N/D
155	MobileX	Turkey	Veloxia	Internet & Mobile Services	N/D	0,4
156	Mynet	Turkey	Rare Forge	Internet & Mobile Services	50%	N/D
157	Naturel Doğalgaz Yatırımları	Turkey	Socar Turkey LNG Satış	Energy	100%	5,4
158	Nokta Holding Yatırım Holding	Turkey	Gokcek Makine	Manufacturing	70%	N/D
159	Noya Celik	Turkey	Ittifak Holding	Manufacturing	10%	N/D
160	Oman Insurance Company	UAE	Dubai Starr Sigorta	Financial Services	49%	N/D
161	On Besicilik	Turkey	Taze Sut ve Sut Urunleri	Agriculture & Breeding	N/D	N/D
162	Oregon Teknoloji	Turkey	Yük Cebinde	Internet & Mobile Services	N/D	N/D
163	Österreichische Post	Austria	Aras Kargo	Logistics & Transportation	55%	N/D
164	OYAK Grubu	Turkey	M Oil, Total Oil	Energy	100%	N/D
165	Oyak Portföy Yönetimi Dördüncü GSYF	Turkey	Hemenal Finansman	Financial Services	100%	N/D
166	Palmet Enerji	Turkey	Baymina Enerji, Izgaz	Energy	N/D	N/D
167	Palsgaard	Denmark	Teknaroma	Wholesale & Distribution	90%	N/D
168	Paraşüt	Turkey	Shopside	Internet & Mobile Services	N/D	N/D
169	Park Holding	Turkey	Silopi Elektrik Üretim	Energy	5%	45,0

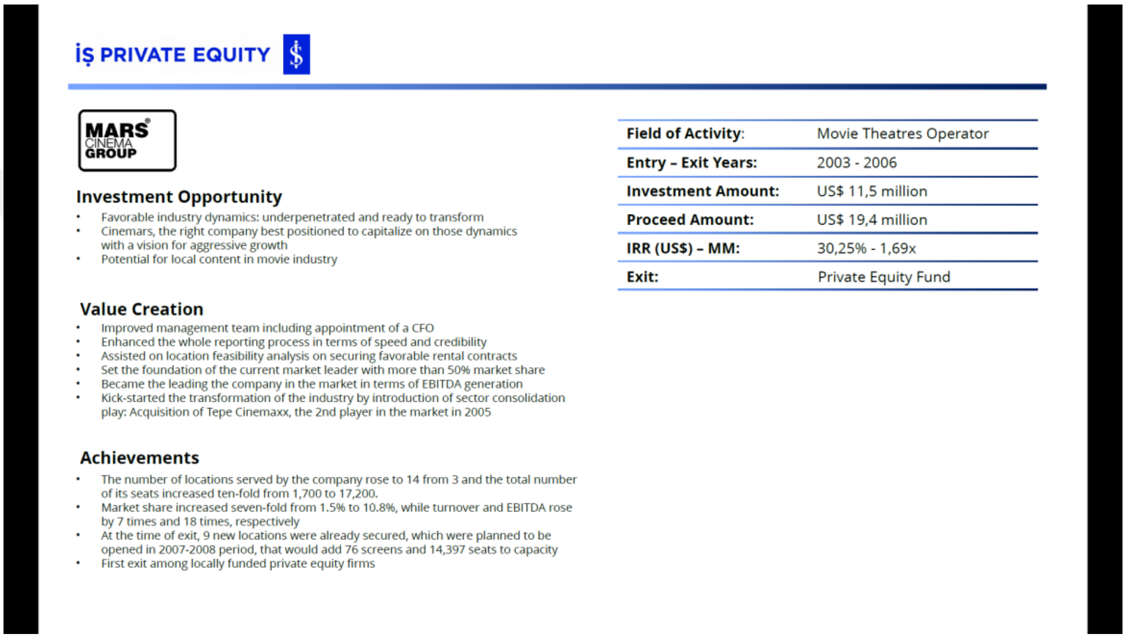
24

Source: Deloitte, Annual Turkish M&A Review, 2020

The last and third type of Private Equity is Buyouts. Private Equity transactions such as buying the target company with the majority stake rather than minority stake are examples of Buyout. In a buyout PE deal, PE company generally holds the management functions in one hand, appoints a new management team, transforms the company structure in cost, adds new values to the existing product & services or creates value-added, new product or services. The main principle of a buyout is to increase the value of the target company's products and services. PE companies focus on the core business of the target company and acknowledge that the value of the target company can be increased by only increasing the value of core products and services.

An example of buyout PE deal is shown in Figure 6 (Is Private Equity , 2006: 1). Is Venture Capital, one of the main PE companies backed by Turkiye Is Bankasi, has acquired 66,28 % of Mars Cinema at $ 11.5 million in 2003. After a 3-year value-creating period, Is Venture Capital has exited this deal by selling the same stake at $ 19.4 million. In this 3-year stage, Mars Cinema has increased the number of locations served, number of seats and market share. These increases in the main operation have increased the revenue and EBITDA. Figure 6 below summarizes the PE with numbers.

Figure 6: Example of Growth Capital in Turkiye by Is Private Equity.

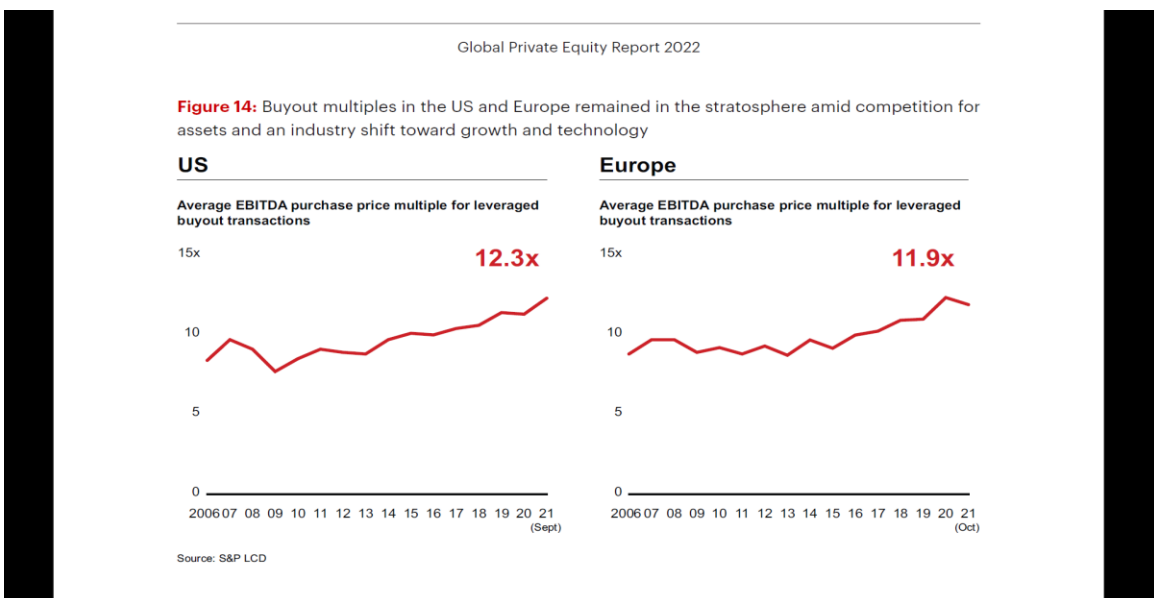


Source: http://isgirisim.com.tr/our-investments/#cinemars, 12.06.2022.

Buyout PE transactions have two main types; Leveraged Buyouts (LBOs) and Management Buyouts (Corporate Finance Institute, 2022: 2) (MBOs). Leverage Buyout (LBO) is the acquisition of another company using a significant amount of borrowed money to meet the cost of acquisition. The assets of the company being acquired are often used as collateral for the loans, along with the assets of the acquiring company (Kenton, 2022: 1). LBOs has some benefits and risks for PE companies. The benefits of LBOs are using tax shield and allocating more money to different target companies with capital of PE capital. At the same time LBOs have many risks. Using more loans and credit and less equity to acquire a target company by using assets of target company as collateral increases the risk of business and default. If there is any problem in free cash flows, the target company can't meet the obligations of debt. The biggest for highly leveraged buyout is coming from risk appetite of the PE companies as well as easiness of excess capital from financial system. According to Dan Rasmussen from Verdad Capital, the success of Private Equity lies on the effective use of leverage (Rasmussen, 2018: 6). But using more leverage increases the risk exposure of the company in any trouble.

Figure 7 (Bain & Company, Inc, 2022: 14) shows how the more leveraged buyout has been getting more popular since. As shown in Figure 7, leveraged buyouts have upside trend both in U.S and EU Markets even though 2008 financial crise, global 2020 pandemic situation, 2021 supply chain, logistic problems. Excess capital in the world lets the PE companies acquire more target companies with higher EBITDA multiple ratios by using more financial leverages. Since 2009 investors willing on using higher leverage is increasing where it has been at the minimum in 2008 financial crisis. Using excess level of leverage may increase the assets prices because of lower level using of own capital in buyout. Easing lending and borrowing conditions accelerates using more leverage.

Figure 7: Buyout multiples in the US and Europe since 2006



Source: Bain & Company, Global Private Equity Report 2022, page 14

By the end of 2021, some central banks started to make interest rate hikes. Also, the FED is expected to make an interest rate hike in 2022. Increasing interest rates may tight the economic activities all around the world. This economic slowing may decrease assets prices or may decelerate the LBO activities.

Before passing Chapter 2, a broad definition of private equity and its variations, are summarized; “Private equity (PE) refers to an asset class in which investors purchase the illiquid equity (or equity-such as) securities of operating companies. This equity is not publicly traded, but instead held in private hands. In exchange for their capital, PE firms take ownership stakes that range from a concentrated minority through to majority ownership in a company. PE investors typically hold these securities for a period of three to seven years with the expectation of generating attractive risk-adjusted financial returns upon exiting the investment as shown in Table 4” (Divakaran, McGinnis, & Shariff, 2014)

Table 4: Private Equity Summery table

Company stage	Uses of financing	Typical sources of financing	Financing stage
Concept: Idea is created, initial business model is conceptualized, but there is limited management in place, no product ready, and no track record	Assess/prove business feasibility and qualify for start-up capital: • Develop business plan • Conduct market research • Build and test prototype • File patents	• Personal savings • Microcredit • Friends/Family • Angel investors • Seed-stage VC firms • Grants	Seed capital
Product development: Business model investigated, product prototype in place, but needs to be finalized and introduced to market	Converting concept into product: • Develop product • Conduct initial marketing • Establish product facility • Recruit key management	• Bootstrap financing • Angel investors • Microcredit • VC firms (golden seed)	Start-up capital
Initial revenue: Have proven product, delivered proof of concept, but cash flow is negative	• Expand sales and distribution • Improve productivity • Enhance team and operations	• Microcredit • Angel investors • VC firms	Early stage
Established company: Sustained positive cash flow; customer base is growing, and the business is viable	• Working capital • Trade credit, factoring, leasing • Expansion: grow sales and assets, ramp up existing operations, capital expenditures, launch new products, or enter new markets	• Cash-flow–based financing: line of credit (working capital), short-term unsecured financing/ long-term debt • Asset-based financing: accounts receivable, inventory, equipment, real estate • Suppliers (trade credit) • Factoring/Leasing • Private/growth equity	Growth equity/debt financing

Corporate: Strong sales/revenue, stable cash flows	• To support growth • Finance acquisition/ management buyout • Optimize capital structure •Provide exit path for existing investors or owners	• Private equity • Initial public offering • Mezzanine financing • Corporate debt	Private equity/debt financing/public equity

Source: (Divakaran, McGinnis, & Shariff, 2014)

Table 4 above shows the main private equity types, sources of financing, where this finance is used and in which life cycle of the company this finance is used (Divakaran, McGinnis, & Shariff, 2014).

CHAPTER TWO

METHODOLOGY

ENVIRONMENT OF PRIVATE EQUITY TRANSACTIONS

In chapter two, more details about Private Equity will be given with the examples of Private Equity transactions, strategies after making some interviews with PE professionals in Turkiye.

2.1. SETTING UP, PARTNERS, MAIN DRIVES, BENCMARKING OF PRIVATE EQUITY?

In section 1.1 it was explained that Private Equity companies are being structured or established as partnerships. In a Private Equity partnership or fund, there are limited partners who want to allocate their funds for acquiring some potential target company and there are general partners who find, evaluate some possible target companies (investee), recommend those targets to Limited Partners, realize the deal, manage the value creation process, and exit from the deal.

Because of the reasons mostly mentioned in Table 2, there may be lots of potential target companies who want to sell some part of their stakes. According to some market professionals, the real deal creating rate is very low in a Private Equity environment. Martin Milev from Abu Dhabi Investment Authority told that only % 2 (American University in Bulgaria, 2014) of potential deals are executed. Also, on a telephone call in Turiye, Mr. Kerem Mutlu declared that only 8 deals out of 300 potential deals have been executed since 2015 in Turkiye from their potential target companies list (Mutlu, 2020). This small number of executions means that PE companies implement a very detailed work for evaluation, valuation, and negotiation process on target companies.

Private Equity companies are set up in different company structures. Some companies exist such as a limited partnership or incorporation, such as Blackstone Inc, Texas Pacific Group in the U.S or Is Girisim Sermayesi A.S and Turkven in Turkiye.

Addition to limited partners, there are some examples of Private Equity mutual funds managed by assets management companies. as an example, Is Assets Management has two PE funds investing in renewable energy and infrastructure companies, while Ak Asset Management has two PE funds on focusing on Clean Energy, Mobile Systems, Medical Chemicals, nanotechnology, marketing app tools, cloud technology companies.

Some limited partnerships and incorporations are publicly traded companies, but some PE companies are not public companies, and it is extremely difficult to get some information from them on their investment details, financial disclosures etc. Because of customer secrecy, both in Turkiye and other countries, PE companies do not accept to give information on their investments. As a result, the only mandatory selection for us is publicly traded companies in Turkiye. In order to reach third party and independent audited financial information, this thesis have used the Publicly Traded PE companies Turkiye. Table 5 in below shows 6 PE public companies in Turkiye with their imported details. Also, table 6 below shows the 4 private equity funds managed by Turkish assets management companies such as Is Assets Management and Ak Asset Management.

There are six public PE companies traded in Borsa Istanbul. As mentioned below, some PE companies have limited partners committing them available funds to acquire target companies. But there are also some PE companies which don't have limited partners, but they are backed by conglomerates or financial institutions such as big banks acting as limited partners. This difference can be seen from the total debt / total liabilities ratio. This basic ratio shows how a Private Equity company funds its short term and long-term assets or shows the leverage ratio (Hayes, 2020: 2).

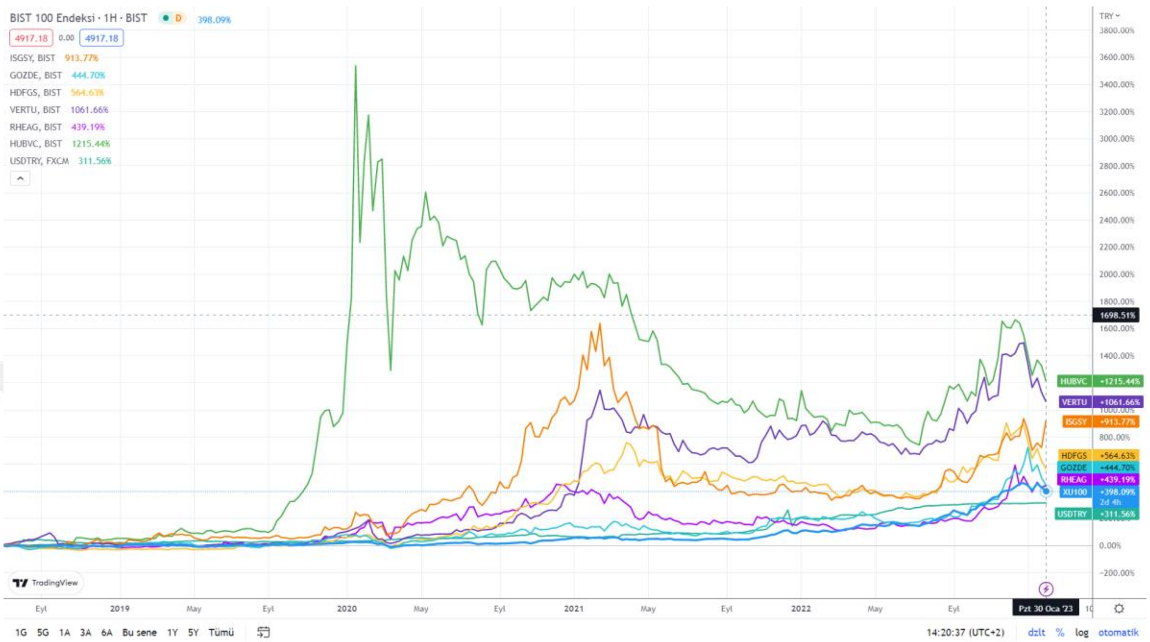
Four Private Equity companies in Borsa Istanbul such as HUB, HEDEF, VERUSA and IS are using their own capital rather than financial debt while other two Private Equity companies in Borsa Istanbul are using short- and long-term debts as well as their own capital to finance their acquisition activities such as GOZDE and RHEA. In Figure 8, we will see the returns of six Private Equity companies traded in BIST.

Table 5: Public PE Companies Traded In Borsa Istanbul, General Information

Publicly Traded PE Funds in BIST	Stock Ticker	# of active PE deals	main PE industry	Year of Establishment	Return since July 2018 (adjusted after dividend)	Total Debts / Total Liabilities 2021/09	Total Debts / Total Liabilities 2020/12	Total Debts / Total Liabilities 2019/12
Hub Girisim Backed By MV Holding	**HUBVC.IS**	**15**	**technology, software, biotechnology**	**2006**	**745,51%**	**0,39%**	0,68%	3,45%
Hedef Girisim Backed By Hedef Financial Conglomerates	**HDFGS.IS**	**7**	**Real Estate, Chemical, fin-tech, Construction Materials**	**2012**	**968,00%**	**0,22%**	0,40%	1,07%
Gozde Girisim Backed By Yildiz Holding	**GOZDE.IS**	**7**	**Islamic Finance, packing, retail on food, shoes and technology, personal care, machine industry**	**2010**	**594,92%**	**16,73%**	**52,21%**	**45,57%**
Verusa Turk Girisim Backed By Investco Holding	**VERTU.IS**	**11**	**renewable energy, mining, software, and gaming, healthcare, and food**	**2012**	**1080,84%**	**4,71%**	**3,36%**	**0,11%**
Is Girisim Backed BY Turkiye Is Bankası	**ISGSY.IS**	**6**	**technology, biomedical, sportive tools, tourism, and dining**	**2000**	**900,00%**	**0,81%**	1,50%	1,52%
Rhea Girisim	**RHEAG.IS**	**4**	**medical disposables, anti-virus software, logistics, venture capital**	**1996**	**614,29%**	**70,81%**	**26,20%**	**21,59%**

Source: Created by the author.

Figure 8: Return of Private Equity funds traded in BIST June 2018 – January 2023



Source: https://tr.tradingview.com/chart/fBaKuoqP/

As seen the in Figure 8 (Tradingview, 2023), PE companies using partial debt rather than fully own capital, have less returns compared to PE companies using less debts. The most important thing for using debt or extra debt (financial leverage) in PE transactions is interest rates. The higher the interest rates, the more difficult to find debt for PE activities. Unlikely to developing countries, in developed markets such as U.S, Canada, U.K, EU where the interest rates are comparatively lower than the interest rates in developing economies, most PE companies use limited partners financial resources to acquire target companies. In Figure 7, it has been shown the increase in the leverage using PE transaction. By the end of financial crises in 2008, using 6x time leverage buyouts was about zero. Since 2009, leverage buyouts have been increased and now by the end of 2021, greater than 7x leverage buyouts composes %50 of total buyouts.

By the end of 2022, there are 227 registered mutual funds focused on PE investment operated in Turkiye. (KAP, Public Disclosure Platform, 2023: 1) We will examine the returns of 4 of those because the assets management companies of those 4 are backed by main commercial banks in Turkiye such as Turkiye Is Bankasi and Akbank. Table 6 below shows the returns and main investment businesses of these 4 PE funds. As stated in the earlier section, fund managers are working meticulously to select the target companies by due diligence. On a telephone call with Ak Assets Managements, Mr. Kerem Mutlu (Mutlu, 2020), the fund manager of PE funds has stated eight of three-hundred target companies are selected since the foundation date. Both Ak and Is Assets Management Companies have been focusing on the companies creating value-added products and services, technology, clean energy, online market and sales business, renewable energy sources, fast moving consumables (health foods and packing) and Islamic finance. All areas mentioned are still new investment field by the end of 2021 in Turkiye. On the telephone conversation with two assets management companies both confirmed that these PE funds have never dealt with classic business concepts in Turkish such as construction, real estate, classic retail channels, public entities privatization, garments, fabric, and textile business because of mass employee needs.

Table 6: Summery table for four PE mutual funds operated in Turkiye.

Mutual Funds focused on Private Equities transactions in Turkiye	Fund Ticker	# of active PE deals	main PE industry	Foundation Date	Nominal Return till 29.01.2022 from foundation	Average Return per Annum
Ak Assets Management PE Fund 1	AGN	8	Clean Energy, Mobile Systems, Medical Chemicals, nanotechnology, marketing app tools, cloud technology	27.06.2016	133,88%	23,92%
Ak Assets Management PE Fund 2	ICI	4		20.12.2018	53,41%	17,15%
Is Assets Management PE Infrastructure Fund	IAG	5	Electricity production centers in Anatolia	27.11.2017	241,99%	57,92%
Is Assets Management PE Renewable Energy Fund	IYG	0	Renewable energy production companies	31.10.2019	59,76%	26,54%

Source: https://www.isportfoy.com.tr/en/Home; https://www.akportfoy.com.tr/en/home/index, 12.06.2022.

However, contrary to the words mentioned above by two important Assets management companies in Turkiye, Table 6 above shows that Private Equity funds managed by Ak and Is Assets companies have similar annual return in three of four funds with local TRY term deposit (Central Bank of The Republic of Turkiye, 2023) on time frame between June 27, 2016, to January 01, 2023. In Figure 8, the average time deposit interest rate for Turkish Liras per annum between 2016 and 2021 has been seen as 17,00 – 18,00 %. Funds such as AGN, IAG and IYG have better returns than time deposit in this period. Fund ICI has very similar or lower return than time deposit. Out of four funds, only IAG funds whose core business, electricity production, has better returns due to electricity price increase in Turkiye, which invested on five different wind-power plants in Turkiye.

For the PE funds other than IAG, the reasons for not generating attractive returns than term deposits could be the main problems in target company returns or the fluctuations in Turkish economy which have important impact on the revenue of target companies.

Figure 9: Weighted average interest rate applied to Turkish Lira time deposit accounts opened by banks between June 27, 2016, to January 01, 2023

Source: Central Bank of The Republic of Turkiye, Ankara

After the establishment of Private Equity Limited partnership, PE managers seek funds commitment from limited partners. In this step, finding a strategic match between limited and general partners has a critical importance. Some partners have short term investment perspective, while others have longer term. If there are no common strategic values and shared targets between general and limited partners, the success chance of a PE transaction is limited. In order to complete the fund commitments, General Partners must approve that expected return on PE transaction will beat other alternative investment returns such as common stocks, mutual funds, funds of funds etc. Especially in some highly leveraged PE deals, limited partners and creditors must share the same strategic view with the General Partners and Target company's management. Leveraged Buyouts (Corporate Finance Institute, 2022: 1) contain high credits which cause the credit default risk. In order to minimize this high default risk, long terms partnership perspective is the key success in PE deals between all parties, such as limited and general partners and creditor banks.

PE deal returns are compared with the return of the target companies in the portfolio against returns benchmarks indexes. In the U.S where financial markets are very developed, the long-term returns of PE funds are better than main indexes such as S&P 500 and Russel 2000 index returns on long-run. Also, in Eu MSCI Europe and in Japan MSCI AC Asia – Pacific, PE funds have been beating the main benchmark indexes in the long-run. The concept here "long-run or long-term" is extremely critical because the limited partners such as institutional investors, pension funds, insurance companies or fund of funds make investments to PE companies on long-run bases.

As we see from figure 10, when the investment period is more than 5 years, PE returns are approximately equal with other main index's return. But if we look at the 10 or more-year term, PE returns are better than other indexes.

Figure 10: The benchmark of Indexes with U.S Private Equity Indexes

US PRIVATE EQUITY (LEGACY DEFINITION)

US PRIVATE EQUITY (LEGACY DEFINITION)

AS OF JUNE 30, 2020

FUND INDEX SUMMARY: HORIZON POOLED RETURN
Net to Limited Partners

INDEX	1-QUARTER	YTD	1-YEAR	3-YEAR	5-YEAR	10-YEAR	15-YEAR	20-YEAR	25-YEAR
US PRIVATE EQUITY INDEX (LEGACY DEFINITION)*[1]	**9.43**	**-1.55**	**3.40**	**10.66**	**10.30**	**13.77**	**11.99**	**10.48**	**12.84**
Bloomberg Barclays Capital Government/Credit Bond Index	3.71	7.21	10.02	5.87	4.74	4.13	4.50	5.30	5.46
Dow Jones Industrial Average Index	18.51	-8.43	-0.54	9.08	10.62	12.99	9.08	7.19	9.69
Dow Jones US Small Cap Index	25.61	-12.61	-6.87	3.08	4.14	10.75	7.75	7.59	9.38
Dow Jones US TopCap Index	21.42	-2.09	8.56	11.13	10.87	14.14	9.07	6.11	9.36
Nasdaq Composite Index*	30.63	12.11	25.64	17.88	15.07	16.91	11.16	4.76	9.98
Russell 1000® Index	21.82	-2.81	7.48	10.64	10.47	13.97	8.91	6.10	9.41
Russell 2000® Index	25.42	-12.98	-6.63	2.01	4.29	10.50	7.01	6.69	8.16
S&P 500 Index	20.54	-3.08	7.51	10.73	10.73	13.99	8.83	5.91	9.27
Wilshire 5000 Total Market Index	21.94	-3.30	6.78	10.13	10.27	13.74	8.86	6.23	9.30

The index is a horizon calculation based on data compiled from 1,585 funds, including fully liquidated partnerships, formed between 1986 and 2019.
[1] Private indexes are pooled horizon internal rate of return (IRR) calculations, net of fees, expenses, and carried interest. The timing and magnitude of fund cash flows are integral to the IRR performance calculation. Public indexes are average annual compounded return (AACR) calculations which are time weighted measures over the specified time horizon, and are shown for reference and directional purposes only. Due to the fundamental differences between the two calculations, direct comparison of IRRs to AACRs is not recommended. For a more accurate means of comparing private investment performance relative to public alternatives, see the analyses in this document using CA Modified Public Market Equivalent (mPME). See Methodology section for more detail.
Sources: Cambridge Associates LLC, Bloomberg Barclays, Dow Jones Indices, Frank Russell Company, Standard & Poor's and Thomson Reuters Datastream, and Wilshire Associates.
*Capital change only

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Source: https://www.cambridgeassociates.com/private-investment-benchmarks/, 12.06.2022

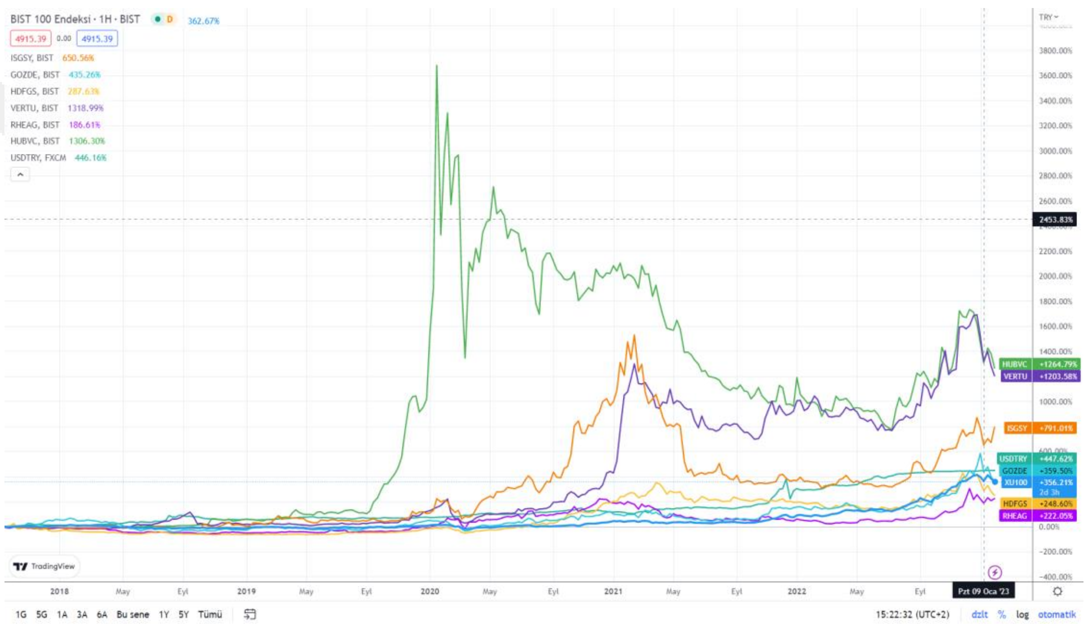
As you see in Figure 10 (Cambridge Associates, 2020: 1), U.S Private Equity indexes have higher returns in all indexes in 10 or more years. Beating all indexes in the long run shows that PE companies or investors in the U.S prefer private equity companies or funds if they prefer to invest in the long run. Pension funds, institutional hedge funds, long term labor funds prefer to invest in PE funds for making investments on a long basis.

As mentioned before, there are six Turkish Public PE companies already traded in BIST. Also, in Turkiye, PE companies returns are better than main stock exchange indexes such as BIST 100. Figure 11 below benchmarks the main 6 public PE companies return with the return of BIST100. Because BIST100 covers more mid-cap companies than BIST30, we used the index of BIST100. The time schedule is 5 years between March 2017 and March 2022.

As we see from the Figure 11 (Tradingview, 2023), four Private Equity companies out of six traded in Borsa Istanbul beat the average return on BIST100 index. For a foreign institutional investor dealing with investing Turkiye may have an idea that investing

Turkish Private Equity companies publicly trade in BIST may have better main BIST indexes, such as XU100.

Figure 11: 5 years Return Chart of BIST 100 and six PE companies in BIST 100 since February 2018. The blue line is BIST100 return line.



Source: https://tr.tradingview.com/chart/fBaKuoqP/

By the end of section 2.1, the establishment process of a PE company, partners, and financial resources of a Private Equity company and how to compare the PE companies were explained. By the next section 2.2, the process of a PE transaction is to be explained.

2.2 IMPLEMENTATION OF PRIVATE EQUITY TRANSACTIONS

In section 2.1 establishment process, partners and financial sources of a private equity company are explained by the details with main motives of the partners and the evaluation or the benchmark of a PE company.

In section 2.2 it will be explained how a PE deal is executed. In a standard private equity transaction, generally there are four main steps. The first step is finding a target company, the second step is the entry step where private equity company acquires some portion of stake in the target company, the third step is the holding or the value creation step where the private equity company adds some extra values (financial or non-financial) to target company where the core business of target company is re-structured or renovated by the support of new partners and the last step is exit stage where private equity leaves this investment by selling or decreasing its stake in the target company and shares the profit or loss with its limited partners. It can be added more steps or removed one of those steps or combined them up to complexity, purpose, and duration of each deal.

Each step has its own important sub-steps or debates in which private equity company has focused on. In table 7, all main steps and its sub-step, important issues are summarized. We will explain them in detail in the next sections.

Table 7: Main steps of a PE transaction with its sub-steps

STEPS OF A STANDARD PE TRANSACTION and ITS SUB-STEPS

Step 1	Step 2	Step 3	Step 4
Finding the Target Company	***Entrance***	***Value Creation (Holding)***	***Exit***
Evaluation of the Country Analysis & Risk	Negotiations	Corporate Governance	Return Calculation (Risk of Local Currency Value)
Evaluation of Industry Analysis & Risk	Contracts	Budget Control	IPO, Buyout
Target Company Analysis	legal infrastructure	Cost Cutting	LBO, MBO
Valuation Methods		Professional Management	Profit Sharing with LP
Due-Diligence		New Products & Services	IRR & CoC Return
Target Company's Aims and its combination with private equity		New Markets, Marketing & Distribution Channels	

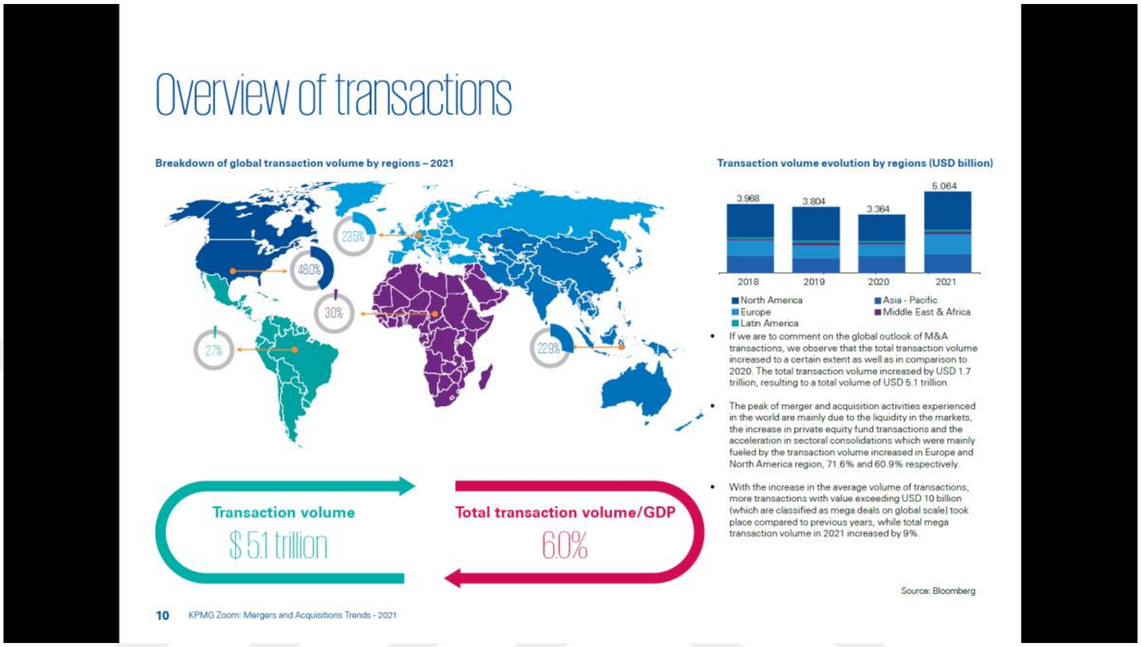
Source: Created by the author.

2.2.1 Finding a Target Company

The initial step in a private equity transaction is to find a target company to acquire or to invest. In section 1.1, the main reasons, or motives for making a Private Equity deal both for a Private Equity company and a Target Company were all explained. Each side has different motives and reasons for a private equity transaction. Having parallel motives by both the private equity company and target company facilitates the transaction process. As mentioned before, deal executing ratio is extremely low in private equity industry (Mutlu, 2020)(American University in Bulgaria, 2014). In order to minimize the risk of selecting and investing in an inappropriate target company, private equity executives make detailed research and analysis both on country, industry and different potential target companies.

Country Analysis: macro-economic and political stability are one of the main conditions for a secure and safe investment environment. Stabile local currency against U.S Dollar in long-term, a transparent investment environment, fair and rapid legal & justice system, stable and lower interest rates etc. are some of the main motives of a private equity company to select a foreign country to invest. By the end of 2021, the global merger and acquisition volume is $5.1 trillion (KPMG Turkiye, 2021: 6) which is the highest amount in the last 20 years. Figure 12 below shows the global overview for M&A activities by the end of 2021.

Figure 12: Global M&A activities by the end of 2021



Source: KPMG Turkiye announces "KPMG Zoom: Mergers and Acquisitions Trends 2021"

Figure 12 (KPMG Turkiye, 2021: 10) above shows that %48 of global M&A activities is executed in North America including U.S and Canada while %23,5 of M&A transactions is executed in Europe and %22,9 is executed in Asia – Pacific. The rest are executed in Africa, Middle East and South America including Mexico. Totally %71,5 of total M&A activities is executed safe and regulated markets such as U.S, Canada, and Europe.

Figure 13 (Bain & Company, Inc, 2022: 9) below shows the 16 years period of global PE transactions. The trend from 2005 to 2021 shows that M&A activities including PE deals have doubled from 2020 to 2021in all regions. Not only the established financial markets such as North America and Europe, but also in the rest of the world, M&A activities have increased more than the past averages.

In order to minimize the country-based risk, M&A activities and PE transactions are mostly executed in western markets. By the end of 2021, the average volume of a

M&A deal in the world is around $75,5 million value (KPMG Turkiye, 2021: 11). The important things affecting M&A in 2020 and 2021 have been pandemic and its variants, global liquidity and increasing risk appetite, logistic problems, decreasing agriculture crop due climate change and global drought, increasing commodity prices including agricultures, logistic problems, inflation and increasing interest rate consequently.

By the first quarter of 2022, another big issue has been added to the list above, the conflict between Russia and Ukraine which affected all commodity prices, oil and gas prices as well as global logistic channels.

Figure 13: Global buyout deal value due to locations by the end of 2021

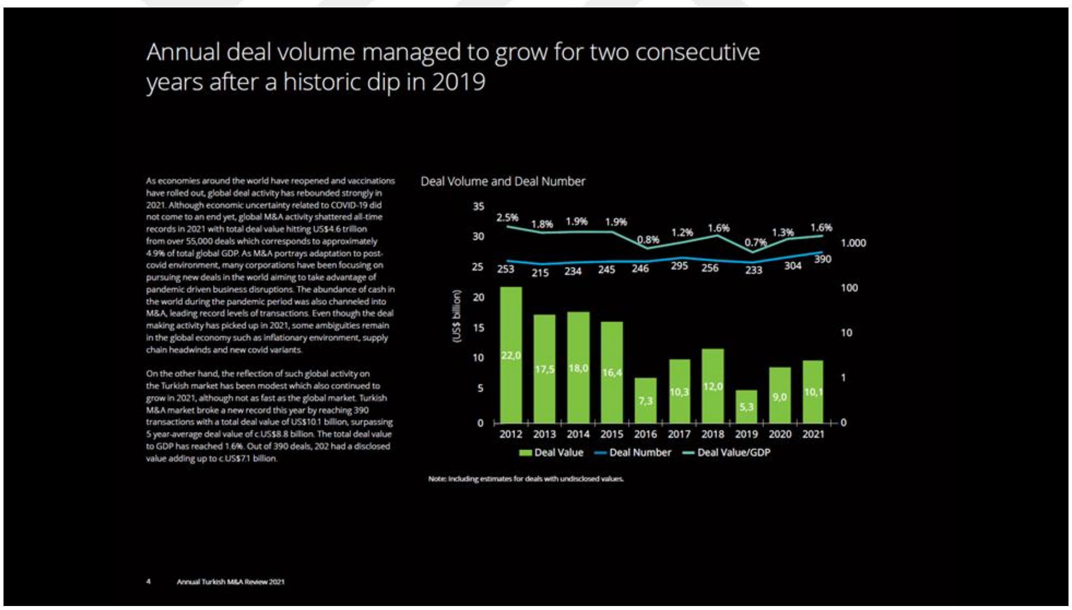
Source: Global Private Equity Report 2022, Bain & Company 2022

Besides the global conditions explained below, M&A and Private Equity activities were affected the special conditions of Turkiye. As an important emerging market, Turkish economy is well-knows with its “home-made crises” in Western World (Egilmez, 2015: 1). These home-made crises can be referred as own unique developments in Turkish economy which are accepted as opportunity to execute PE deals.

With the start of pandemic situation by the first quarter of 2020, Turkish economy has increased its uncertainty, instability. Besides the global factors, the deep decrease in the value of local currency against U.S dollar, increasing prices more than %100 in 2 years made Turkish assets, companies, and SME relatively cheaper in all assets class in emerging economies.

By the end of 2021 the total M&A deals were estimated between 10 – 14 billion USD according to different global companies. (KPMG Turkiye, 2021: 16) (Deloitte Turkiye, 2022: 3) Figure 14 (Deloitte Turkiye, 2022: 4) shows the M&A activities in Turkiye according to Deloitte.

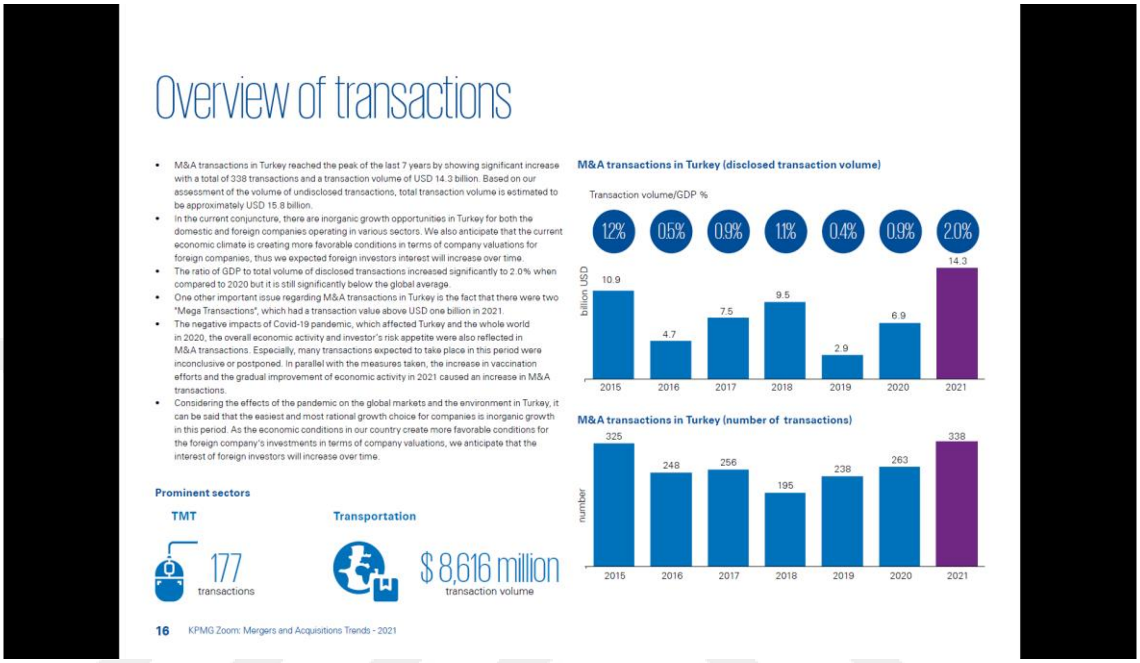
Figure 14: Number and value of M&A deals in Turkiye between 2012 – 2021



Source: Deloitte, Annual Turkish M&A Review, 2021

Figure 15 (KPMG Turkiye, 2021: 16) below from KPMG approaches number of deal and value of Deloitte, but KPMG has predicted undeclared deal values in Turkiye and has estimated the total value in Turkiye as 14.1 billion U.S Dollar (KPMG Turkiye, 2021).

Figure 15: Number and value of M&A deals in Turkiye between 2012 – 2021



Overview of transactions

- M&A transactions in Turkey reached the peak of the last 7 years by showing significant increase with a total of 338 transactions and a transaction volume of USD 14.3 billion. Based on our assessment of the volume of undisclosed transactions, total transaction volume is estimated to be approximately USD 15.8 billion.
- In the current conjuncture, there are inorganic growth opportunities in Turkey for both the domestic and foreign companies operating in various sectors. We also anticipate that the current economic climate is creating more favorable conditions in terms of company valuations for foreign companies, thus we expected foreign investors interest will increase over time.
- The ratio of GDP to total volume of disclosed transactions increased significantly to 2.0% when compared to 2020 but it is still significantly below the global average.
- One other important issue regarding M&A transactions in Turkey is the fact that there were two "Mega Transactions", which had a transaction value above USD one billion in 2021.
- The negative impacts of Covid-19 pandemic, which affected Turkey and the whole world in 2020, the overall economic activity and investor's risk appetite were also reflected in M&A transactions. Especially, many transactions expected to take place in this period were inconclusive or postponed. In parallel with the measures taken, the increase in vaccination efforts and the gradual improvement of economic activity in 2021 caused an increase in M&A transactions.
- Considering the effects of the pandemic on the global markets and the environment in Turkey, it can be said that the easiest and most rational growth choice for companies is inorganic growth in this period. As the economic conditions in our country create more favorable conditions for the foreign company's investments in terms of company valuations, we anticipate that the interest of foreign investors will increase over time.

Source: KPMG M&A Trend in Turkiye, 2021

Number of deals and deal volume from 2012 to the end of 2021 in Turkiye have been affected by macroeconomic parameters mostly in Turkiye as well as political issues in Turkiye and in the world. Since 2013 continuous devaluation in Turkish local currency against U.S Dollar, increased interest rates, unstable macroeconomic conditions, unpredicted political risks such as military coup attempt, political problems with U.S, global pandemic conditions, war affect between Russia and Ukraine, logistic problems have affected Turkish Economy in a negative way. Figure 8 and Figure 16 (Tradingview, 2023) shows the basic economic parameters in Turkiye since 2017.

As a result of the negative economic outlook in Turkiye, the number of M&A deals as well as deal values have been both affected in a negative way. As seen in both in Figure 14 and 15, number of M&A deals in Turkiye stayed same since 2012 to the end of 2019 which is about 250 deals per annum according to Deloitte. Also deal value between 2013 – 2021 was in the weak point in 2016, 2018 and 2019 according to both Deloitte and KPMG. After 2019, it was seen that there was an increase in number of deals and value of deals in 2020 and 2021. At this point, USD / TRY FX rate must be considered. Both Turkish domestic and foreign investors prefer higher USD & TRY currency rate in entry period in order to buy the target company cheaper in terms of USD.

Figure 16: USD / Turkish Lira Indexes since 2013

Source: https://tr.tradingview.com/chart/fBaKuoqP/, 12.06.2022.

Figure 16 above confirms that USD/TRY rate has started increasing sharply after 2018. Meanwhile, the stable currency policy has been abandoned after 2014 which has decreased the target companies' valuations in terms of USD. Historically the ruler political part in Turkiye has given economic and political confidence between 2002 and 2013 to international and domestic investors which increased the number and value of M&A activities. From 2002 to 2013, the main M&A deals were privatizations such as Turk Telekom, Turkish Ports, Public electricity distribution. Only between 2006 – 2008, public privatization in Turkiye was 20,60 billion US Dollar. (Arolat, 2014: 1)

However, by 2013, politics and economics problems in Turkiye have started to increase. As a result of increase country risk in Turkiye, M&A activities including the number and deal value of PE transactions have started to decrease. International investors should have a pioneering knowledge of the country’s risk level before investing their savings in a country. For this purpose, Credit Default Swap (CDS) Agreements that serve as insurance against investor’s risk of not collecting their receivables have been developed (Avşargil & Turğut, 2021: 1) which means the risk value of a country's economy is measured by Credit Default Swap premiums, shortly CDS premiums. Figure 17 (Investing.com, 2023) below shows Turkiye 5 years CDS premiums since mid-2008 till September 2022 with the bar of USD / TRY currency exchange rate. In 2009 with the effect of 2008 global mortgage crises, Turkish CDS premiums made a hike to 480 and then made a dip point at the end of 2010. Since that date, Turkish CDS premiums have a steady upside trend which means the foreign investors assume Turkish economy more risker every day.

Figure 17: 5 Years CDS premiums of Turkiye since Mid-2008 to January 2023 with USD / TRY currency rate bars

Source: https://tr.investing.com/rates-bonds/turkey-cds-5-year-usd-streaming-chart, 12.06.2022.

Figure 17 above shows another relationship between upside trend CDS premiums with increasing USD / TRY rate. Figure 17 shows a positive relationship between two parameters, increasing CDS premiums and increasing USD / TRY rates. These parallel increases may mean devaluation in Turkish Local currency against U.S Dollar.

As a general conclusion of country risk, both Figures 12 and 13 show that global M&A activities including Private Equity have been increasing from the bottom level in 2009 after 2007 – 2008 financial crises even there is a slow-down in 2019 and 2020 because of pandemic situation. Both the number of deals and deal value have been increasing from 2009 bottom in the world and made a peak value in 2021 despite the negative effect of pandemic situation in the world by the first quarter of 2020.

Specifically, Turkiye has a different direction compared to developed countries in M&A activities including Private Equity deals. Since 2012 both the number and the value of deals have decreased and made a weak point in 2019 which confirmed a fact that Turkiye has lost its economic attractiveness which was gained in period of 2003 – 2008. Figures 14 and 15 show and confirm that the M&A activities have started decreasing since their peak in 2012 and made dips in 2016 and 20019.

In addition to the constant decreases in M&A activities both in number and value of deals, Turkiye's major economic parameters have some negative results in the same period. The value of local currency against U.S dollar and Turkish 5-year CDS premiums results were seen in figure 16 and 17. The value of Turkish local currency has been decreased since 2013 against U.S Dollar and by the September 2022, TRY is in the weakest point against U.S Dollar. This constant devaluation in Turkish Lira decreases the revenue of target companies in terms of U.S Dollar both being invested and to be invested and postpones the exit time. M&A activities including Private Equity investments are assumed as foreign investments in a target Turkiye. These financial transactions are recorded, valuated, and measured in U.S dollars because of its global strength. Steadily increasing or decreasing local currency against the U.S Dollar affects the value of total foreign investments, as well as the value of target companies. Unfortunately, steadily increasing USD TRY currency rate has decreased the value of all Turkish companies, as well as target companies in U.S Dollar as shown in figure 17.

Currency risk as a part of country risk evaluates the current valuation and future cash flows of the target company. In a basic equity transaction, PE firm seeks to generate both capital gain and dividend gain from the target company. Capital gain should be assumed as the difference between the selling price and buying price of the target company. Dividend gain should be assumed as a yearly net distributed profit to all shareholders. PE company wants to maximize this total return. The currency rate between the local currency which the target company operates and the hard currency which PE fund evaluates its operations evaluate the final return on PE transaction. In Turkiye, the local currency is Turkish Lira and hard currency is mostly U.S Dollar. The value of Turkish Lira against U.S Dollar will evaluate the exit results of each transaction. Steady increases USD / TRY will decrease the value of target company in terms of U.S Dollar while the steady decrease in USD / TRY will increase the value of target company in terms of U.S Dollar.

In a PE transaction, capital gain for a PE firm, both for general and limited partners, is the sum of growth of target company after the transaction by adding extra value on profit, sales, cash flows and the increasing value of local currency, here is Turkish Lira, against U.S Dollar. Decreasing value of Turkish Lira decreases the value of target company in terms of US Dollar which is a capital loss for PE company and decreases the total capital gain for a PE deal. In Figure 16, it has shown that Turkish Lira has kept its steady value against U.S Dollar from 2002 to 2013. After 2013, it is shown that Turkish Lira has started to lose its value against U.S Dollar and it is still in this period. Both number and value of deals in Turkiye show PE activities were in downside trend since end of 2012. Also Figure 17 confirms that Turkish CDS are in upside trend since 2013. As a conclusion it can be told that PE companies preferred investing on Turkiye where local currency will reevaluate against U.S Dollar or at least keep its value steady against U.S Dollar like the Turkish Lira between 2002 – 2013. And after 2013, PE companies has decreased their attention to Turkish companies since 2013 till today. Table 8 below shows the currency rate effect on a PE transaction.

Table 8: Currency Rate effect on a PE Transaction

Transaction A	Entry		Transaction B	Entry
Date	30.12.2016		Date	31.12.2003
Deal Price ($)	$10.000.000,00		Deal Price ($)	$10.000.000,00
USD / TRY (30.12.2016)	3,5255		USD / TRY (31.12.2003)	1,3993
Deal Price (TRY)	₺35.255.000,00		Deal Price (TRY)	₺13.993.000,00
Transaction	Exit		Transaction	Exit
Date	7.09.2022		Date	31.12.2009
USD / TRY	18,2468		USD / TRY (31.12.2009)	1,4945
Deal Price (TRY)	₺176.275.000		Deal Price	₺69.965.000,00
Exit Price (USD)	$9.660.598		Exit Price (USD)	$46.814.988,29
Holding Period (days)	2077		Holding Period (days)	2192
Capital Gain in holding period (in USD)	-$339.401,98		Capital Gain in holding period (in USD)	$36.814.988,29
Capital Gain in holding period (in USD)	-3,39%		Capital Gain in holding period (in USD)	368,15%

Source: Created by the author.

As mentioned before, PE funds collect hard currencies from their partners and investors to minimize the currency risk from different investors and currencies. Hard currency refers to money that is issued by a nation that is seen as politically and economically stable. Hard currencies are widely accepted around the world as a form of payment for goods and services and may be preferred over the domestic currency (Chen, 2022: 1). The well-known hard currencies in the world are U.S Dollar, EU Euro, and British Pound. But in PE transactions in the world are mostly executed in U.S Dollar.

PE funds making transactions in Turkiye must evaluate their investments in U.S Dollar even the target companies operate in Turkish Lira. Figure 16 above shows how Turkish Lira kept its value against U.S Dollar between 2007 – 2013, how it started to lose steadily its value against U.S Dollar 2013 – 2018 and the sharp decrease in value Turkish lira against U.S dollar after 2019.

Table 8 the effect of currency risk on PE transactions in Turkiye in different time zones when the Turkish Lira lost its value against U.S Dollar between 2016 and 2022 and when Turkish Lira kept its value against U.S Dollar on steady term between 2003 and 2009. By the end of 2016, a PE company, called PX Fund, had valued and acquired a Turkish local target company (Company A) at 10.000.000 USD when the USD/TRY exchange rate was about 1 USD = 3,5255 TRY. PX has paid 35,255,000 TRY to the shareholders of Company A and recorded this entry cost as 10.000.000 U.S Dollar even the Company A has been operated in Turkish Lira.

As explained earlier, PE funds prefer selling their target company after a while when they made some value-added operations. This selling strategy is called exit strategy where PE funds evaluates different options as sell the company, fully sales, partially sale, management buyout or initial public offerings. By the mid of 2022, after 5,5 years later after PX has acquired company A, PX has decided to exit this investment and got alternative offers from potential investors both local and foreigner. By due diligence with potential buyers, by September 7, 2022, company A was sold to another investor at 176.275.000 TRY which means an increase of 141.020.000 TRY in local currency or %300 capital gain in 5,5 years, 2077 calendar days.

However as shown in Figure 16, by September 7, 2022, USD/TRY exchange rate was about 18,2468 (Central Bank of The Republic of Turkiye, 2022) which means the local currency Turkish Lira has lost % 317,56 of its value against the hard currency U.S Dollar between in all holding period between December 31, 2016, and September 17, 2022.

Apparently PX company made a profit of 141.020.000 TRY in local currency. However, as mentioned earlier, PE funds evaluate their transactions in hard currencies, which is mainly the U.S Dollar. After assuming exchange rate USD / TRY between December 31, 2016, and September 07, 2022, PX has lost $339.401,98 between buying price, $10.000.000 in entry stage and selling price, $ 9.660.598 in exit stage. This loss, $339.401,98 $ means a capital loss of %3,39 lost in 5,5 years or 2077 days. This capital loss of around $339.401,98 excludes any divided payment if done.

PE transactions in Turkiye after 2013 have faced this currency rate problem after 2013. The average USD / TRY exchange rate was about 1,50 TRY between 2002 – 2010. This exchange rate was used in nearly all PE transactions between 2002 – 2013. So, any PE deal entered before 2013 and exited after 2013 have faced the same exchange problem.

As seen in figure 16, Turkish Liras has started losing its value against U.S Dollar after September 2013. Till that time, especially between the end of 2002 and September 2013, Turkish Lira has kept it core value against U.S Dollar, which was tried to be explained in the example below. PX private equity fund had another transaction before 2013 in Turkiye. PE fund evaluated and valued company B by the end of 2003. PX acquired company B at $ 10.000.000 by December 31, 2003, when the USD / TRY exchange rate was 1,3993. Company B was operated in Turkiye and its valuation in terms of TRY was 13.993.000 TRY by the end of 2003 as an entry price. After 6 years, PX fund decided to sell company B as an exit strategy and made a deal with another local investor for 69.965.000,00 TRY when the exchange rate was 1,4945. This means in total six years; TRY has kept its value against USD and just lost about % 6 of its value. Converting this exit price, PX fund received $46.814.988,29 total which was a capital gain of % 368,15 in total 6 years.

In both two examples, PX found sold the target company %400 higher than entry price in terms of local currency, TRY. But in example 1 when the zone was between 2016 – 2022, USD / TRY exchange rate was increased %417,57 and capital gain in terms of USD was removed by this exchange rate increase. However, in example two, USD / TRY exchange rate has just increased % 6,80, so the capital gain has been almost kept its value even in hard currency, USD.

It may be concluded that constant devaluation in local currency, such as TRY, against hard currency such as USD, could be reason for a principal loss rather than a principal gain in terms of U.S Dollar where PE funds seeks capital gain in U.S Dollars rather than local currency. That’s why international big PE companies seek stable or predictable local currencies or markets to secure the value of target company in terms of U.S Dollar. In the opposite case, number, and value of PE transactions as well as M&A

activities may be decreased, postponed, or cancelled in target country; it is now the reals case of fear about Turkish Economy.

Country risk is also measured by CDS premiums as mentioned in page 37 and figure 17. The important reasons for increasing CDS premiums of Turkiye could be the unrealistic economic management in public side, unpredictable political activities in Turkiye, concerns on political independence of Turkish Central Bank which causes devaluation in Turkish Lira. Under these conditions, by September 7, 2022, CDS premiums of Turkiye have seen 785 all-time high levels. Under these conditions, M&A activities including PE transactions were lower in 2019. Since 2019, the number and value of M&A activities are in upside trend but both 2019, 2020 and 2021 results are lower than 2016, 2017 and 2018 results and very far from the results of 2013, 2014 and 2015.

There are many dimensions of country risk other can currency risk. However, in Turkiye, local currency risk is assumed as the main country risk parameter where currency rate risk sets the rules of foreign and local investment decisions. Naturally, PE deals are affected by the currency rate risk by number of deals and value of deals. Both figures 14 and 15 show the number of deals and value of deals between 2012 – 2021. After 2012, the number and value of deals started to decrease till 2019 which has the weak values both in number of deal and value of deals. By the 2020, number and value of deals has started to increase because of base affect in devaluated Turkish Lira against U.S Dollar. Most of emerging Turkish companies have been assumed as relatively “cheap” in terms of U.S Dollar compering to other emerging markets. Also deal value which was peak in 2012 by 22 billion of US Dollars but weak in 2019 by 5.3 billion U.S Dollar. This extreme decrease in deal value between from 2012 to 2019 was just an example of how foreign investors, partners of foreign PE companies, assume public Turkish Economy Management.

Even though PE companies avoid country risk, they always seek different opportunities. “Higher the risk, higher the return potential” has been the main drive for all international investors especially in long-term. It was summarized in Table 2 and was shown in Figure 10, PE companies deal with longer term investment opportunities. Because of the problems of Turkish economy, the assets price and valuations of Turkish target companies shall be cheaper in US Dollar compared to other target companies in other emerging markets. Even though the problems in Turkish economy, Turkiye has been accepted in the first 20 biggest economies in the world, with its increasing younger population, increasing export revenue, and higher future potential.

After understanding, calculating, and accepting the country risk, PE companies research for available industries in target country having higher growth potential. Besides growth potential, PE companies choose industries offering higher local demand and competitive export advantages. Having local demand and competitive export advantages are the key factors for electing and eliminating the industries. Eliminating the industries is the key, the reason for this very low execution rate which can be summarized as the very detailed examination of investing company by PE, the possible conflict on target price between the PE and target company holder. This detailed examination done by PE is called due structure. Target company’s financial ratios, future possible growth potential, future possible cash flows etc. take some extra time and effort. Also, the same financial ratios are not implemented in the same way. This makes finding the target company process very long and critical.

Industry Analysis: In a general private equity deal, making an industry analysis by evaluating risks is accepted as the second step. As mentioned in the previous parts, PE deals starts with evaluation of country analysis and risk specifically effect a particular country where the PE fund swallows all the country as whole, for example Turkiye. However, ‘Industry Risk Analysis’ specifically refers to the factors that can impact (both positively and negatively) a particular industry rather than a country, which can in turn affect companies within the sector. Just as the economic performance of economies can vary widely, the performance of industries across the spectrum too can differ considerably (Mehta, 2021: 1). Besides macroeconomic and political risk attributed to a particular country mentioned in country analysis section, specific industries have specific risk factors. These risk factors can affect the growth, profitability, sales, cash flows and value of each individual company in that industry. Therefore, PE executives have always been concerned about industry risks.

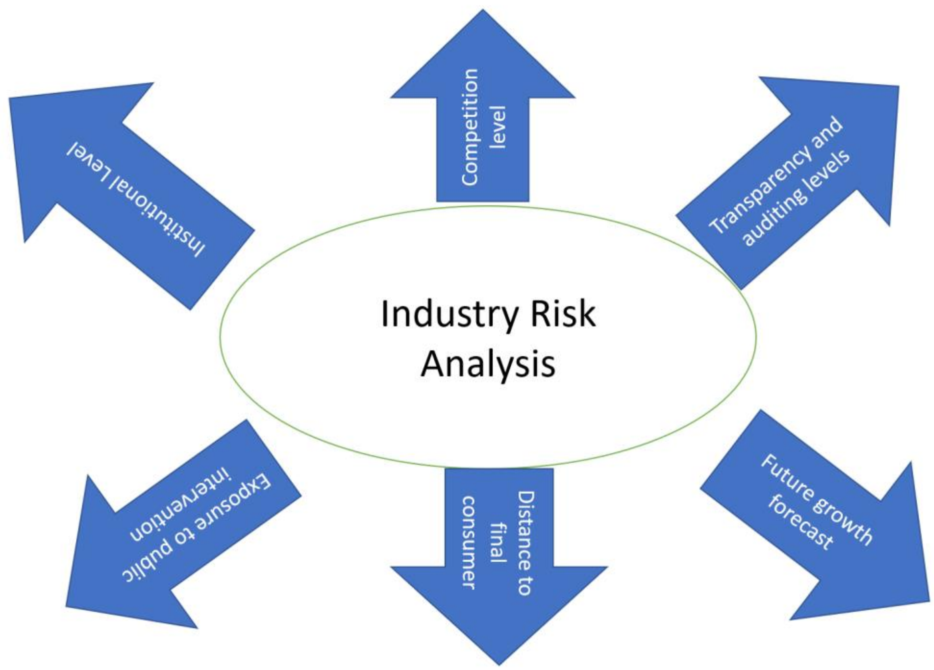
Each industry has its own risk factors. Some industries have strong barriers to entry but offer higher growth rates while some have little barriers which facilities entry but offering lower growth opportunities. There are some main factors in evaluating the industry risk; specific growth prospects for the industry, competition level, audit level, technology level, sensitivity to changes in macroeconomic variables (such as currency risk), bargaining power of the suppliers, competitive threats, risk of substitute products, industry complexity, barriers for entry, industry life cycle.

The number of factors used for evaluating industry risk can be increased or decreased as the main characteristic of the industry. Also, some industries may have shorter factor lists while some have a longer risk because of the complexity of the industry.

But Private Equity perspective has given extra importance to some industry risk factors which are very critical for their transparent business philosophy, growth prospects, competitive level or type, audit level and sensitivity to macroeconomic variables.

In previous sections, it was mentioned that Private Equity funds are accepted as financial investment for a period of 5 – 7 years and PE funds usually seek exit opportunities in order to get the profit and to invest it into other opportunities (target companies). These limitations and constraints force PE funds to find industries having lower but fair competition levels, offering higher financial audit abilities, offering higher technology standards, strong macroeconomic view especially on local currency, offering higher growth rates. Figure 18 shows the main risk factors used while making Industry Risk.

Figure 18: Main risk factors considered while making Industry Analysis



Source: Created by the author.

Competition level: there are mainly four accepted competition levels in economics: perfect competition, monopolistic competition, oligopoly, and monopoly (The University of Minnesota Libraries, 2023: 1). Each type of competition level has a different market structure. Because value creation and cost structuring are the well-known methos for the PE companies to overcome the competition level, PE funds seek perfect competition or at least normal competition to avoid the negative effects of monopoly and oligopoly competition.

Transparency and auditing levels are another risk prospect of industry risk. Because PE companies use due diligence before making an investment decision, this industry must have transparent business structures. For example, the industries containing export or import oriented players provide transparent and accurate information because either the first or the last step of the business process is under Government or Custom control. Also, industries who have audited players, especially third-party independent audit, provide much more accurate information about the industry.

Future growth forecast is another risk parameter for the industry. Mature industries have different characteristics than early emerging industries. Emerging industries such as smart phones application software business, clean energy, fin-tech software, recycle offers higher growth rates and mature industries such as textile, infrastructure, mining and chemical. Higher growth rates forecasts provide more profit and exit opportunities for PE funds.

Distance to final consumer is another risk factor in industry analysis. Some industries stay at the beginning of the business cycle as suppliers of raw material which keep them far away from final customers and cash generating. However, some other industries, for example retail, such as Migros, internet sales, marketplaces such as Trendyol stay at the end of the business cycle and are the nearest position to the final consumers where they generate the cash conversion.

Exposure to public intervention and independence; some industries are open to government intervention which blocks the existence of competitive market structure. Industries selling product and services for final consumers may be assumed as the reason of higher inflation or lower supply and government or public regulation board may intervene the companies by giving penalty fees or extra taxes which is unfavorable for a PE fund. Turkish retail supermarkets such as Migros, BIM, A101 were assumed as the reason of higher food inflation and received financial penalties by 2021.

Institutional level, Institute structure and corporate governance is another risk factor for industries. Some industries are close to institutionalism, while some sectors are far from institutionalization due to the nature of their business. This corporatism affects the control of the company, audit level, easiness on working with the former partners. For example, industries dominated by small family enterprises or sole partnerships may have lower institution level while some industries are dominated by incorporations.

Industry risk factors may change to the nature of the industries but are one of key elements for making decision which industries must be invested or not after country risk analysis. Ultimately PE fund are accepted as financial investments and always seek to make exit with a profit. These main drives force PE funds to choose industries where they make less competition, having higher future growth potential, offering higher transparency standards and audit levels, staying closer to final consumer for being near to cash generation, offering higher institution level for easy corporate governance and finally staying away from public intervention and public control.

Target Company Analysis is accepted as the third step in finding a target company step. In the first two steps, PE fund managers evaluate the risk and analysis of the country where they will invest and the industry where they will work in. In both two steps, PE funds understand the general acceptable conditions of the country and the industry before making a target company analysis.

Target companies preparing themselves for a Private Equity deal are evaluated in different dimensions. Because this evaluation is a subjective process, and each company analysis may have different results. Buyer and seller may have different analysis perspectives for the same target company and as a result, both parties may have different analysis results. Company analysis has two main parameters based on financial analysis methods and the methods analyzing the professionalism and tendency for partnership and corporate governance. Both analyses have different purposes. Figure 19 below summaries the purposes of each analysis. Financial analyses try to make a prediction about the financial situation of the target company in terms of sales, revenue, cost, and profit margins. While corporate analyses are used to see the competence to adapt to professional management with the new partner, Private Equity fund.

Figure 19: Purposes of Target Company Analysis

TARGET COMPANY ANALYSIS

- **FINANCIAL ANALYSIS**
- **Sales Analysis**
- **Cost Analysis**
- **Profit Analysis**
- **Ratio Analysis**
- **Future Free Cash Flow Predictions**
- **Growth and Discount Rate Predictions**
- **Benchmarking**

- **CORPORATE ANALYSIS**
- **Carrying similar purposes as a Private Equity fund**
- **Compliance with budget discipline**
- **Compliance with the partnership culture**
- **Accountable management**
- **Transparent management culture**

Source: Created by the author.

There are many purposes for making financial analyses; to check current value of the target value, to predict potential future value of the company by adding value added products and services after PE transaction which will trigger revenue and profit growth till the exit stage. As mentioned in previous sections, PE deals are assumed as financial investments for an average period of 5 - 7 years. Nearly all PE funds prefer to make an exit after this period with a relatively higher profit compared to other alternatives.

Financial analysis mainly covers the sales analysis, cost analysis, profit, and free cash flow analysis. Besides these analysis, financial analysis contains ratio analysis, growth, and discount rate analysis for making comparing / benchmarking activities.

Besides financial analysis, target company analysis is also containing “corporate analysis”. The purpose of the corporate analysis is to see the institutionalism and professionalism level of the company. As predicted, PE activities are accepted under M&A activities and in most cases, there will be a partnership after PE deal. Even though some PE deals will not be partnership which means PE fund acquires % 100 of the target company, but in most cases, PE funds prefer to acquire some portion of the target company in order to use the experience of existence old or new partner.

Carrying same or parallel business purposes between the existing owner and PE fund is the crucial parameters in a PE deal. After the deal, if partners do not have the same views for the company, there will be a conflict of interest between the partners which will make blocks or delays in potential growth process and exit time. Working in harmony enables companies to reach the exit stage in shorter time.

According to the interview with Mr. Kerem Mutlu (Mutlu, 2020), appointing a new CFO is the best way in Turkiye to set the professionalism and to control the budget. Budget control is one of the important points for the company after PE deals. If the budget is set and implemented according to agreed-upon goals, the target company can reach the goals as planned.

Family-owned companies may have difficulties with partnership structure and professional management such as CFO because of their customs and old family traditions. Resistance to professional management, appointed CFO, 3rd party audit, regular inspections either from customers or from PE fund may create a dilemma between the partners which may causes problems in mutual values and purposes.

The structure of Private Equity funds is mostly filled with professional employees. This professional staff requires professional business language with the companies, both target companies and invested companies. Accountable and transparent business culture hereby plays an important role between PE fund managers and companies. If such transparent business language can't be constructed between the parties, a successful PE deal may not be created.

After introducing the main subjects in "Finding the Target Company" in step, a closure view for valuation methods will try to be explained.

Valuation Methods: methods based on financial models for any company are generally called "company valuation". The purpose of company valuation is to predict the value of the firm which will be acquired by paying a price. The price and value of any assets may be different. As said of Warren Buffett's most famous quotes (via Benjamin Graham) is, "Price is what you pay; value is what you get." (Town, 2018: 1) Both seller (the existing owner/s) and the buyer can make company valuations due to their perspective. The purpose of the buyer, PE fund, is to find target companies whose prices are lower than the values, which means cheaper target company. On the other hand, the purpose the seller, the owner the target company is to find alternative buyers willing to pay higher price for the value of the existing target company which means to sell company with higher price. This conflict-of-interest causes using different valuation approaches and techniques.

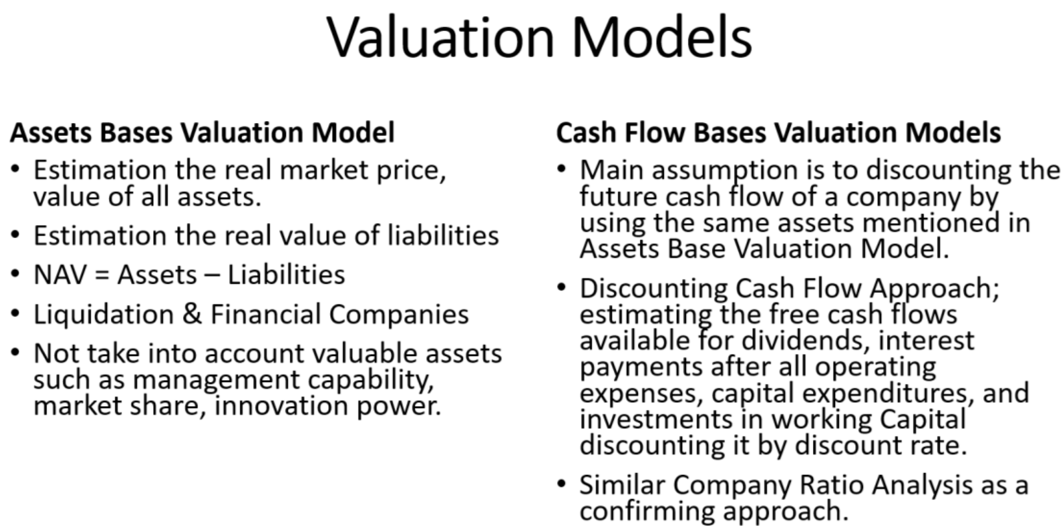
Company valuation is subjective rather than objective which means the buyer and seller of same target company, or a third party can find different results due to their perspectives and purposes mentioned above.

Valuations methods change due to the structure of the industry. Some industries are valued according to the assets and some industries are valued according to the future cash flow or the net income generated by the company. Because of this difference, some valuation methods are focused on the assets of the target company and some methods are focused on predicting the future cash flows of the target company.

The situation of the company makes another variation. Some companies are valued because of bankruptcy by assuming that the company will not generate any income anymore. Some companies are valued on an assumption that they will produce free cash flow on perpetuity bases.

There are two main models or approaches used in company valuations (Zengin M. S., 2018). Assets base valuation models, cash flow valuation models (Zengin M. S., 2018). Figure 20 below shows the main approaches in valuation models.

Figure 20: Basic Valuation Models



Source: Created by the author.

Assets-based valuation models are based on identifying and summing the current values of each asset and liability of the company. Assets to be valued by the company can be receivables, stocks, equipment, vehicles, facilities, real estate, trademarks, patents etc. Liabilities to be valued of the company could be payables, trade finance, bank loans etc. The basic approach of these methods is to find the equity value by deducting the value of the company's total liabilities from the total value of the company's assets (Gorbon, 2012: 9).

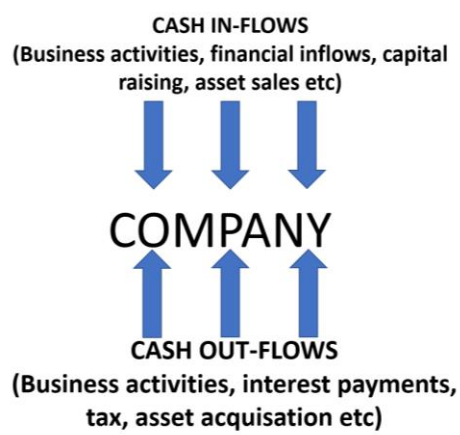
Financial institutes, banks, investment companies, conglomerates, liquidated companies, non-operating (non-generating income) can be valued by the asset-based valuation models, because their current and fixed assets reflect the real values current values. Also, real estate investment trusts are valued with the same assets-based models because their fixed assets are easy to value, such as land and real estates rented. Companies in liquidation stages are also valued by assets-based models. Because these companies are not assumed as income generated companies.

Asset-based valuation models are based on estimating the net assets value (NAV) of the company. NAV is defined as the value of a fund's assets minus the value of its liabilities (Corporate Finance Institute, 2022: 1).

Cash based valuation models: Discounted Cash Flow (DCF) Analysis is a valuation method based on to check ability of a company to generate free cash flow on a perpetuity basis. DCF considers valuation by discounting these free cash flows to the present and adding the available free cash as the market value of the company.

The main categories used in free cash flow estimations are free cash flows from operations, assets acquisitions or asset sales, financial inflows or financial expenditures, changes in net operating capital, tax, capital increase or dividends distributed and existing cash balance. Figure 21 below summarizes the main cash resources and cash outflows in a company.

Figure 21: Main cash in and Out Flows Sources In A Company



Source: Created by the author.

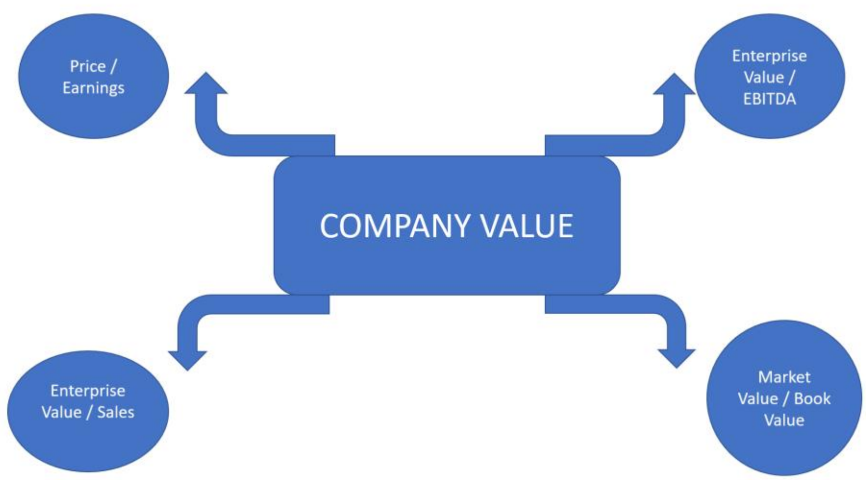
There will be a cash in or outflow for each balance sheet item mentioned above. The target market value of the company is reached because of discounting the free cash flow amounts obtained after the offsetting of these money inflows and outflows, at a certain rate (KARGEM, 2023: 1). This certain rate is called discounting rate. A discount rate covers the risk of the company, risk rate of risk-free investment alternatives or alternative companies' risk rate.

The discount cash flow approach has some difficulties for estimating the future cash flow of the companies and discounting rate. All these estimations are based on so many predictions on company and country. Also, the discounting rate and growth rate for future cash flows can be changed more than expected.

In order to control the estimated valuation by discount free cash flow, PE funds use company multipliers method or similar company ratio analysis methods for evaluating the target company. The multiplier analysis is obtained by applying some parameters, which are formed by the pricing of similar companies, to the target company to be valued. Multiplier analysis is a market-based valuation method.

In a PE deal, the same parameters mentioned below are examined through the financial statements of the company and a price is reached by comparing these elements with similar companies. This is the logic on which the factor analysis is based, and the main elements used here are called "multiplier". The main multipliers used in the factor analysis are as follows:

Figure 22: Main Multipliers Used in Valuations



Source: Created by the author.

The main assumption in ratio analysis is to assume the same multipliers are valid for all companies in the same industry, same scale and same business. In an example while valuing a target company, PE professionals assume that the value of a target company can be found by multiplying the ratio of the same companies in the same industry or market. For example, if the price to earnings ratio is 10 in a specific industry, company A from the same industry has and earning of 5 means the price of company A must be 50. Ratio analysis is used for controlling the valuation obtained by discount free cash flow analysis. Well known multipliers used in valuation are Price to Earnings Ratio, Enterprise Value to Sales Ratio, Enterprise Value to Ebitda Ratio, Market Value to Book Value ratio, Market Value to Net Assets Value Ratio (Gorbon, 2012: 10).

Because every industry has its own market structure, analysists use different multipliers for different industries.

P/E ratio can be the most well known and most used ratio analysis especially for companies in stock exchange. It shows how many times the market value of the company is its net profit on an annual basis. It is the ratio of stock prices to net profit per share. It indicates whether the value of the stock is relatively low or high relative to the companies being compared. Because the net profit figure is used, it is a multiplier that also reflects the financial structure and conditions of the company.

EV / EBITDA ratio is one of the most used and reliable multipliers. EBITDA can be found by adding tax, depreciation, and interest expenses to the net profit. The EBITDA multiplier is roughly; It shows how many years the transferred company's income arising from its main activities and the price paid to the company will be amortized, that is, it will come to a break-even point. Therefore, it is a valuation method used in leveraged purchases made by borrowing in periods when cash flow is significant (Aköz, 2019: 2).

EV / Sales ratio one of the multipliers used specially to avoid the effects of different accounting techniques and to compare companies with different debt structures. Although it does not show the cash generation capability of the company as well as the EV / EBITDA multiplier, it is a multiplier that reflects its growth potential. It also does not consider the operating expense structure of the company.

MV / BV ratio is the multiplier mostly used for financial sector companies. It is obtained by dividing the market value of the company by the total equity in its financial statements.

MV / NAV ratio is the ratio mostly used for holding companies, real estate investment companies, mining etc. It is the multiplier mostly used in companies that manage fixed asset weighted portfolios. It is obtained by dividing the market value of the company by the adjusted equity value.

Each industry has its own characteristics, because of this fact, every ratio can’t be implemented to each industry. The results of ratio analysis can be interpreted by comparing the industry results. For example, if EV / EBITDA ratio is 10 in a particular industry, and company X’s EV / EBITDA ratio is 6, then it can be interpreted that company X is cheaper than its rivals in the same industry according to EV / EBITDA parameter.

The next step after target company valuation is due diligence.

Due Diligence: Due diligence is an investigation, audit, or review performed to confirm facts or details of a target company before a PE transaction. In the PE industry, due diligence requires an examination of financial records before entering a proposed transaction with another party (Chen, Due Diligence, 2022: 1). Even though there are many variations on due-diligence, PE transactions assume due diligence as double check for all information supplied by the target company. In a PE transaction, private equity due diligence describes a potential investor’s process for assessing the desirability, value, financial viability, and potential of an investment fund before they commit capital (CEPRES, 2023: 1).

The participants of a PE due diligence can be third party analysts on behalf of “limited partners (LPs)” such as investment banks, pension funds, insurance companies and other institutional investors and parties in the name of General Partners. Private equity due diligence generally includes collecting and processing data about a “general partner (GP)” or fund’s past investment performance, its finances, and other details. LPs also perform qualitative analyses that vary from investor to investor, as well as quantitative analyses that are more standardized across LPs.

There are many types of due diligence due to the structure of the deal and target company. Administrative, financial, asset pricing, human resources, environmental, taxes, intellectual property, legal infrastructure, customer oriented, strategic fit between the partners (Corporate Finance Institute, 2022: 1).

The main reason for due diligence is to convince the limited partners to acquire the target company, which means the investment. This process may take up to 6 months in which both the limited partners and general partner (PE fund) make a deal on the new investment or not. If the outcome of due diligence convinces the Limited Partner, then LP will make investment on target company.

The difficulty in due diligence is to collect private data for private companies and interpreting them. As you know most target companies in PE environment are private companies which are not listed on stock exchanges. So, accurate information about them is not easy to collect, it is expensive and may take longer time.

If the outcome of due diligence is positive for LPs, the second step is entrance step in a PE deal.

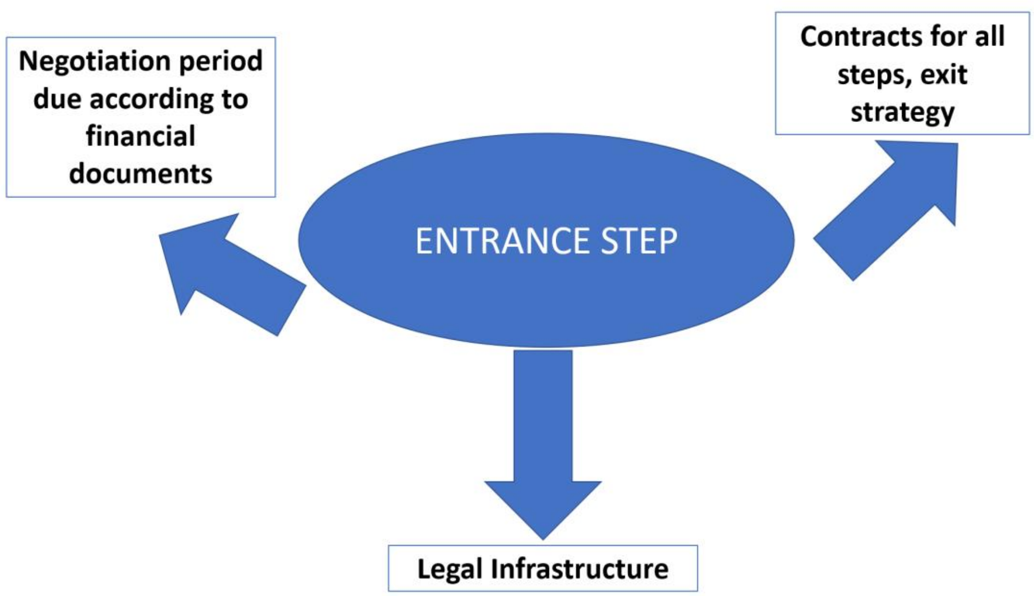
2.2.2 Entrance Step

The entrance step can be accepted as the introduction step between the target companies and PE funds. Each party makes their own valuation due to their own interests. Target companies claim higher valuation in order to strength their negotiation power while the PE funds claim lower valuation results in order to acquire cheaper. Reason of this lower valuation could be to avoid any possible risk because of "unknown and unpredictable situation about the company, limited information on financial situation of target company, unpredictable competition with rivals on target's sector, general economic conditions (such as increasing FX rate in Turkiye in July 2018) etc". These potential risks generate some question marks which can be accepted as risk premiums in PE fund's mind where they want to deduct these risk premiums from valuation of target company.

Even though there are different valuation methods mentioned in previous sections, Private Equity transactions for Small Medium Enterprises (SMEs) are based on valuation method of Discounted Cash Flow analysis. As a due diligence and a confirmation controlling method EV / EBITDA multiple is used for benchmarking with similar companies in the same scale, same industry or even in country.

Entrance step covers the negotiation period and contracts among the new partners under legal infrastructure. According to an online meeting with Is Private Equity (Bıyıklı, 2022) negotiation period takes 6 – 8 months in order to set all critical points between the PE fund and target company. Investment plans for the near 5 years, target EBITDA value and profit margins, amount of funds needed for these plans, planned value added products and services, competition and rivals are important discussion points between the partners. Figure 23 shows the main components of the entrance step.

Figure 23: Components of Entrance Step



Source: Created by the author.

Making contracts is one of the key steps in the negotiation process. As mentioned before PE funds are accepted as financial investments rather than strategic investments. All PE funds seek exit opportunities before making a PE deal. This exit strategy covers convincing the existing partners; either leaving the company together or separately. Some partners may prefer not to make an exit with PE fund, they either prefer keeping their stake or selling their stake to another buyer or at another time before or after PE funds exit time. These possible activities cause a conflict of interest during the holding period and make delays in the exit period. In order to avoid this risk, PE funds prefer making strong contracts with the existing owner if they will stay as partners. According to Mr. Biyikli (Is Girisim Sermayesi) making contract between international Limited Partners invested in PE funds operating in Turkiye and Turkish target company owners is one of the most difficult steps in a PE deal. Limited Partners and General Partners of an international PE fund keep the obligations of the contract.

Legal infrastructure is the place where the country risk is changing. Independent and impartial courts, right of appeal, fast-paced court process, arbitration are important elements of legal infrastructure. PE funds are accepted as direct foreign investments, especially in Turkiye. Without a healthy legal infrastructure, international PE funds will not prefer Turkiye as a target country too much. Because in any conflict with the existing and potential partners, the only place to solve these matters is independent and impartial courts.

In order to avoid these possible risks, PE funds prefer investing companies with "clean financials" managed and owned by "prudent merchants" (Bıyıklı, 2022). Also target companies audited by third party audit companies such as KPMG, Deloitte, Ernst & Young have limited risk for non-accurate financial information and existing owner problems.

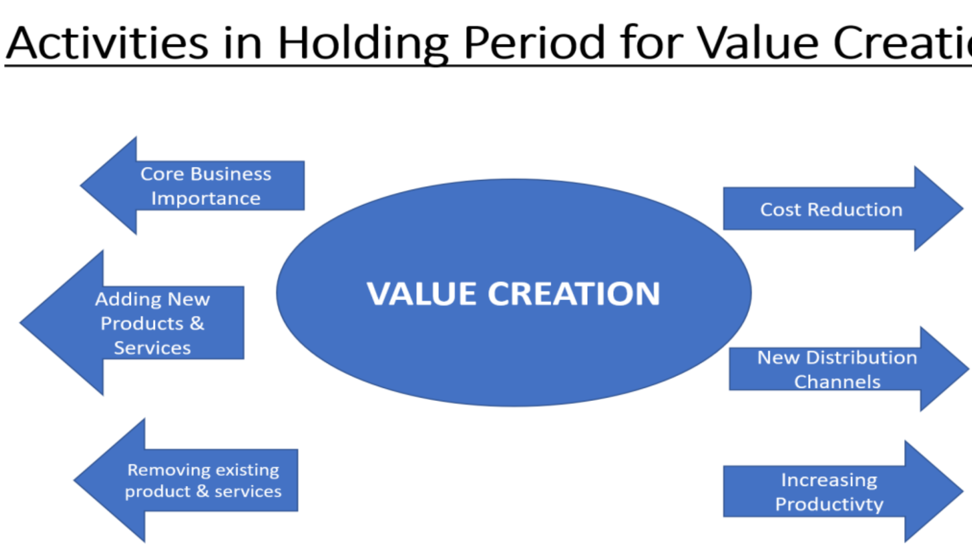
2.2.3 Holding Period

Holding period is accepted as "value creating period" for target company. In finding a target company step, PE fund evaluates different markets, industries, and target companies and after eliminating the potential target companies, and entrance step PE funds sets the contracts under legal infrastructure to be sure about any conflicts about the new partners. But the real value creation is planned and generated in the holding period by implementing different strategies according to competition, rivals, and objects.

According to interviews with Is Girisim Sermayesi and Ak Asset Management, PE funds start holding period by increasing corporate governance. Corporate governance is accepted as keeping the target company under remote control by appointing and hiring qualified staff such as a new CFO directly reporting to PE fund. By appointing a new independent CFO, PE funds control the budget and check the funds invested in the target company to be efficiently used for the aims.

After setting corporate governance, PE funds' main aim is to increase the effectivity, productivity, profitability of the target company such as adding value to products and services. Expected results are increased growth, increased profit, and increased company value before exit period. Figure 23 below shows the main activities made in the holding period.

Figure 24: Main activities of Holding Period



Source: Created by the author.

In previous sections, the holding period was defined as value creation period before exit stage. Main aim for holding period is to increase the market value of the target company by increasing sales, revenue, profit margins between entrance step and exit step. This period, which is called the holding period has an average of 4,9 years per PE deal (Lykken, 2020: 1). Increasing time in holding period may cause missing other PE deal opportunities while decreasing holding period time may cause insufficient business growth before exit.

Even there are lots of tools used due to structure of the target company, natura of the business and competition and target of PE fund for exit, the important methods used in holding period for creating extra value are adding new distribution channel, launching new product or services, investment on research, development and technology, cost reduction such as stuff reduction, focusing core business rather than ineffective business, removing unprofitable products and services or selling fixed assets.

Private equity fund evaluates the target companies mostly to their core business potential. Because of some limitations or former management decisions, target companies may not focus on core business and spend their energy with core and side business together. PE funds' new management requires target companies to focus on core business or the main activity rather than side operations. Eliminating or removing the side activities may increase the focus on core business which is the main revenue resource of the company.

Increasing the revenue is one of the main aims for PE fund on target company. There are lots of strategies for increasing the revenues, but the key strategy is to increase the number of customers, either existing or new channels. Adding new distribution channels is a sub-strategy for increasing the number of customers. These new distribution channels may be physical markets such as new export markets which target company does not export currently or online markets such as Amazon, E-Bay, Trendyol. Smart phone applications and web stores are other examples of new distribution channels. Also, some PE funds prefer adding new distribution channels vertically such as acquiring the customers or suppliers of target companies.

Adding new products or services is another strategy by PE funds to expand the sales volume. Due to customer loyalty to existing products / services, PE may add some alternative new products and services. Also, some PE funds decrease the number of products and services due to low profit margins or for focusing on core businesses.

Technologic improvements, search and development are important factors for increasing value-added services and new products. Because of limited financial resources, potential SMEs can't invest in R&D activities for making new products and services. Partnering with a PE fund enables them to find necessary financial resources for R&D activities.

Productivity is a measure of economic performance that compares the amount of goods and services produced (output) with the number of inputs used to produce those goods and services (What is Productivity? , 2023: 1). It is so normal for each company to increase their productivity, but PE funds give extra importance to increasing productivity during the holding stage in order to be ready for a successful exit stage. The term productivity reminds two similar but different terms for the companies, cost control and cost reduction. In prior sections, an example for Turkish PE fund method was explained in order to increase the corporate governance and budget control which is "appointing a new CFO". A new CFO can be assumed as a method as cost control. But it is not sufficient for cost reduction. Cost Control is a technique which provides the necessary information to the management whether actual costs are aligned with the budgeted costs or not. Conversely, Cost Reduction is a technique used to save the unit cost of the product without compromising its quality (Surbhi, 2017: 1).

Table 9: Cost Control versus Cost Reduction

BASIS FOR COMPARISON	COST CONTROL	COST REDUCTION
Meaning	A technique used for maintaining the costs as per the set standards is known as Cost Control.	A technique used to economize the unit cost without lowering the quality of the product is known as Cost Reduction.
Savings in	Total Cost	Cost Per Unit
Retention of Quality	Not Guaranteed	Guaranteed
Nature	Temporary	Permanent
Emphasis on	Past and Present Cost	Present and Future Cost
Ends when	The pre-determined target is achieved.	No end
Type of Function	Preventive	Corrective

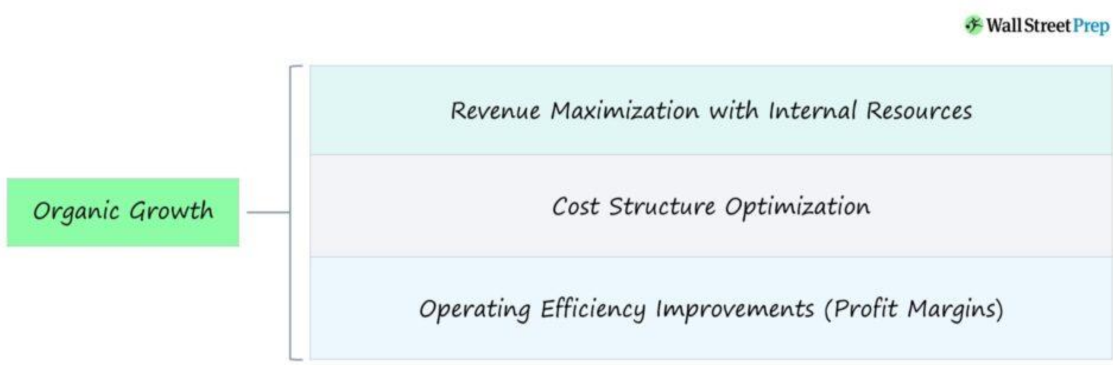
Source: (S, 2023)

Table 9 above summarizes the basic differences between cost control and cost reduction (Surbhi, 2017) . In practice the term "cost control" refers to budget control. By cost control, the target company can maintain it budget limits. But the term "cost reduction" refers to continuous improvement in production, research and development, technology in order to decrease the unit cost while keeping the quality same or higher.

Another important tool for the new management is to use "interest tax shield" by increasing the debt ratio of target company. In practice it is called using leverage. Financial leverage or using debt is a tool to get benefit from interest tax shield. Interest Tax Shield refers to the tax savings resulting from the tax-deductibility of the interest expense on debt borrowings. The payment of interest expense reduces the taxable income and the amount of taxes due – a demonstrated benefit of having debt and interest (Wall Street Prep, 2023: 1). By using shareholders' equity / capital, companies must pay dividends which are not tax-deductible. Using financial debts has an interest payment which is tax deductible. By this way target company can increase its EBITDA value to an optimal point without losing its financial security. Using too much leverage and too much financial debt may cause uncontrolled risks. The major risk is to increase the risk of bankruptcy. In any unexpected negative situation about a company’s activities, lenders may request financial loans given to the target company back and the company can’t pay them all. In the same situation, the company does not pay any dividend to shareholders or requests extra new capital. An example of an unexpected situation for higher debt ratio is 2020 pandemic crises. Tourism companies, airlines, hotels which were using higher leverage ratios, carrying extra financial load, could not pay their debts on time due to unexpected economic stop.

All tools mentioned above, and other tools implemented on target company by PE fund is to generate “organic growth”. Organic Growth is growth that is achieved from a company’s internal initiatives to improve its business model, resulting in improvements to a company’s revenue growth rates, profit margins, and operating efficiency (Wall Street Prep, 2023: 1).

Figure 25: Organic Growth Model



Source: (www.wallstreetprep.com, 2023)

Businesses can achieve organic growth by expanding into new markets, improving their existing product/service mix, enhancing their sales and marketing strategies, and introducing new products (Wall Street Prep, 2023). Organic growth is assumed to be healthy growth for the target company during the holding period which is called value creating period.

In this time frame from 5 to 7-years, target company uses different organic growth techniques as shown in Figure 25 (Wall Street Prep, 2023) by the help of PE fund in order to obtain maximum revenue generation before entering exit step.

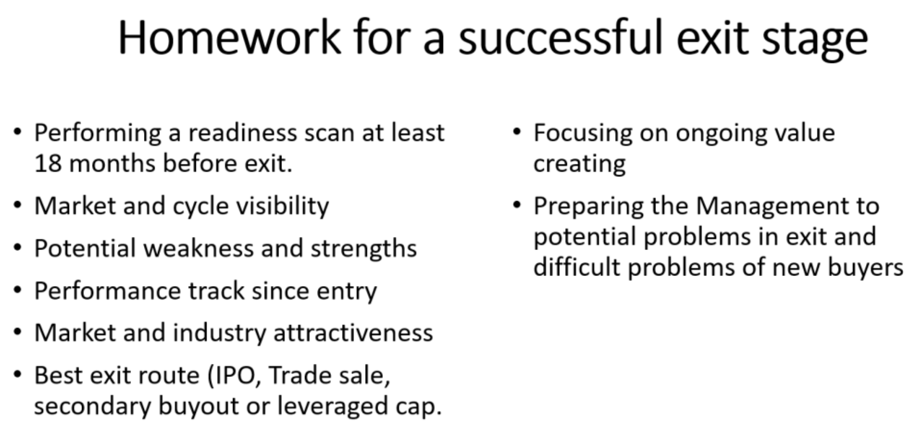
As we see in this example, if the valuation was wrong, the ultimate solution was unsuccessful. There are many successful PE deals as well as unsuccessful ones. In most cases, the biggest mistakes are over-valuation (using higher EBITDA multiplier), not generating enough growth potential, high debt ratio by using leverages and other unexpected risk emerging from country, politics, etc.

2.2.4 Exit Stage

Previously mentioned in earlier sections Private Equity companies are managed by companies such as an investment fund or hedge funds in which the main aim is to sell the assets bought at a good profit. But unlike investment and hedge funds, Private Equity funds invest their capital or dry powder in real and small & mid cap companies mostly not listed in public markets. Investment funds and hedges funds can sell their assets in stock exchange markets in a second while PE fund must find a new buyer or a new partner to sell the target company invested. This selling stage is called the “exit stage” which is much more difficult, complex, and complicated than an investment fund stock sells.

In order to decrease the risk of this difficult and complex stage, PE funds always look for alternative exit stage options before and during the holding period. For a successful exit stage, PE funds follow some important strategies before exit; Perform a readiness scan 18 months before the exit, focus management on continuing to capture value while preparing for the exit and post-transition process, prepare management to address potential problems and give forthright answers to buyers’ difficult questions (Green, Hayes, Seghers, & Zaets, 2018: 2).

Figure 26: Homework before exit stage



Source : (Cazalaa, Hayes, & Morgan, 2019)

Figure 26 shows an example of homework for each target company before entering exit stage (Cazalaa, Hayes, & Morgan, 2019: 3)

Preparation to exit process is important but implementing the exit process is much more critical than preparation where unexpected problems may exist. According to international audit company, PricewaterhouseCoopers, there are five phases of a well-structured exit process (Panson & Seagroves, 2019: 3); Making the decision to sell, Understanding the buyer universe, Preparing the business for a sale, The deal process, Preparing for life after the deal.

Figure 27: Phases of a well-structured exit process

Five phases of a well-structured exit process

1. Making the decision to sell : Identifying objectives and goal both financial and non-financial.
2. Understanding the buyer universe : Making empathy from buyers' view.
3. Preparing the business for a sale : valuing the target company, core Business, corrective actions, due-diligence.
4. The deal process : Using Professional advisory with due-diligence.
5. Preparing for life after the deal : Transfer the wealth for the next Operation.

Source: (Panson & Seagroves, 2019).

Figure 27 below shows five important phases for a successful exit stage (Panson & Seagroves, 2019: 4). Success in the exit stage is primarily based on definition of the goals and objectives of exit both financially and non-financially in front. Selling the whole stake of target company or remaining as a partner in the target company, staying in the industry with a new target company or leaving the industry are all different scenarios which must be identified before the exit process. The right exit plan can be chosen if all financial and non-financial goals and objectives are set in front.

Even though the difficulties, viewing your own company from potential buyers' or from competitors' eyes can gain some important advantages as a seller. A potential buyer can see the weakness and strengths of a target company in a more objective way. Because a potential buyer can see different target companies and makes evaluation more objective. Having a buyer view can enable the seller to develop the weakness and strength of the target company.

Some experts say that “run and organize the company as never sell but prepare the company ready to be sold by tomorrow”. (Ege Sanayicileri ve İşinsanları Derneği (ESİAD), 2022)

Using expertise and instant connection with third party advisors can gain time, effort, and money in all Private Equity transactions. Most buyers take professional advisory before entry stage. But using the same advisory sometime omit because of impatience. However professional advisory is critical even in exit stage. Intermediary companies can find the right buyer for the target company, evaluate the target company with a professional view and make negotiations in a more stable, accurate way. There are two important examples of using professional expertise from Turkiye are selling Turkish Betek Boya (Filli Boya) (Ünlü & Co, 2019) Painting company to Japan Nippon Painting company and Turkish Olmuksa Paper Company sale to Mondi International Paper company (owner of Turkish Tire Kutsan Paper company) (Ünlü & Co, 2021).

Even though there are many options for exit, four main exit strategies are implanted in private equity transactions; trade sale, IPO, secondary buyout and leveraged capitalization. Figure 28 shows the main exit options used in the Private Equity environment. (Cazalaa, Hayes, & Morgan, 2019: 3)

Figure 28: Main exit options used in Private Equity

Main exit options used in Private Equity

1. Trade Sale : Selling the stakes as whole or partially. Less cost, less time, bargain price.
2. Initial Public Offerings (IPO) : regulations, bureaucracy, expensive transaction cost, risk and question marks about the IPO.
3. Secondary Buyout: financial investment by another Private equity (example of Asset Medical)
4. Leveraged Recapitalization : selling target company by borrowing huge amount of Money (leveraging) to pay dividends or repurchase of shares to PE fund. Higher risk & limited examples. Leveraged or Management Buyouts.

Source: (Cazalaa, Hayes, & Morgan, 2019)

Private Equity may company sells all its stake to a third-party buyer which may be a strategic buyer, or a competitor from the same industry willing to make horizontal growth, a supplier, or a customer in the same industry willing to make vertical growth or an investor who wants to invest this target company for any reason. This exit is called Trade Sale. This option is generally preferred because of the ability to exit as whole with minimum effort and cost. But the selling price may be dominated by the new buyer and can be competitive.

The second exit option is Initial Public Offering (IPO). Going public by an IPO has too many risks, costs and requires long time for the regulations. As a meeting with Turkish PE Executive Mr. Cenk Coskunturk (Coşkuntürk, 2022), Partner of Mediterra Capital PE company in Turkiye, he argues that the last option for an exit stage is IPO because all risk and governmental requirements. One of the main risks for the PE company is to offer all its stake to the public. Even though IPO generally generates the highest return for PE company, it has expensive transaction cost and longer duration time.

On some occasions, PE company sells the target company to another financial partner. The main motive behind this sale may be assuming more growth and profit by the new PE company, transforming the target company from angel investment to venture capital or from venture capital to growth capital company or any strategic reason. This strategy may be implied where the first PE company cannot afford to sell its stake to an investor or public by an IPO. This exit strategy is called Secondary Buy-out.

The last and the most complex, the most risk exit strategy is called Leveraged Recapitalization (also called dividend recapitalization). Examples of Leveraged Recap is very limited and there is almost no example in Turkiye. The main condition for leveraged recap PE is easy access to borrowing and lower interest rates which are mainly available in the U.S and other developed economies. In most cases of a Leveraged Recap exit strategy, Private Equity company sells its whole stake to another past such as former owners of target company, former professional managers, or any other parts while the payment to PE funds generated by dividend which is organized by getting a high leveraged debt from banks. This process is risky because in order to exit the existing PE fund, the company gets more credit from banks which they have to pay their principles and interest rather than capital expenditures and long-term investment.

CHAPTER THREE
DISCUSSION
PRIVATE EQUITY IN TURKIYE

Private equity[1] transactions are assumed under Merger & Acquisition (M&A) activities. M&A activities are mostly assumed under direct foreign investment activities which consists also privatizations, block sales of government and private banks, government energy distribution channel distributions, marine ports, airports. Since 2002, privatization and selling of Turkish National Banks are calculated as 160 billion U.S dollars. (Romano, 2021) Even if they are assumed as M&A activities, all those transactions must be deducted from M&A transactions. After all related reductions the M&A activities in Turkiye is accepted as six billion U.S dollars per year and seventy-five transactions per year (Ege Sanayicileri ve İşinsanları Derneği (ESİAD), 2022). M&A activities is about 6 trillion U.S in 2021 globally, 2 trillion U.S dollar which is almost %10 of U.S GDP. In Turkiye, 2021 deal value is about 8 billion U.S dollar, which is %2 of Turkish GDP.

Private equity funds in Turkiye are executed by PE funds (Turkey Private Equity Firm Investors, 2022) such as Actera Group, Mediterra Capital, Taxim Capital, Turkven PE, Pera Capital, Is Private Equity, Ak Asset Management mostly backed by local banks such as Turkiye Is Bankasi, Akbank, conglomerate holdings Esas Holding, Yildiz Holding, MV Holding or foreign investment and financial institutions, such as European Investment Fund, European Bank of Reconstruction and Development, International Finance Corp, Alp-invest, IVCI. (Coşkuntürk, 2022) Facilitations in lending, borrowing, and leveraging and easy access to money are important factors increasing the value and deal number of PE activities. Such examples are developed markets such as the U.S and EU countries. Because of lower financial limits for PE activities, Turkish PE environment

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[1] For "private equity activities in Turkiye" is prepared by unstructured interview with **Mr. Cenk Coskunturk**, Partner in Mediterra Capital, online meetings, telephone calls and mailings with **Mr. Kerem Mutlu**, Head of PE in Ak Assets Managements, **Mr. Nevzat Bıyıklı**, Investment Professional in IFC (former director in Is Private Equity), mailings with **Mr. Hakan Kıldokum** (PhD), Ministry of Treasury & Finance Turkiye, and YouTube seminars of **Mr. Ibrahim Romano**, Managing Director of Unlu & Co and reports on PE in Turkiye by **Deloitte Turkiye and KPMG Turkiye**.

are backed by foreign investors and Turkish Bank and conglomerates. Figure 29 (Romano, 2021) summaries the main framework for PE environment in Turkiye. For both groups, if the interest rates are lower and lending & credit lines are expanding, the number and value of PE transactions are increasing.

Figure 29: Private Equity in Turkiye – Market Analysis

Source: (Romano, 2021)

Especially for foreign groups having PE investments in Turkiye the main concerns are on legal infrastructure and foreign exchange policy of Turkish economy. The main issue for FX policy of Turkiye is devaluating Turkish Lira against U.S Dollar. As mentioned in previous sections, PE funds want to make an exit from each PE transaction after a while and calculate their performance mostly in U.S dollar. Stable devaluation in Turkish Lira against U.S dollars has melted their profit in U.S dollar terms and limited their exit strategies.

In order to eliminate FX risk on target companies, current interest from foreign PE funds is focusing on companies in Turkiye such as generating export revenue, the companies are in early-stage technologic improvements & applications such as fintech companies, companies in fast moving consumer products, retail business especially in food, food supplies, packaging, baby care, clean energy, software companies, automotive components, biomedical products are preferred by PE funds. Industries touching the final consumers with a brand reputation is also preferred by PE funds.

Also because of possible international sanctions, PE funds do not deal with companies such as in defense industry companies working with non-NATO members, construction companies working in Middle East, Russia, African countries, companies with governmental contracts and tenders whose receivables coming mostly from governments, also companies in cigar industry or gambling business are not preferred because of health problems, social pressure, government penalties and consumer concerns. Industries offering lower growth potential, and working in imperfect competition, working out of EU standards and non-audited by an international audit company are not preferred by PE funds in Turkiye. Industries focusing on importing in the U.S dollar and offering products in TRY to local markets are not preferred by PE funds. Figure 30 (Bıyıklı, 2022) shows the main framework for industry preference.

Figure 30: Private Equity in Turkiye – Industry Analysis

Source: (Bıyıklı, 2022)

As previously mentioned in chapter two, after making a country and industry analysis, PE funds make target company analysis in which the constraints are very strict (Mutlu, 2020). The purpose of target company analysis is to find a company offering high growth potential via new value-added products and services while it has lower valuation. In Turkiye, because of currency rate problems, Limited and general partners of any PE fund look for target companies generating export FX revenue. Companies offering local business growth and revenue in Turkish Liras are not preferred that much because of melting value of Turkish Lira against U.S Dollar steadily.

Having a high potential for creating value added products service is one of the main criteria for a target company (Coşkuntürk, 2022) . PE funds support the target companies for finding international networks, for establishing a professional business structure, for compensating investments, but the core strategy here is to find high potential value-added products and services. Figure 31 shows the main framework for company preference (Bıyıklı, 2022).

Figure 31: Private Equity in Turkiye – Target Company Analysis

Source: (Bıyıklı, 2022)

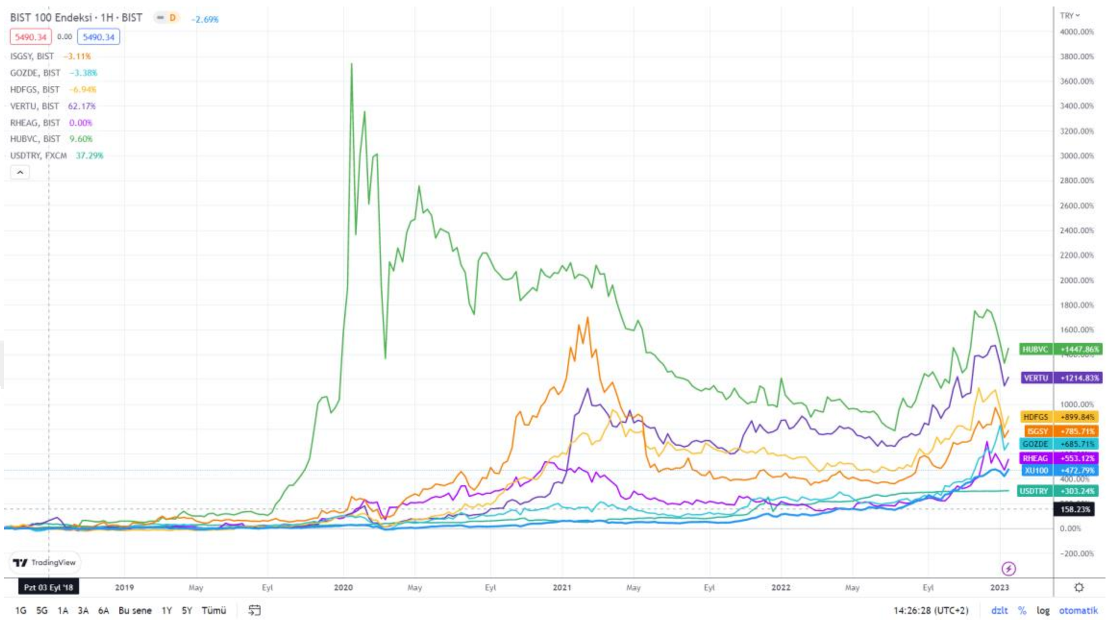
Target company owners must be aware that eventually PE funds make an exit stage after 5 – 7 years of entry. In order to eliminate the problems to occur in exit stage with existing partners, PE funds make contract with them before the entry stage. PE funds in Turkiye prefer to sell the target company to strategic buyers in the same industry which wants to make a vertical or horizontal expand in the industry (Coşkuntürk, 2022). Also, the price negotiation process with a strategic partner is much easier.

Appointing a new CFO is an example of transforming a professional management under budget constraints. In both conversations with Mr. Kerem Mutlu and Mr. Nevzat Bıyıklı, both PE funds managers, confirmed that the existing partner must accept appointing a new, independent CFO in order to establish the professional management.

SME's in Turkiye are mostly small size and family-owned companies. Especially after FX turmoil in 2021 and 2022, the sales revenue and financial size of SME's in Turkiye has lost their value in terms of U.S dollar where the PE funds mostly evaluates them in U.S Dollar (KOSGEB, 2022). With the new legislation for SME's in Turkiye, companies with average annual sales revenue less than 50 million TRY (2.670.000 usd) are accepted as small business and companies with companies with average annual sales revenue less than 250 million TRY (13.350.000 usd) are accepted as middle business. Most SME's are family companies and PE funds do not prefer to deal with family business because of prejudice and old customs from family roots.

In Turkiye, there are some public companies traded in BIST100 whose focus' are making private equity, venture capital investments on different industries. As an investor, the gains on publicly traded PE companies are better than investing on BIST 100 as general. Figure 32 (Tradingview, 2023) below shows the gains since 2018 mid till today. Even if there are some fluctuations on returns, all 6 stocks have beaten BIST 100.

Figure 32: Returns of public Private Equity Companies in Turkiye in BIST



Source: https://tr.tradingview.com/chart/fBaKuoqP/?symbol=BIST%3AXU100, 12.06.2022.

As we see from the figure above, both six companies have a better return in the middle run than BIST 100. But from international PE funds' side the critical is here the evaluation in U.S dollars. At the same time-period Turkish Lira has lost its value %303 against U.S dollar. It means even though the official TRY return of BIST100 is %472 in the same period, the U.S dollar has increased its value against TRY % 303. So, the net BIST 100 increase is %169 since September 2018 till today.

According to Mr. Ibrahim Romano, there is always an interest from international PE funds and institutional investors to Turkish Companies for both M&A and PE activities. But because these international investors evaluate their return in U.S dollar rather than TRY, the fluctuations in TRY against USD, limits their investment interest to Turkish Companies. Figure 30 shows the total net return of BIST 100 in U.S dollar is %169 in the last 4 years and 5 months while in the same time horizon international indexes such as Dow, S&P 500, Nasdaq in U.S have equal or better returns. These markets have less risk level than Turkish indexes, which shows Turkish PE industry risker than other developed countries.

CONCLUSION

With the increasing monetary supply and globalism, decreasing interest rates in developed economies in the last 40 years, Private Equity investments have increased their capacity and popularity with better than main U.S indexes. Today global M&A activities is about 6 trillion U.S dollar and 2 trillion U.S dollar PE transaction has been realized which is almost %10 of GDP of U.S economy.

Requiring less documentation and bureaucracy or no regulation, hidden financial documents, less public disclosure make PE activities more popular for private investors.

As a developing country, mostly all companies especially SME’s in Turkiye needs financial resources to expand their activities. Structural problems such as unpredictable economic situation in Turkish economy limits the credit services, lending and borrowing activities to SME’s. Besides financial limitations, unprofessional business structure of small size companies such as family owned, and operation SMEs have limited capabilities to find extra finance resource for expanding.

Partnering with a PE company or acquiring wholly by a PE fund may be thought as an alternative solution for financial and non-financial problems of any SME in Turkiye. But both international and locals PE funds are not looking for any target companies seeking financial support with a cheaper valuation in terms of foreign exchange. PE fund managers interviewed in Turkiye have declared that their focus in selecting a target company is to find the right company offering extra value-added products & services which are touching to final customer, offering higher growth potential in middle terms, generating sustainable revenue mostly from export activities, attempting on partnering culture on a professional business view and having lower valuation.

Four PE fund managers interviewed with making decision on selecting target companies for PE funds operated in Turkiye have explained the difficulties to detect a real candidate target company having the capabilities mentioned above. Only %2 of target companies inspected and negotiated has passed PE evaluation process and gets an investment from a PE fund.

Small size and in U.S Dollar term annual revenue of Turkish SMEs is lower than expectations in PE funds criteria. Even the %99 of Turkish companies are accepted as SMEs in official terms which shows %99 of Turkish economic players are potential target companies for PE funds in theory, total M&A activities in Turkiye by 2021 is just % 2 of Turkish GDP. And PE transactions are accepted as a sub-variance of M&A activities which include privatization, government contracts, port, energy, and bank privatizations.

General condition of Turkish economy is accepted as "risky" by international financial institutions. Even M&A and PE activities are increasing since 2019 despite of economic turmoil in inflation, currency rates since 2018, both number and deal value of PE activities are not sufficient to declare that Turkish SME's gets PE investments, especially in terms of U.S Dollar where limited and general partners of PE funds are using.

Turkish SME's mostly owned and operated by families have family business culture which is accepted as non-partnering orientation due to its own old customs and based on business biases. PE funds in general do not prefer doing business with close family structures because of difficulties on biases and possible family problems.

The assumption that PE fund may be solution for financial problems of Turkish SME's is not valid due to the mismatch of PE investment philosophy and SME's business culture in Turkiye. As explained in different ways in previous sections, PE funds make investment the future growth, extra value creating with PE and potential of target companies under some important assumptions. However, in most cases Turkish SME's has a view that PE funds make acquisition or partnering decision just by the lower valuation in terms of U.S Dollar. Having a company lower valuation in terms of U.S Dollar because of increasing U.S / TRY rate is neither the only nor the valid criteria of PE fund researching investment opportunities. PE funds make investments on sustainable growth potential by creating extra value with partnering which is very difficult to find.

SME's in Turkey willing to get PE investment must be aware of that transaction / deal execution rate is about 2 % in PE industry. (Mutlu, 2020) (American University in Bulgaria, 2014). This low ratio means that Private Equity funds are very selective in their target company selection process. In order to attract the PE funs, SME's in Turkey must prepare themselves to a potential PE deal. Complying to corporate and partnering culture, adaption to working with a new partner under a transparent and reliable business environment, implementing culture of accountability, focusing on creating extra value added product and services, obeying the rules of CFO, budget and its limit, acknowledging the exit process in front are just few examples of non-financial examples of homework for each SME's in Turkiye in order to attract the PE funds.

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