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A PRIMER

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Private Equity Funds and Hedge Funds:

A Primer

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1 Background of this paper

Private equity funds and hedge funds are both alternative asset classes that are continuously growing in importance. Although they have different focuses, they share some characteristics. First of all, both have or allegedly have a significant impact on the economy as well as the financial system they operate in. Therefore, the question of a potential regulation of both asset classes arises. Due to the lack of sophisticated knowledge about the differences of these asset classes, market players fear that attempts to regulate hedge funds will adversely affect private equity funds. Besides the regulatory issue, there are several other links between these two asset classes that have to be looked at. The relationship between those two asset classes is therefore of general importance.

Last months' developments in the hedge fund industry (e.g. rumors about turbulences as well as hedge funds forcing the dismissal of the CEO of Deutsche Börse AG) have now even led to a broad public debate about private equity and hedge funds. At least in Germany the debate has been partly fueled by the fact that both types of funds are highly funded by institutional investors from abroad. Due to this, the debate widened and included criticism on "Anglo-Saxon style" capitalism as well. In the light of the last German elections, hedge funds and private equity funds have even been compared to locusts, notorious for exhausting companies. However, the distinction between hedge funds and private equity funds remains very vague in this discussion, so that deep mistrust is spread among the public opinion against these new, mostly unknown and misunderstood types of investors.

For this reason it is important to:

- discuss the arguments for or against regulation,
- look at the major links between the two asset classes,
- look at the major differences that exist between the asset classes and
- conceive a set of criteria to clearly distinguish between both types of funds.

The purpose of this paper is to comment on possible solutions to the above mentioned tasks. It outlines preliminary thoughts and findings. Further, it comments on the steps that we think should be taken to further enhance perception of private equity funds as opposed to hedge funds from a public as well as a regulatory perspective.

2 Regulation of hedge funds

2.1 General aims of regulation

In general, financial regulation is based either on an inherent instability of a financial market or on a lack of investor protection leading to potential market failure. With respect to the first concern, regulators are focused on behavior that could potentially destabilize the financial system. In the case of hedge funds, there are at least two factors that call for attention:

- the considerable use of leverage and
- the use of derivatives, and, especially, short selling.

It is an open question, whether these two factors may be sufficient for causing an instability on global financial markets. However, the case of Long-Term Capital Management (LTCM) may serve as a warning of the potential danger inherent in hedge funds' activities. Due to a failed investment strategy, in September 1998 LTCM was unable to meet creditor demands. An intervention by the Federal Reserve prevented LTCM's insolvency which was feared to severely destabilize financial markets.[1] As the size of funds under control of hedge funds today is by far larger than it was by the end of the nineties, it might be an interesting issue to reconsider the impact of globally acting hedge funds on worldwide financial stability.

As far as the second issue is concerned it should be taken into account that hedge funds as well as private equity funds normally do not solicite retail investors. They are, in fact, financial intermediaries acting on behalf of sophisticated investors only. Although recently some exceptions to this rule have been experienced, the quest for regulation should not rest on investor protection issues as long as retail investors are not directly touched by these funds.

This is especially true for private equity funds, as their limited partners normally are institutional investors only. Moreover, as far as the financial stability issue is concerned it should be noted that private equity funds leverage themselves, especially in the context of buy-out transactions, but they do so to a very much lower degree than arbitrage focused hedge funds. Finally, derivatives or short sellings play no role in a private equity investment strategy. For these reasons, their potential impact to harm the stability of the financial system is by no means comparable to hedge funds.

2.2 Present SEC regulation of hedge funds

The US Securities and Exchange Commission (SEC) has already taken a first step to regulate hedge funds – which might serve as a blueprint for other countries. In Germany, in order to cite an example, a working group of the ministries of finance, justice and economy has recently proposed to follow the US example[2].

In 2005, the SEC adopted a new rule requiring advisers to certain private investment funds to register as "investment advisers" under the US Investment Advisers Act of 1940. The decision of the SEC to initially study the hedge fund industry[3] was based on the growth of the hedge fund assets paired with SEC's lack of information about their investment pools. The staff was concerned that the Commission's inability to examine hedge fund advisers would make it difficult to reveal fraud and other misconduct. Another concern was related to the manner by which hedge fund managers value hedge funds' assets. The power of discretion they have and the lack of any independent review over that activity gave rise to questions about whether some hedge funds' portfolio holdings are valued accurately.

Although this rule is directed towards hedge funds and was never intended to include private equity funds, there are concerns that it might negatively affect private equity funds and other private investment funds as well. These concerns are based on three reasons:

The major concern is the fact that both asset classes - at least in the US - rely heavily on funds from public institutions, such as state pension funds and university endowments. The SEC argues that pension fund investment would be a significant indicator of "retailization" of hedge funds[4]. The National Venture Capital Association (NVCA) therefore strongly objected the suggestion, that pension fund investment in a fund implicates the need to heighten SEC scrutiny[5].

[1] Cf. Edwards (1999), p. 2.
[2] Cf. Riedel (2005), p. 24.
[3] Cf. SEC (2003b).
[4] Cf. SEC (2004).
[5] Cf. NVCA p. 7f.

Secondly, hedge funds could pretend to be private equity funds in order to circumvent hedge fund regulation. For this reason the industry is interested in a clear distinction that cannot easily be misused.
Thirdly, even if only the hedge fund industry would be regulated, it has to be feared that the hedge fund industry would publicly demand a private equity fund regulation in order to avoid competitive disadvantages between both asset classes.

2.3 Limits to regulation

International capital flows can only be regulated on an international level. A national solution would create a serious competitive disadvantage for one country without creating any positive impact for the stability of the financial system in general. The US market serves as a proof of this shortcoming of national regulation as hedge funds moved to offshore financial centers (e.g. Bahamas, Bermuda, Cayman Islands) to circumvent compliance with the new SEC rule. The only solution to this problem could be a world-wide regulation as the International Monetary Fund has been demanding for years. For the time being it is not clear how such a regulation should be taken into place.

2.4 Self regulation

Also it should be noted that the significant trend towards fund of fund approaches within the hedge fund industry has led to relatively high levels of control on processes and risk approaches exercised by the fund of fund managers over individual funds. Whether this de facto self control is sufficient remains subject to considerable debate. Additionally, at least for private equity, it has to be mentioned that the industry associations themselves aim at establishing professional standards of conduct (e.g. reporting and governance guidelines).

3 Similarities between the two asset classes

The two asset classes share several common characteristics. Some of these exist between the two asset classes in general. Others are only valid between private equity and a certain sub-group of hedge funds. This sub-group covers hedge funds whose investment strategy is comparable to that of private equity houses, i.e. acquiring stakes in companies and influencing corporate decisions. This may be true for the whole hedge fund or parts of the allocated capital. We refer to these market players in this paper as private equity-style hedge funds.
However, a discussion about the potential convergence of private equity and hedge funds is greatly hindered by the fact that neither practice nor academia has yet come up with a systematic and broadly accepted definition of hedge funds and a classification of the various sub-groups of hedge funds.[6] The following description can therefore not build on that kind of (necessary) fundament. However, it tries to show the broad range of potential economic links.

[6] Cf. Edwards (1999), p. 4; Das et al. (2002), pp. 12f.; Getmansky (2004), p. 4.

3.1 Private equity funds and hedge funds

Both asset classes address *institutional investors* for fundraising. In their effort to increase capital allocation in alternative asset classes with a focus on absolute returns, institutional investors mainly resort to hedge funds and private equity funds, as these are not the only, but the major choice of alternative investments. For this reason, private equity funds and hedge funds compete in the fundraising process. While this applies for the general case between the two asset classes, it is especially true with regard to private equity funds and the sub-group of hedge funds that is equity-focused. As a response to this pressure, some private equity funds (such as Texas Pacific Group) team up with hedge funds to jointly compete for funds.[7]

Furthermore, some *hedge-fund-of-funds* also *invest in private equity*. UBS Global Asset Management for example is reported to launch a hedge-fund-of-funds in summer 2005 in Germany that also aims to invest in private equity[8]. In the course of the presentation of this new product it was stressed that UBS believes in a merger of the world of hedge funds and the one of non-hedge funds. Instead of the investment strategy, the difference between absolute and relative return strategies would serve as a factor to distinguish funds in the future.[9]

Apart from that, some institutions offer *hedge funds and private equity funds under one umbrella*. Examples for this are Fortress and Partners Group. These institutions may develop by means of internal growth, but they can also be created through a business combination of existing entities. In the US there have been mergers of hedge funds and private equity funds. The private equity player AEA Investors and the hedge fund manager Aetos Capital for example merged in order to create one big fund.[10]

Instead of always competing sometimes both entities work together. Hedge funds are an important buyer of the *junk bonds that private equity funds issue* in order to finance the deal. On a positive note, this means that hedge funds facilitate the private equity business. However, discussions about the stability of the hedge fund industry might therefore also endanger private equity deals.

Finally, both fund types have some structural characteristics in common. They are typically organized as *limited partnerships*. While the investors are limited partners, managers (mostly represented by an entity advising the fund vehicle) are general partners. Compensation systems are also quite similar as they are charged on a performance basis.[11] Both types of funds show similar characteristics in their relationship towards investors, as they fulfill the definition of *private funds*.[12] And they both have the problem of a low transparency of the underlying. This, however, is less of an issue for private equity investments as carry is not paid on an annually mark-to-market basis.[13]

[7] Cf. Thornton/Zegel (2005), p. 1.
[8] Cf. Narat (2005), p. 34.
[9] Cf. Narat (2005), p. 34.
[10] Cf. Rettberg (2005), p. 23.
[11] Cf. Fung/Hsieh (1999), pp. 1f.
[12] Cf. Heesen (2004), p. 71; SEC (2005).
[13] Cf. Borello/Bader (2004).

3.2 Private equity funds and private equity-style hedge funds

Private equity-style hedge funds are not a theoretical concept, but are already active market players. According to Business Week, private equity-style hedge funds completed at least 23 deals valued at about $30 billion in 2004.[14] This sub-group of hedge funds shares more similarities with private equity funds than regular hedge funds. Private equity and this sub-group of hedge funds compete against and potentially complement each other at the same time.

Firstly, they compete for *investors*. The competition between private equity funds and hedge funds in general, which we already mentioned above, takes place on the market for distinct asset classes in the orbit of alternative assets for investors. The sub-group of equity hedge funds (which is another class not exclusively, but also including private equity-style hedge fund) and private equity funds could be seen as perfect investment alternatives.[15] Equity hedge funds in this context are defined as those hedge funds that follow strategies, which have an implied correlation to equity markets (e.g. through holding long and short positions, or through merger arbitrage transactions).

Some argue that this similarity would not exclusively have disadvantages. Instead of considering investments into equity hedge funds as substitutes for private equity, the former could be used as a tool to manage the committed, but un-invested private equity capital.[16] However, calling capital that is not yet needed for investments in order to invest in equity hedge funds would considerably change the business model of private equity investments. There could be a rationale to due so, because investors could plan better. This would mean that private equity funds would move into the hedge fund arena.

Secondly, they compete for *investment opportunities*. This is not true for the whole spectrum of private equity investments but for buyouts, especially big ones. The increased competition for deals entails higher prices and thus reduces the potential returns, e.g. in the case of Texas Genco or Toys'R'Us. However, it has to be noted, that the growing similarities between the two fund types in this case are also driven by the movement of the private equity industry into public markets.

Apart from the public capital market, the competition for investment opportunities also relates to the private capital market in the form of mezzanine finance and distressed lending[17]. Hedge funds start not only to buy whole debt portfolios but increasingly also single debt positions. For instance, in the German Mittelstand hedge funds buy distressed debt and later on they restructure the company.[18] So-called vulture funds have long been active in US distressed situations. Due to this behavior the general public opinion might mistake hedge funds' behavior to be similar to the involvement of private equity companies.

However, there is an argument that hedge funds will break into the private equity field only in limited cases while the other way around seems more probable. Apart from the idea to allocate not yet invested capital in hedge funds, private equity companies might start to launch hedge funds. The installment of a hedge fund arm would give private equity funds the possibility to better capitalize their extensive due diligence – in case they reject investing private equity they could still provide financing in different ways through their hedge fund arm.[19] As reported, The Carlyle Group for example plans to launch a hedge fund of funds as an initial step followed by its own hedge fund later this year. As already mentioned above,

[14] Cf. Thornton/Zegel (2005), p. 1.
[15] Cf. Borello/Bader (2004).
[16] Cf. Borello/Bader (2004).
[17] Cf. Briefel/Mariathasan (2005), p. 22.
[18] Cf. Köhler (2005), p. 26.
[19] Cf. Davies (2005) for the following estimates.

Texas Pacific Group, Blackstone and Bain have also launched their own funds or entered into joint ventures.[20]

Further, as the gap between both business models narrows, private equity funds and private equity-style hedge funds also compete for *talent*. This is not only true for new graduates entering the job market but especially for experienced professionals of the private equity scene. The latter are especially important for hedge funds in their effort to build-up expertise which is a prerequisite for broadening their business model in the direction of private equity markets. Consequently, personnel costs can be expected to rise. Indeed it is already argued that mid-ranking private equity professionals were seeing big increases in compensation. Some recruiters even say US and European private equity partners would take pay cuts to keep staff from leaving for higher-paying hedge funds.[21]

Despite the competition between the two types of funds, the emergence of hedge funds investing private equity style brings along an advantage for both parties: *syndication of deals* is facilitated as the number of active market players increases. An example for this is the merger of US Airways and America West that is mainly driven by Texas Pacific Group. Two hedge funds will participate in the equity offering necessary to finance the merger. Another example is Horizon Natural Resources financed by a consortium of hedge funds and private equity funds.

With regard to the public opinion, the similar behavior of both types of funds influences the perception of each class. In the course of the public debate both groups are often referred to under the common label of "financial investors". In Germany both were labeled as locusts without any distinction of the business models.
As a side note, the behavior of hedge funds may also influence the perception of private equity funds as the former shares some characteristics with the notorious vulture funds. The private equity industry therefore has to differentiate itself from both groups.

4 Major differences between private equity funds and hedge funds

4.1 Differences between the two business models

The major differences between private equity funds and hedge funds are both the *time horizon of the investment* and the *investment strategy*.
Private equity funds are long-term oriented investors in portfolio companies. They are structured as closed-end-funds which bound their investors for around seven to nine years. Private equity funds mostly focus on private companies, in which they invest for several years and get involved in the management in order to foster the corporate development. However, in the case of public to private (PIPE) transactions, they acquire stakes in public companies to take them private afterwards. In order to seize control or at least have a strong influence on a portfolio company, private equity funds usually aim at owning majority stakes.

[20] Cf. Alt Assets (2005); Thornton/Zegel (2005), p. 1.
[21] Cf. Butcher (without year).

Hedge funds on the contrary are short-term investors usually allowing their investors to retrieve their money on a monthly or quarterly basis, even though in some case the redemption period might be significantly longer. For this reason, hedge funds cannot exploit mispricing that tends to be dissolved only in the long run. This might cause a specific short-term thinking in their investment strategies. From this it becomes clear why a hedge fund normally would not buy a majority stake in a company that needs to be turned around, as such a strategy normally takes several years. This is why they might prefer to bet on exerting pressure on the management of a publicly traded company with the goal to cause a short-term price reaction on the stock market. Although it is not put into question that this may cause also a long-term value increase in the company, it has to be emphasized that this approach is quite different from how a private equity fund would try to exploit a perceived underpricing of a company.

For this reason the SEC focuses on the redemption and liquidity aspect that is typical for hedge funds, in order to distinguish them from the broader range of other private funds, i.e. also private equity funds.[22] Their new rule applies to funds that permit investors to redeem or withdraw their interests within two years of purchase.

The long-term/short-term-argument is extremely powerful. It is easily understood. Apart from that, the long-term attitude of private equity companies is in striking contrast to the behavior of the so called locusts which stay by definition only for a very short time. It is striking that the time horizon has not been used more consequently in the public debate about the differing behavior of the two sorts of funds and its potential outcome.

Bearing in mind the different time horizon it becomes obvious that hedge funds can – unlike private equity funds – not set a strategic agenda in a portfolio company. On the contrary, they can only generate profits by making use of undervaluation that can be partially dissolved in a short-term. One example of this is the activism vis-à-vis Deutsche Börse to distribute retained profits to shareholders. Gaining a profit that way, however, can be seen much more skeptically by the public then a profit earned through serious operative involvement. Additionally, it should be taken into account that due to this short-term focus under some circumstances hedge funds might not be interested in betting on a perceived undervaluation, whereas private equity funds might do so. This is always the case, if it is agreed upon that undervaluation will only be recitified after a time and effort consuming change of incumbent management and strategic redirection of a company. Although it is very important for the well-being of a society that these kind of companies will be taken over, hedge funds might refrain from doing so as the pay-off of such a strategy will accrue only in the long run. Hence, private equity funds can create value where hedge funds cannot because of their short-term approach.

4.2 Limitations to this distinction

However, there are two limitations to this distinction. Firstly, there is an ongoing development in the industry concerning these criteria. The hedge fund industry is moving in two different directions[23]: one even enhancing liquidity for clients, the other demanding a longer time-horizon. A major aspect is that *hedge funds* have good strategic reasons to *reconsider their short-term-orientation*. More restrictive redemption and liquidation rights allow funds to increase their time horizon of their investment strategy. This prolonged investment horizon leaves enough time to hedge funds to build-up an organization including infrastructure and

[22] Cf. Collins (2004).
[23] Cf. Ferro (2005a), p. b03.

talent in order to pursue complex, illiquid, long-term investments – i.e. private equity-type investments. As an effect one might expect other hedge funds to follow the example provided by The Children's Investment Fund (TCI) that imposed a two year lock up-period on its investors. Comparably favorable funding conditions allow certain hedge funds to operate more on a long-term basis as the case of Deutsche Börse AG has shown. Some established, very successful funds have therefore convinced investors to allocate their capital for one, two and in some cases even up to five years.[24]
The number of hedge funds being able to use a similar strategy than private equity funds seems to be quite restricted according to some sources[25]. StratCom, a US research and consultancy firm, estimates that out of more than 9,000 existing hedge funds worldwide, at most twenty hedge funds are capable of challenging private equity funds in mega buy-outs[26]. Carlyle's David Rubenstein mentioned 16 hedge funds with serious capital allocated to private equity strategies, including Cerberus, Highland Capital, Och-Ziff Capital and George Soros. Other sources claim that several hedge funds are building up "side-pockets" (i.e. capital they can dispose of over a longer period than the regular 1 year funding), which could be used for private equity-style investments. As these side pockets are said to account for between 10% and 20% of the funds' value, hedge funds would dispose of a war chest big enough to seriously intervene in the private equity market – a potentially painful action for private equity funds.[27]

Secondly, apart from this change in the business model, it seems probable that some hedge funds *misuse* this exclusive focus on the length-criterion. By adjusting their investment conditions, they might be qualified as private equity funds and thus circumvent regulation.

Up to now, the time period of capital commitment that hedge funds choose is still significantly shorter than the commitment period of private equity funds. However, this criterion proves to be far too diffuse and imprecise for regulatory purposes. Even if the SEC would change the time span it uses to differentiate from two years (as it is today) to five years or more, it still would not define a clear line between hedge funds and private equity funds.

5 Distinction of funds by selected criteria

5.1 Empirical criteria of distinction identified by the SEC

As shown above, one single criterion does not seem to be sufficient to distinguish between private equity funds and hedge funds. As the SEC's release and the subsequent report indicates, a broad range of factors can be used to distinguish hedge funds. These are[28]:

[24] Cf. Ferro (2005b), p.38.
[25] Cf. Davies (2005) for the following estimates.
[26] Cf. also Briefel/Mariathasan (2005), S.22.
[27] Cf. Anonymous author (2005).
[28] Cf. SEC (2003a), pp. 3ff.; Collins (2004), p. 21.

Criterion	Hedge funds	Private equity funds
investment strategy	public markets and liquid assets	private markets, investments in operating companies and illiquid privately negotiated positions
return strategy	absolute return strategy	absolute return strategy depending on portfolio company development
trading frequency	frequent trading	holding for long-term capital gain
financial instruments used	use of public market instruments, such as securities, derivatives and short-selling	special-situation use of derivative instruments to preserve unrealized gain
use of leverage	heavy use of leverage	use of leverage
fund structure	fund structure with open periodic admissions and redemptions of investors	closed-end fund with no withdrawal or redemption except for regulatory reasons
payment modus	up-front payment of investor commitment	payment of investors' commitment as called by the manager
involvement in company management	investment positions independent of involvement in company management	close oversight or involvement with company management, regularly also supervisory board seats

5.2 Additional criteria

In addition to the criteria used by the SEC, other characteristics could be also used to distinguish between the two funds:

Criterion	Hedge funds	Private equity funds
investors[29]	institutions and individuals	nearly exclusively sophisticated institutional investors
co-investment of fund managers	managers significantly invest their own money	managers do co-invest, but mostly smaller amounts
stake in companies	minority	often majority
number of portfolio companies	potentially small, as hedge funds exploit highly selected investment opportunities and do not follow a systematic approach of screening potential investments to build up a sizable portfolio	generally high (i.e. 10 or more) in order to reduce risks for their investors (diversification)
hedging strategy	90% of hedge funds are hedged[30], as the original con-	generally not hedged

[29] Cf. Heesen (2004), p. 71.
[30] Cf. Das et al. (2002), p. 13.

	cept of hedge funds is to capitalize on market imperfections (arbitrage opportunities) while being immune against market movements	
character of portfolio companies	public companies	exclusively private companies; however, private equity funds might hold stakes during the lock-up period in former portfolio companies after they have gone public
focus, specialization	completely unrestricted	strongly restricted due to: a) contractual stipulations (investment agreement), which limit investment universe with regard to company location, industry, maximum capital allocation per portfolio company, etc.[31] b) specialization of managers with regard to industry know-how, network of partners, etc.[32]
fee structure[33]	2% management fee plus 20% of outperformance	2% management fee plus 20% of outperformance, but: hurdle rate of 8%
calculation of share of profit	calculated and earned on an annual basis mark to market on unrealized gains and losses	only on realized gains which means only in the last 2 or 3 years of a fund
payment of profit	on an annual basis	as gains have to be realized, in general only in the last 2 or 3 years of a fund

The fee structure and calculation of the profit share seems to be a potentially powerful argument in the public debate. Obviously, the private equity industry's compensation and incentive schemes focus on long-term realized gains – with emphasis on *realized* gains. Hedge funds, however, get usually short term profits – based on gains that are still unrealized, i.e. theoretically (mark-to-market) calculated. This comes back to the maxim: Hedge funds make money, private equity funds create value.

With regard to a fund's investors another argument is valid: Hedge funds investing in private equity might "fool" investors who have up-front decided to which degree they want to invest in hedge funds or private equity funds – and have attached different remuneration schemes to that too. Most hedge fund investment agreements typically give managers the flexibility to invest up to a stated limit in private equity and this limit has been increasing to a level of as much as 30% for some firms.[34] However, this is still not in the best interest of the investor.
If hedge funds end up in the private equity business, investors are as hedged in their investments as they thought they would be, because private equity investments – unlike other hedge fund investments – cannot be generally hedged. On the contrary, due to a smaller size of portfolios, investments are even more risky than they would have been in the private equity orbit. And investors "pay" for this not along the lines of private equity remuneration but on an annually, mark-to-market basis without a hurdle rate.

[31] Cf. Anonymous author (2005).
[32] Cf. Goldstein (2005), p. 4.
[33] See for fee structure, calculation and earning in detail Spangler (2005).
[34] Cf. Briefel/Mariathasan (2005), p.22.

For this reason it is in the very interest of investors themselves that either there is a clearer line between hedge fund and private equity investment or that remuneration schemes are changed. If markets are indeed converging, investors should demand the same fee structure. From their perspective, it does not make sense to invest in private equity on hedge fund terms.

5.3 Exceptions from the criteria defined above

Coming back to the differentiating criteria between hedge funds and private equity funds, it is however noteworthy to add that the description of the two funds provided above portraits the general forms. To capture general movements and recent developments of the market, it is necessary to look at these characteristics in greater detail. Some deviations have already been mentioned. To encompass all of them would call for more thorough research.
The latter would be of importance in order to define a clear line. Otherwise critics would say that the formula is based on a business model already changing. On the other hand one should bare in mind developments that one does not want to impede. Whatever distinctive criteria are chosen, these should be flexible enough to remain applicable in this dynamic environment.

Some examples of concrete deviations from the patterns described above:

Criterion	**Hedge funds**	**Private equity funds**
investment strategy	also invest in non-public companies: Investments in distressed debt of German Mittelstand companies and restructuring of the latter	also increasingly invest in public companies, aiming at taking them private as well as securitized facilities and public market portfolio hedging[35]
redemption schemes	lock up periods of one, two or up to five years	some funds permit limited redemption or withdrawal rights, but only for unforeseen or extraordinary circumstances
fee structure	"high-water mark" (hurdle rate equivalent)[36]	
stake in companies	also majority stakes (as in the case of Circuit City, BlueLinx Holdings, MeadWestvaco's etc.)[37]	
character of portfolio companies	also private companies	also public companies

[35] Cf. Collins (2004).
[36] Cf. Getmansky (2004), p. 5.
[37] Cf. Schönauer (2004), p. 18 citing Kravis; cf. Thornton/Zegel (2005), p. 3 for other majority stakes.

involvement in company management	activist	no true value adding approach but relative quick exit, e.g. criticized in the case of Serona Dental (tertiary)[38] or Celanese (IPO)[39]
financial instruments used	not restricted to any type of investment[40]	idea of “venture hedge funds”[41]

Apart from a defining line towards hedge funds a clear distinction between vulture funds and private equity funds is needed. As mentioned, vulture funds also act with a short-term perspective even shorter than hedge funds. Therefore their behavior might negatively impact the debate if they are mixed up with private equity funds in general or if they are considered to be a sub-group of private equity funds.

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[38] Cf. Köhler/Landgraf (2005), p. 25.
[39] Cf. Anastassiou (2005).
[40] Cf. Getmansky (2004), p. 4.
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