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What do we really know about private equity?

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What do we really know about private equity? Private equity has become a meaningful portion of the U.S. economy. It regularly receives attention from the media as well as regulators. In fact, the Securities & Exchange Commission recently introduced extensive new disclosure rules for private-equity funds.

The facts about private equity, however, are not well known and often are not well described in the media. They are actually largely positive. So, let me describe those facts, both at the level of the private-equity fund and the companies the private-equity funds invest in.

Let's define private equity. In most cases and here, when people talk about private equity, they are talking about buyout investments in mature or existing companies. Technically, private equity also comes in other forms: venture capital, in startups and early-stage companies; growth equity, in growing companies; real estate private equity; and infrastructure private equity.

Private-equity investors raise money from pension funds, endowments and other sources of capital that they then invest in companies. It is important to know how the investments in the funds perform and what happens to the companies the funds invest in.

Private-equity performance at the fund level, net of all fees, has been remarkably good for a long time. A good way to see this is to compare investing in the average buyout fund raised each year to investing the same funds in the S&P 500. Then follow the performance of that average fund and the S&P 500 over the fund's lifetime. It turns out that in every vintage year from 1992 to 2019 (through the end of 2022), the average buyout fund has beaten the S&P 500. That outperformance has been more than 4% per year over a long period of time.

Significant value has gone to pension funds. The performance does not appear to be explained by leverage/risk. Although there is no guarantee that record will continue, the strong performance is one of the reasons so much money and attention have flowed to private-equity funds.

Where does the strong fund performance come from? It turns out that at the company level, the evidence overwhelmingly indicates that private-equity investors make companies more efficient and productive. The most comprehensive studies of large samples of buyouts find positive results. Private-equity investors do not pillage or gut the companies in which they invest.

Winners outweigh losers

Of course, there are bad outcomes. And they often get a lot of media attention. But the winners outweigh the losers. Given the strong performance at the fund level, it would be surprising not to find this result. The private-equity investors generate this performance at the company level by providing better incentives, better governance and help in operating the companies more effectively.

Employment at bought-out companies also gets a lot of attention. There is a view that private-equity investors are not good for employees. The reality is more nuanced. Employment growth in buyouts of privately owned companies actually exceeds employment growth in other similar companies. At the same time, employment growth in buyouts of public companies does lag employment growth in other similar companies. There are no significant differences in average compensation per employee.

The bottom line, then, is that private-equity investors have been successful in delivering returns to their investors at the fund level — better than public markets — by adding value to and improving their portfolio companies.

Steve Kaplan is the Neubauer Family Distinguished Service Professor of Entrepreneurship & Finance at Chicago Booth School of Business and Kessenich E.P. Faculty Director at the Polsky Center for Entrepreneurship & Innovation at Chicago Booth.