Private Equity & Hedge Fund Investing

ECON GU4911

Meeting time: T 10.10 - 12.00
Meeting place: IAB 1027

Office address: IAB 1002A
Office hours: Th 11.30 - 12.30 and other times by appointment

Course Overview
This seminar course discusses the economics of professional asset management with special focus on private equity and hedge fund investing. The aim of this seminar is to provide the students with the analytic skills and conceptual frameworks necessary to significantly deepen their understanding of asset management. This course will examine some of the central issues about the structuring and organization of these so-called alternative investment vehicles as well as the main investment strategies of their asset managers. Four facets of the subject will be emphasized.

(i) Investment funds: The first section examines how private equity funds and hedge funds as the two most prominent alternative investment vehicles are raised and structured. These funds often have complex features, and the legal issues involved are frequently somewhat arcane. It is important to understand these issues, whether one intends to work for, receive money from, or invest in or alongside these investment funds. We will seek to analyze and understand the features of these funds and the roles of the various actors in the fundraising process. A good portion of the section will use agency and contract theory to examine the contractual terms in a limited partnership agreement. We will discuss how contract design and reputation (e.g. the mix of formal and implicit contracting techniques which characterize private equity and hedge fund structures and transactions) can mitigate potential incentive problems and conflicts of interests between the general partner and limited partner in the light of asymmetric information. In addition, we will discuss the main structural differences between a private equity fund and a hedge fund.
(ii) **Private equity deal making:** The second section of the course considers the interactions between private equity managers and the entrepreneurs or portfolio companies that they finance. These interactions are at the core of what private equity managers do. We will approach these interactions using analytical frameworks (such as valuation and option pricing methodologies) that highlight the particular challenges that investments in portfolio firms pose to private equity investors. We will highlight the mechanisms that these investors have developed to address the challenges of due diligence and financing strategies. We will also discuss typical investment terms found in the web of arrangements between private investors, entrepreneurs, management teams, lenders and co-investors. The subject of corporate governance will be examined, whether in the context of a venture-backed start-up company or a leveraged buyout, as well as the dynamics of negotiation between management and the private equity investor in the post-financing phase.

(iii) **Hedge fund investment styles:** The third section discusses how hedge fund managers make investment or trading decisions. Hedge funds aim to deliver positive returns under all market conditions. We will discuss different types of investments strategies that are commonly employed to achieve the return objective such as long short equity, event driven, fixed income arbitrage or global macro. The focus will be on statistical arbitrage and distressed investments.

(iv) **Evolution and performance:** In the last section, we will look at the subject of private equity and hedge funds as distinct asset classes. How do the characteristics of these investments influence the asset allocation decision made by institutional investors? What are the trends behind the growth of the pool of capital available for this category of alternative investments? The objective of private equity and hedge funds is to deliver absolute returns. We discuss whether these investment vehicles outperform their relevant benchmarks given the high fee structure in this industry.

In sum, the aspiration is to have the course represent a pedagogical approach which is multidisciplinary (drawing upon the fields of finance, economics, law, organizations and strategy), transactional and practical, i.e. how deals are done and how capital and ideas come together in this arena.

**Course Requirements**

The main course requirements are participation in class discussions, a written seminar paper and a class presentation. Grades will be allocated according to the following weights: midterm topic proposal of three pages that outlines the paper topic (20%), the final written paper consisting of 12-15 pages (50%), and class presentation of the project plus class participation (30%).
Students are required to submit a one page proposal due week 5 which should address the following three questions. (1) What do you want to do? (2) Why do you think the topic is interesting? (3) How do you plan to approach it? Students have full flexibility and are free to pick any topic they are interested in as long as it is related to the course materials. More information about suggested topics will be provided in class.

Term papers will be evaluated on the basis of the quality of the economic analysis provided in the paper. Class presentation will be evaluated primarily on the basis of clarity of arguments.

**Reading Assignments**
Students are expected to read the assigned readings before the respective class meeting. In addition, there will be a long list of optional readings on each of the topics. The lectures and discussions in the classroom will be much more meaningful if the required readings have been studied in advance.

**Class Participation**
Active class participation is very important for this course. Because so much of the learning in this course occurs in the classroom, it is important that you attend every class. All students are expected to participate in class discussions.

**Course Schedule**

**Session 1**  
Course introduction

**Sessions 2 - 4**  
Investment funds

**Sessions 5 - 9**  
Private equity deal making  
Hedge fund investment styles

**Sessions 10**  
Evolution and performance of private equity and hedge funds as asset classes

**Sessions 11 - 14**  
Students’ presentations