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On the Risk Control of the Exit Mechanism of Private Equity Investment

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Abstract: With the development and expansion of China's private equity investment market, the risk control problem of the exit mechanism has attracted more and more attention. In private equity investment, the exit mechanism is the key link for investors to realize their investment and obtain returns. However, the implementation of the exit mechanism has certain risks, including market risk, manipulation risk, operational risk, regulatory risk, etc. Based on this, this paper will discuss the risk control of the exit mechanism of private equity investment, in order to provide reference and guidance for relevant investors.

Keywords: Private Equity Investment; Exit Mechanism; Risk Control

Introduction

Private equity investment refers to a form of investment in non-listed companies made by professional investment institutions or individuals. Private equity investment has the characteristics of large leverage effect, high risk and high return, and has gradually become an important part of China's capital market. However, because the investment objects of private equity investment are mostly unlisted companies, and the market transaction liquidity is poor, its exit mechanism faces a series of risks. How to effectively conduct risk control has become an urgent problem to be solved in the private equity investment community.

1. The risk of the exit mechanism of private equity investment

1.1 Market risk

Market risk is one of the main risks facing the exit mechanism of private equity investment. Market risk refers to the fluctuation of the market price that may affect the exit return of the investors. In the exit stage, the market environment may undergo adverse changes, such as the deterioration of macroeconomic environment, industry competition, customer demand changes, investment threshold changes, etc., resulting in investors' unable to exit at the expected price or time. If market prices fall, investors may not be able to sell their shares as expected and may risk losses.

1.2 Manipulating risk

Handling risk is also one of the risks that the exit mechanism of private equity investment needs to pay close attention to. Manipulation risk mainly refers to that investors may use their own advantage to manipulate in the exit process, in order to obtain higher exit returns. For example, investors may obtain illegitimate benefits by providing false information to the market, manipulating financial data, or using inside information.

1.3 Operational risk

Operational risk is also an important risk that private equity investment needs to pay attention to in the exit mechanism. Operational risk mainly refers to the risks of corporate governance, financial management, human resources and other aspects that the investment company may face in the exit process. The company's operational risks are mainly manifested in: business model risk, operation and management risk, financial risk, supply chain risk, legal compliance risk, etc., which may have a negative impact on the company's profitability, financial position, competitive advantage and the exit mechanism of investors[1]。

1.4 Regulatory risk

Regulatory risk mainly refers to the risks of laws, regulations and policy changes that investment companies may face. Because private equity investment is a non-public investment behavior, and the regulators have relatively weak supervision, investors may face relatively high risks. Changes in regulatory policies, approval and registration requirements, investment restrictions and prohibitions, risk assessment and regulatory requirements, and restrictions on exit mechanism are all the main aspects affecting regulatory risks.

2. Risk control countermeasures of the exit mechanism of private equity investment

2.1 We will improve the risk management and control system

It is of great significance to improve the risk control system of the exit mechanism of private equity investment to improve the risk management ability of investors and the effectiveness of the exit mechanism. First, a risk management organization should be established. Private equity investment institutions should set up a special risk management department responsible for monitoring, evaluating and managing investment risks. The department shall be composed of professional risk management personnel with rich experience in investment and risk management. Secondly, private equity investment institutions should formulate scientific and reasonable risk assessment methods, including the comprehensive evaluation of the financial, commercial, market, legal and other aspects of the project, and can use cash flow analysis, market research, due diligence and other methods to assess risks[2]. Thirdly, according to the different types of risks, formulate the corresponding risk management strategies. For example, diversified investment and hedging strategies can be adopted for market risks, and a reasonable exit plan can be established for liquidity risks. Finally, private equity investment institutions should strengthen the supervision and management of investment projects, and enterprises to establish a good communication mechanism, timely grasp the operation of the project, find and solve potential problems, reduce risk, and regularly review and summarize the risk of investment projects, identify the shortage of risk management, timely adjustment and improvement. Private equity investment institutions should, according to their own conditions and combine their investment strategies and market environment, formulate appropriate risk management measures and methods, so as to improve the ability and level of risk management.

2.2 Risk assessment

Risk assessment is an important work in the exit mechanism of private equity investment, whose main purpose is to identify and evaluate all kinds of risk factors faced by investment projects. First, the market risk assessment. Assess the market environment of the project, including the market size, development trend, market competition and other factors, and judge whether the project can obtain a competitive advantage in the market through the analysis of the market supply and demand relationship, competition pattern and other aspects. Secondly, business risk assessment. Assess the operating status and operating risks of the project, including the financial health status of the enterprise, management team ability, marketing strategy and other factors, and evaluate the profitability and anti-risk ability of the enterprise by analyzing the profitability, cost structure, cash flow and other indicators of the enterprise[3]. Third, the legal and policy risk assessment. Assess the legal and compliance risks exposed to the project, including contract risks, intellectual property risks, dispute resolution risks, etc. By working with legal professionals to evaluate the legal compliance of the project to ensure that the project operates within the legal framework. At the same time, to evaluate the impact of the macro policy environment of the project on the project, including industry policies, tax policies, regulatory policies, etc. By understanding the policy direction and policy risks, evaluate the sustainability of the project and the impact of the policy risk on the project exit. Finally, the feasibility analysis. Assessment the technical feasibility, market feasibility, financial feasibility, etc., according to the business model and core competitive advantage, a comprehensive analysis and evaluation of the feasibility of the project, through the above risk assessment work, private equity investment institutions can conduct a comprehensive assessment of the risk of investment projects, provide the basis for exit decision, in order to reduce the investment risk and protect the interests of investors.

2.3 We will strengthen regulatory compliance

Strengthening regulatory compliance is an important aspect of the exit mechanism of private equity investment, which is helpful to protect the legitimate rights and interests of investors and reduce illegal operations and risks. First, abide by the laws and regulations. Private equity investment institutions shall actively abide by relevant laws, regulations, rules and policies to ensure the legality and compliance of investment activities. Secondly, establish and improve the internal compliance system. The institution shall formulate an internal compliance system, clarify the investment process and internal control measures, standardize personnel behavior, and ensure operational compliance and risk control. Thirdly, strengthen the internal risk management and control. The institution shall establish a risk management and control system, including risk management policies, risk control indicators, internal audit, etc., to monitor and control the risks in investment activities. Finally, strengthen information disclosure and transparency. Private equity investment institutions should actively fulfill the responsibility of information disclosure, timely provide investors and regulatory agencies with true, accurate and complete information, maintain transparency, prevent the risk of information asymmetry and manipulation, so as to ensure the compliance of investment behavior and controllable risks, and provide investors with a more secure and stable investment environment.

2.4 Develop a reasonable exit strategy

Developing a reasonable exit strategy is an important part of private equity investment. The following are several common exit strategies: First, IPO listing: bring the invested enterprises into the open market, issue shares, and listing on the stock exchange. Investors can exit by selling part or all of the shares. Second, equity transfer: to transfer the equity held to other investors or enterprises, and to realize the exit by selling the equity, you can choose to transfer the equity to strategic investors, private equity funds or other investment institutions. Third, merger and acquisition transaction: the invested enterprise merges or buys with other enterprises, and transfers the equity to the acquired enterprise or the newly established merged enterprise, from which the exit income is obtained. Fourth, dividend return: after the invested enterprise makes profits, it obtains exit income by paying dividends or repurchase part of the equity. Fifth, secondary market transactions: find a buyer in the secondary market, sell the equity, to realize the exit.

In formulating the exit strategy, the following factors need to be considered comprehensively: First, the investment period: according to the investment period of the investor, choose the exit strategy in line with the development of the project to ensure that the exit can be realized at an appropriate time. Second, the market environment: according to the different market environment, choose the most suitable exit way. If the market is booming, you can choose to exit through IPO listing or mergers and acquisitions. Third, corporate value: to ensure that when choosing the exit method, a reasonable valuation can be achieved and that the investors can get the desired return. Fourth, investor needs: consider the needs of investors, and choose the exit strategy in line with their investment preferences and risk tolerance. Fifth, risk and return: comprehensively considering the risk and expected return of the investment project, choose the most suitable exit strategy to realize the balance between risk and return.

3. Epilogue

In short, the risk control of the exit mechanism of private equity investment is crucial for investors. Investors should fully understand the risks of different exit mechanisms and choose appropriate exit mechanisms; avoid investment risks, maximize investment returns and promote the healthy development of private equity investment market by improving the risk control system, risk assessment, strengthening regulatory compliance and formulating reasonable exit strategies.

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