

Private equity has been publicly berated, but its growth will only continue, according to **David Bailey MSI**

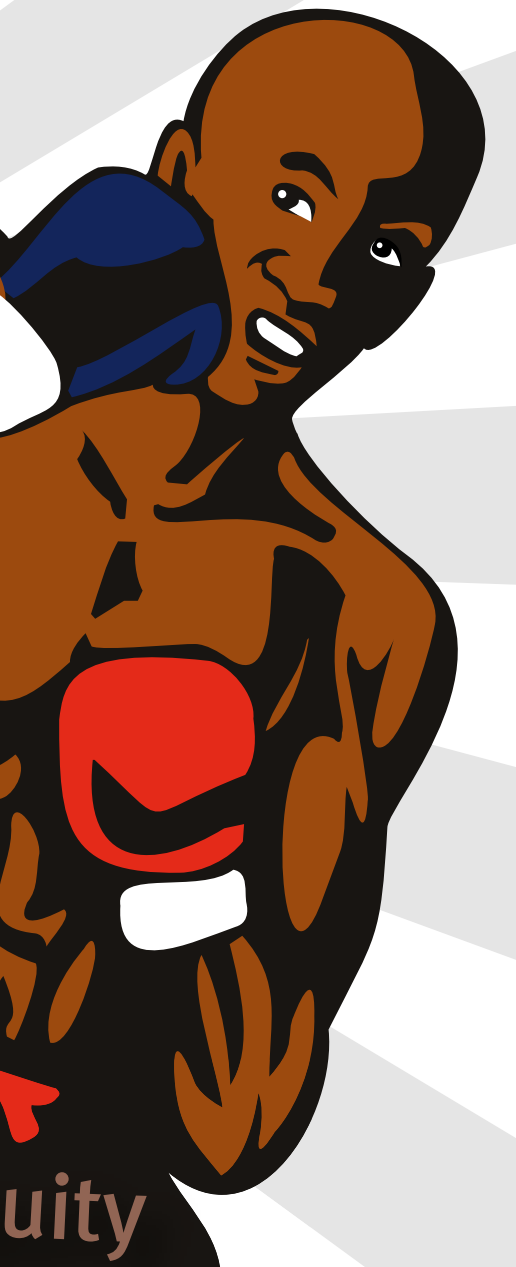
**P**rivate equity (PE) has been appearing in the press every day for the past 12 months. It has been criticised by trade unions, the media and politicians, and raised several questions, such as why has it now become so public? What effect will the fall-out in the sub-prime markets have on it? Will politicians seek to tax the managers?

PE is now a substantial and important asset class in many portfolios. Ten years ago, the PE industry raised €20bn of new money. In 2000, at the height of the tech bubble, it raised €48bn. In 2006 it raised €112bn – nearly two and a half times the previous high – and the UK was the largest market, raising €75bn (or 66.8 per cent) of the total funds in Europe, according to the 2006 European Venture Capital Association survey. Many pension funds now

allocate 3 to 5 per cent to the asset class. Why? Over the ten years to 2006, PE has returned 18.6 per cent per annum, outstripping all other asset classes, according to research from the British Venture Capital Association (BVCA). Its performance continues to attract money from both new and existing investors.

PE is no longer a small player. With banks offering leverage on top, it can only get larger. The industry has been criticised for leveraging up its deals and making money purely out of financial engineering.

However, for some time, PE has not been able to make money purely out of financial engineering. It has to be actively involved in the management of the companies that it purchases, helping them to expand into new products and markets, and creating bigger companies with higher market values. This



contributions to the dynamic and entrepreneurial business environment in which we now live – and has helped to maintain UK businesses within the global competitive markets. With more restrictive legislation, less entrepreneurial environments and, consequently, lower levels of PE activity, the economies of markets such as France and Germany have suffered. Activity levels are now increasing in these markets – and so is their economic growth.

With such contributions made to the UK economy, and its business culture as a whole, why has it been so berated in public? Firstly, it is a national pastime to criticise anything that is successful and so, with the increase in deal size, and therefore the greater publicity, it was only a matter of time before the daggers came out. Trade unions criticised the industry for creating redundancies. Sometimes, when turning a business from a low-valued ailing business into a high-valued slick and profitable operation, it is necessary to downsize.

This has not just been the strategy of the PE community – many have proceeded down this road but it was redundancies at the PE-owned AA that highlighted the issue. The same issue is being debated at BAA, and redundancies

too much and they will move. Switzerland is waiting in the wings and would love the PE industry to move from London.

### Starter for ten

The asset class will get bigger; the performance of the funds continues to ensure that. The issues being created by the US sub-prime market are reducing the leverage available to managers. Recently, PE managers have been expressing concern about the levels of leverage being offered by the banks. This is now being rectified in the market. Some of the larger buy-out funds may take a bit of a dip – they have been on a roll for the past five years – but others will emerge. Many managers have been raising money for distressed funds recently, and these are now swinging into action. It is likely there will be more growth in the secondary market – it is a small part of the market at present, probably less than 5 per cent, but with plenty of room to grow.

The PE market has come far since 2000, and it is a serious asset class in terms of size and performance. It makes considerable contributions to economic growth and is generally encouraged by politicians.

More investors are becoming involved in

“It has undoubtedly made substantial contributions to the dynamic and entrepreneurial business environment in which we now live”

enables PE investors (and the managers) to make money. Pure financial engineering is a thing of the past.

### Contribution to the UK

The UK PE industry now employs more than 2.8 million people. According to the BVCA, this represents more than 19 per cent of private sector employees with the majority of PE-backed companies being privately owned small to medium enterprises. Undeniably, the big deals get highlighted in the press, such as Boots, for example, which is now owned by a PE fund. But the majority of deals go unnoticed by the general public, who do not know that PE often creates or saves jobs, turning businesses that were in jeopardy of failing into stronger concerns.

It has undoubtedly made substantial

are starting to occur in banks following the fall-out from the sub-prime issue. But this is called effective business management, isn't it?

The growth of the UK economy over the past ten years has been substantial and PE has contributed to it. The environment created by the politicians has encouraged this growth. The fiscal and tax environment has been created to encourage economic growth, and the PE community has only made use of rules available to everyone.

All PE managers invest their own personal money in their funds – their investors expect the managers to take the same personal risks as they do – and they use the tax legislation available to minimise their liabilities. The fiscal environment created in the UK is little different to that in the US and other entrepreneurial countries. Tax the managers

the sector. PE is growing in the Middle East and Asia and there are murmurings in Africa. Germany and France are becoming active and the US continues to power ahead. It may experience more growing pains, but it can only get bigger. ■



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