Private Equity Is a Force for Good

Bad press and negative public perception are masking the significant and positive impact of private equity investment

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Several years ago, I spent Thanksgiving with my Millennial niece (among other family members). As the wine flowed, the conversation turned to work, and she asked me what I found meaningful about my vocation in private equity. I responded with what I had thought for a long time, probably since I took my first undergraduate economics class, and said that I believed the one competitive advantage that market economies have over other centrally planned (and quasi-centrally planned) economies is that capital on average eventually flows to the best returning investments, which leads to higher growth and higher standards of living. And that I was proud to play a role, albeit a small one, in that process.

Okay, roll your eyes and call me Pollyannaish, but I did hedge my comments by making sure I included the words 'on average' and 'eventually.' What amazed me was the incredulous reaction from my niece. She looked at me with great surprise, and it was obvious that the opinion I had just expressed was as foreign to her as it was intrinsic to me. Part of her reaction was likely based on her frame of reference – she was a recent college graduate working for a non-profit organization – but I also think it was the result of a larger problem of public perception. Since the Global Financial Crisis, finance has become a four-letter word (and I don't mean 'bank'), and private equity probably has one of the least favorable images in the public eye, only slightly better than that of hedge funds. At least no-one is making a cheesy, self-indulgent, and overwrought streaming series about our industry…not yet anyway.

It's a shame that a few bad headlines mask the obvious good private equity does. Yes, there was much discussion of an academic study[1] published in January 2019 that private equity-led take-private transactions led to a 13% decrease in employment. Bloated payrolls were likely a contributing factor which allowed those companies to be taken private. The same report also states that private equity-backed private companies increased employment by 13%, though that part of the study failed to make headlines. Also missing from the discussion is the fact that the number of private-to-private transactions far outweigh public-to-private transactions, and thus the net effect of private equity investing would be a net increase in employment, which makes sense. The vast majority of private equity capital is invested in buyout strategies, where growing a company's top and bottom line is the focus, and higher revenues require a higher number of employees, as a general rule.

[1] *The Social Impact of Private Equity Over the Economic Cycle, Steve J. Davis, John Hawltiwanger, Kyle Handley, Ben Lipsius, Josh Lerner, and Javier Miranda*

Another piece missing from the discussion is the outperformance of private equity. Hamilton Lane's recent report, Beast in the Jungle, shows that private equity outperforms all major asset classes on a risk-adjusted basis for five-, 10-, and 15-year periods ending 30 June 2019. This is rarely mentioned as the focus is usually directed to the high fees paid by investors. That's like complaining about Mike Trout's contract without conceding he's the best player in baseball and maybe deserves that contract. I think providing higher returns to pension plans for the benefit for their employees and to endowments and foundations so they can pursue their mission is significant and something to be proud of.

Something else that is pretty cool and something to be proud of? My once incredulous niece quit the non-profit, earned a graduate degree in industrial design, and is now working in the private sector.

Happy New Year!

Capstone Partners

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