



Challenges and Opportunities for Private Equity

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All asset classes were hit hard by the global financial crisis, and private equity was no exception: investing, fundraising, and distribution volumes all dropped dramatically after 2008. There were concerns that major private equity firms might fail; that large limited partners might not be able to honour capital calls; that many of the most visible buyout deals would go bankrupt; and that governments would take steps which would significantly hamper the industry's future viability.

These concerns turned out to be, on the whole, unfounded. Six years after the global financial crisis began, private equity remains an asset class that is widely recognized for its unique capabilities and growing investor appeal.

Evolution of the Industry

The relative strength of the industry is due to a number of factors: improved general partner/limited partner alignment; the blossoming of transparency and ESG practices; the strengthening of investment and lending discipline; and greater development of value-added operational capabilities.

As the industry has evolved and become more "mainstream," rather than "alternative," and more global rather than focused on developed markets, there are several key challenges and opportunities which should be addressed if private equity is to reach its full potential.

Challenges (and Opportunities) Remain

First among these challenges is the need to improve the industry's image by de-mystifying how private equity actually works and how it adds value to society. Although measurable progress has been made in this area over the last few years, the industry's image took a hit during the recent US presidential election.

A second challenge is the need to ensure that governments and regulators around the world do not take actions that inhibit private equity firms from achieving superior returns for their investors, many of which are pension funds that represent blue collar and middle income workers.

Third among the challenges is making certain that returns for the industry's investors continue to outpace those that might be achieved in traditional asset classes and that this outperformance is clearly communicated. While, on an absolute basis, returns will likely come down from earlier peak levels, on a relative basis, returns will still almost certainly outpace those from most other asset classes. The industry needs to prepare investors for the

decline in absolute returns by delivering both better means to measure private equity returns as well as better means to compare those returns with the returns of other asset classes.

The fourth challenge is ensuring attractive returns are in fact achieved in any investment environment. The industry needs to continue to expand its post-investment, value-add capabilities; failing to do so in a time of uncertain-to-modest underlying economic growth will threaten the industry's ability to achieve the same levels of performance in the future. In the future, returns will likely be generated from operational improvements, and developing that in-house skillset will be essential for every private equity firm.

And the fifth and final challenge is the need to "democratize" the private equity investor base by developing – with the approval of regulators – investment vehicles (with appropriate safeguards) which enable smaller individual investors to access the higher return levels that up until now have only been available to institutional investors and high-net-worth individuals. Arguably, it is the smaller individual investor which most needs these higher returns, and it is the smaller individual investor which can be the industry's new source of capital as it continues to expand throughout the world.

Outlook

To be clear, addressing these five challenges will not solve all of the industry's problems, or address all of the concerns expressed by the industry's critics. However, the industry's full potential can be much more readily achieved if the need for further change is recognized and steps along the lines described here are taken.

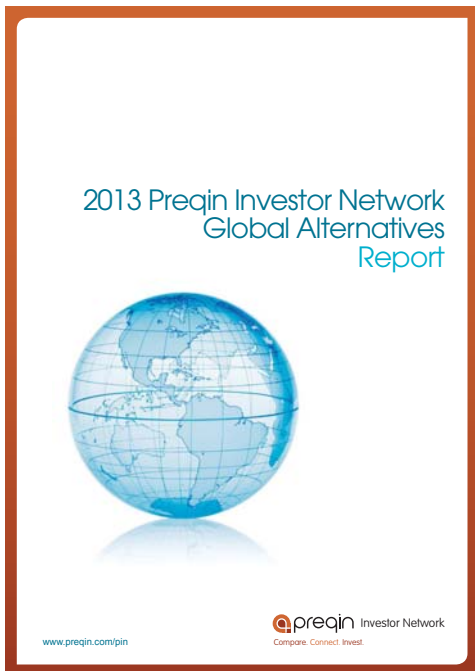
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