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Private equity buyouts and firm exports: Evidence from UK firms




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We assess the impact of private equity buyouts on the export behaviour of target firms exploiting data on UK firms over the 2004-2017 period. We provide evidence that following private equity (PE) buyouts, non-exporting firms are more likely to begin exporting relative to their non-PE backed counterparts and they are more likely to increase their value of exports and their export intensity. Further, when we perform a split-sample analysis, our results signal the importance of the credit constraints and the productivity channels. This suggests that PE investors add value to their portfolio firms by easing their financial constraints and improving their productivity.

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The role of Private Equity financing in the performance of their portfolio firms

PE buyouts have a significant impact on their targets' activities. They help their portfolio firms enhance their operating performance, productivity and employment (see, for example, Boucly et al., 2011; Davis et al., 2014; Bernstein et al., 2019; Biesinger et al., 2020). With respect to exporting, PE targets receive strategic advice, financial support, and industry specialisation. PE investors with an international presence and operational knowledge of overseas markets may offer a comparative advantage to their portfolio companies relative to non-PE-backed firms. Therefore, target firms are more likely to expand their operations abroad, improve their exporting status, and overcome the sunk cost of entering a foreign market. The upshot is that exporting can provide varied and diverse benefits to PE-backed firms. A very recent report estimates that UK export production supports around 6.5 million jobs, or 23% of total UK full-time equivalent jobs (Black et al., 2021). The report likewise shows that the number of jobs supported by exports has increased considerably over time. Motivated by these considerations, our study provides novel evidence of how PE buyouts affect exporting among portfolio companies at the intensive and extensive margins of export. In other words, we explore whether PE ownership helps targets to become exporters (extensive margin) and to increase their export intensity (intensive margin). Further, we document two channels through which PE investors unlock firms' exporting potential, paying attention to the relaxing of financial constraints, and firm-level productivity improvements.

Matching deals data with UK firms' financial accounts

We construct our dataset using different sources. First, to build our sample of private equity-backed companies, we use Standard and Poor's (S&P) Capital IQ and Thomson Reuters Eikon to identify all private equity buyouts with targets in the UK. As for the PE investor exit deals, we rely on Capital IQ's merger & acquisition database, Factiva and manual searches of financial news involving the target firms. We match target firms from our list of transactions to the FAME database, which provides comprehensive balance sheets and income statements data.

We first define a matched control group of non-PE-backed firms, which should be similar to sponsored firms (PE-backed) in the pre-buyout period. To provide a simple visual account of the evolution of firms' exports and productivity around the transaction, we present Figures 1 and 2. Both our treated and control samples follow similar paths in the run-up to the transaction, after which there is a divergence in exporting behaviour and productivity.

Figure 1: The effect of PE ownership on export activity

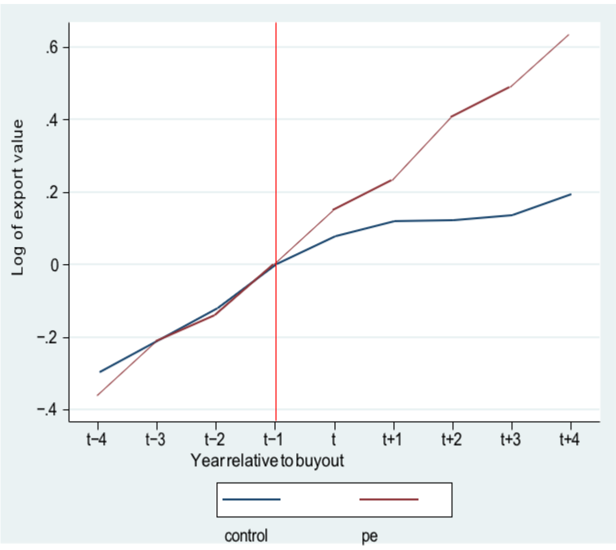
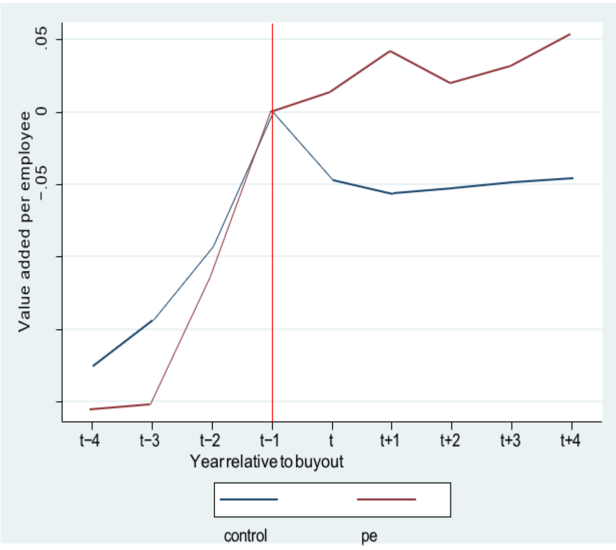


Figure 2: The effect of PE ownership on productivity



Extensive and intensive margins of export

In Lavery et al. (2021) we show that private equity buyouts positively affect the extensive margin of exporting. Results suggest that PE investors can help target firms to overcome the associated financial and strategic hurdles to geographic expansion. The probability of entering the export market increases by 4.6 percentage points when a firm is acquired by a PE company.

Next, we investigate the impact of private equity ownership on the intensive margin of export. We find that, following the buyout, the intensive margin of exporting is more sensitive for sponsored firms. Specifically, we document that private-equity backed firms increase the value of their export sales by approximately 36 percentage points, relative to similar non-PE-backed firms. We also detect a significant effect of private equity ownership on the share of export sales to total sales. Exports as a share of total firm sales among buyout targets increases by around 3% more than in matched control firms.

As know-how is a key resource for business, our findings suggest that private equity investors may provide financial and active strategic support to help companies accelerate their growth. 53% of PE investors in our sample have an international presence with offices in the UK and abroad. As a result, investors can bring expertise and experience of overseas markets, and act as a source of knowledge transfer for their portfolio companies, allowing them to reap the benefits of PE sponsorship via a growth in international expansion.

Explore the mechanism: The constraints and productivity channels

Deal and firm level heterogeneity

Private equity investors can play an important role in relaxing financial constraints in their portfolio companies (Boucly et al., 2011; Fracassi et al., 2018; Lerner et al., 2019; Bernstein et al., 2019). This may have implications for exporting, as financially constrained firms gaining access to PE funding may be subsequently able to cover trade costs and expand their sales to foreign markets. Indeed, financial frictions impact on whether and how much firms export (Manova, 2013; Muûls, 2015). The upshot is that PE firms help portfolio companies to diversify their sources of financing and the associated risks.

We assess targets' financial constraints using three attributes at the onset of the transaction, namely listing status, size, and age. First, we split our sample into two groups of deals (private-to-private buyouts, and public-to-private buyouts & divisional buyouts) to find strong evidence of post-buyout growth at both the extensive and intensive margins of exporting in private-to-private targets. Private firms have limited access to external funding compared to public firms, which explains that private-to-private buyouts experience a more potent post-deal increase in exporting activity. At the extensive margin, private-to-private targets are around 6 percentage points more likely to be exporters relative to matched control firms. At the intensive margin, the value of exports grows by over 47% for PE-backed firms in private-to-private targets. To provide further evidence of private equity investors alleviating constraints in portfolio companies, we perform two more tests to explore firm-level heterogeneity by dividing firms based on their size and age. Companies that are smaller and younger and therefore more likely to be financially constrained, exhibit considerably higher post-transaction growth in exporting activity relative to larger and older firms. Availability of outside capital through private equity investment plays an important role when markets face higher trade costs and exporters require more external financing to meet these costs.

PE buyouts and productivity improvements

There is a clear scholarly consensus about the positive impact of private equity investment on target firms' productivity. Buyouts are less productive than comparable firms before the transaction, but thereafter experience a significant increase in productivity. Changes in productivity begin at the time of the PE buyout and may last for up to five years after the PE investor exits (Lerner et al., 2019; Biesinger et al., 2020). At the same time, less productive firms would be unable to obtain sufficient external funding and would be forced to export lower quantities to reduce their trade costs (Manova, 2013; Feenstra et al., 2014). We posit that the differences in the ex-ante productivity level of firms might affect disproportionately the likelihood of exporting and the export intensity.

Productivity improvements brought about by PE investors could result from better firm governance and reductions in moral hazard, as well as from operational improvements. To assess whether different levels of firm productivity drive the relationship between private equity ownership and exporting, we categorize firms into high/low productivity in the pre deal period. PE investors add value to the low-productivity targeted companies by increasing their productivity level post-buyout and their likelihood to engage in exporting. The extensive margin of exporting, and to a lesser extent the intensive margin, adjusts disproportionately more for less productive target firms, compared to high-productivity targets.

Conclusion

Our results from a panel of 917 private equity-backed firms and 4,076 control firms from 2004 to 2017, show that private equity investors are able to relax financial constraints, making their portfolio companies subject to fewer distortions and hence improving their exporting infrastructure. This effect holds for both the intensive and the extensive margin of export. The availability of outside capital through private equity investment plays an important role when markets face higher trade costs and exporters require more external finance to meet these costs. We show that productivity is also an empirically important driver of exporting in the context of private equity ownership. Exporting provides many benefits to firms, including higher survival amid economic crises. By helping their portfolio companies to increase their exports, private equity firms protect them from crises. This boon is particularly important now that the Covid-19 pandemic has badly hit the corporate sector. From an economic policy point of view, understanding exporting is important, as growth of firms, and engagement in international markets are important aspects of industry dynamics and employment growth, forming the competitive landscape in an economy.

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