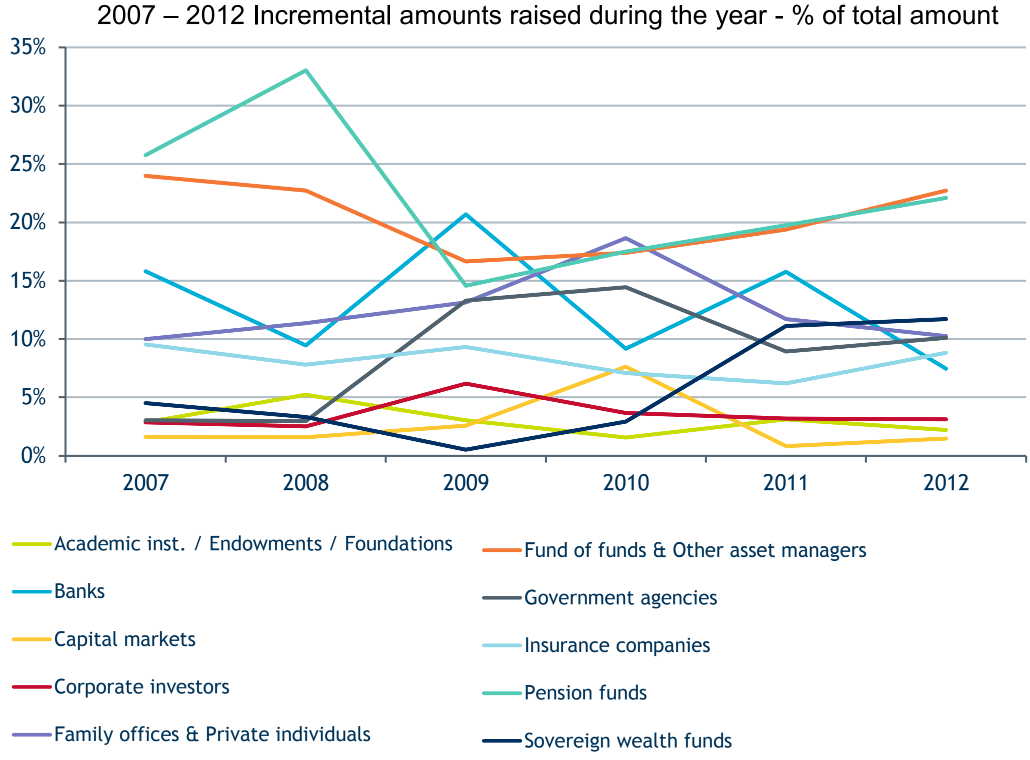
LONG-TERM INVESTMENT: THE PRIVATE EQUITY CONTRIBUTION

The robust corporate governance and value creation model that private equity (including venture capital and growth capital) investors apply to the ownership and development of unlisted companies has earned private equity a position as a well-established investment strategy. Private equity has a strong track record that investors, governments, and civil society can assess. Private equity is valued by the businesses and employees in whom it invests for the innovation, growth, renewed dynamism and sustainability that it can deliver, and by institutional investors for the contribution it can make to the delivery of long-term returns for their underlying clients, including pensioners and insurance holders.

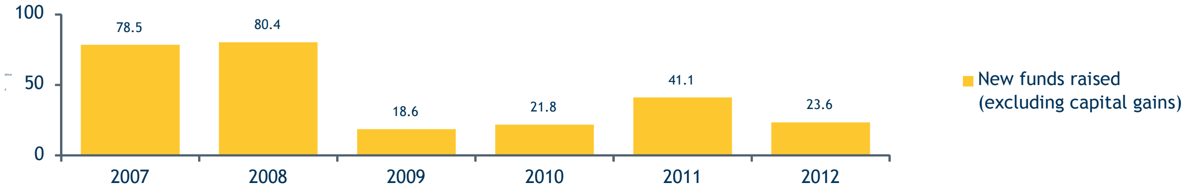
Between 2007 and 2012 European private equity funds attracted € 264 billion of commitments, with pension funds providing approximately 25%, insurers 8% and ‘funds of funds’ 15% of that amount (with pension funds in particular providing a significant portion of the amount invested by funds of funds). Overall, 35% of all funds raised were attracted from institutional investors outside of Europe.

Figure 1: Funds raised by type of investor



Source: EVCA \ PEREPAnalytics

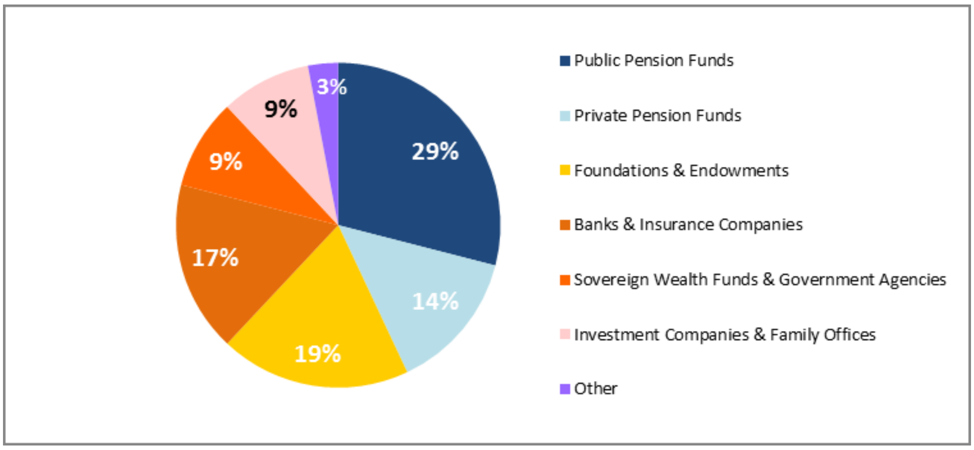
Figure 2: New funds raised



Source: EVCA \ PEREPAnalytics

Similarly, private equity investment in the United States during 2007-2012 totaled US$ 2.4 trillion over 11,152 transactions.[1] It is estimated that public and private pension plans are the source of capital for 43% of global private equity investments during 2001-2011.[2]

Figure 3: Private Equity Investors by Capital Invested, 2001-2011



Source: Preqin.

The reason for significant investment by institutional investors in this asset class is clear: private equity and venture capital can deliver strong returns, usually out-performing other asset classes on a consistent basis over the longer term. As institutional investors, operating in a low yield environment, search for the returns that are necessary to deliver on the long-term commitments they have made to *their* clients, the performance that private equity and venture capital can deliver through its ownership of unlisted companies of all sizes, industries and stages of growth becomes even more valuable.

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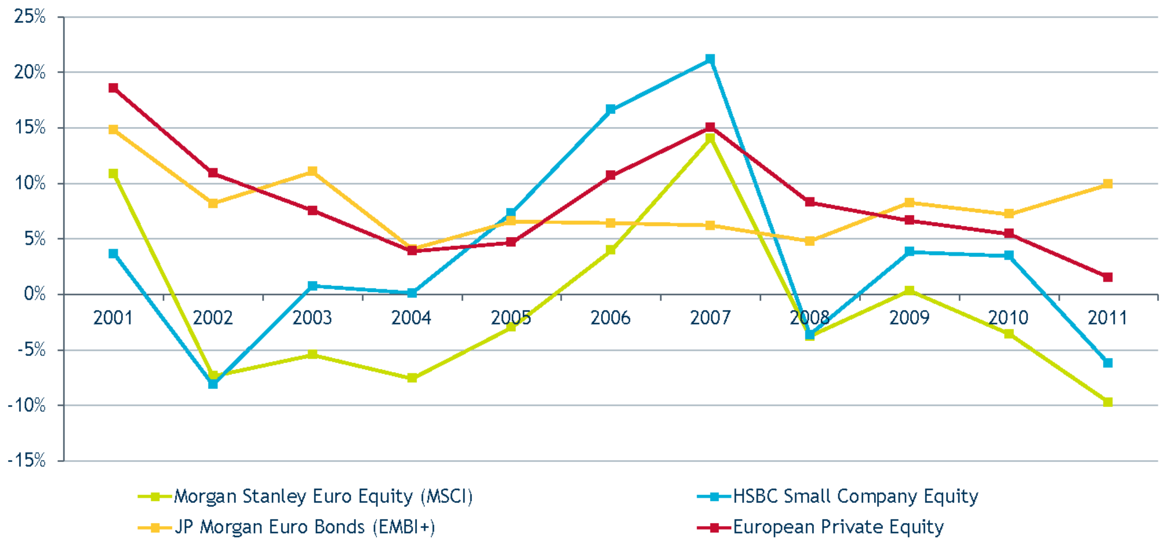
[1] Source : PitchBook.
[2] Source : Preqin.

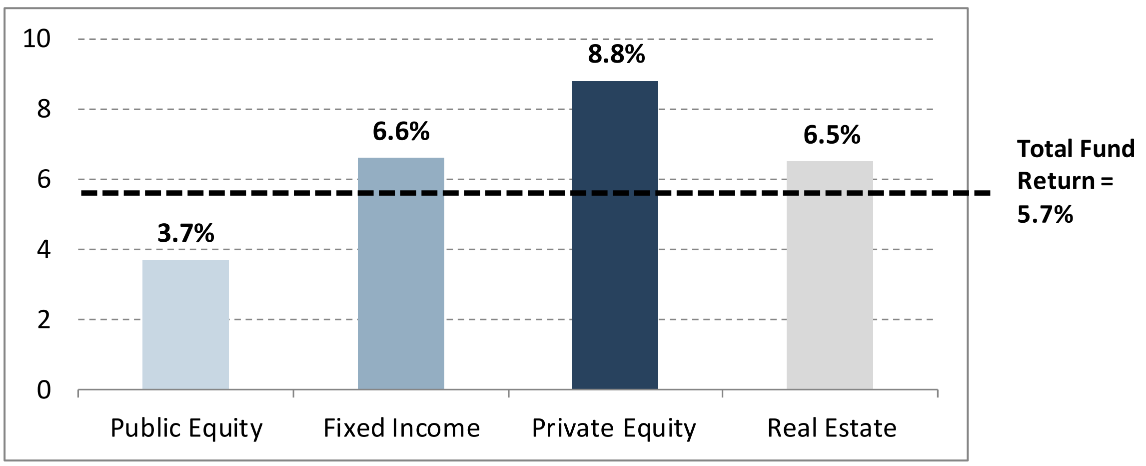
Figure 4: Evolution of comparators - five-year rolling IRRs



Source: Thomson Reuters

A study of US-based public pension plans with assets of $1 billion or more found that the median private equity portfolio returned an annualized 8.8% during 2001-2011, compared to a total fund return of only 5.7% by the median public pension fund during the same period. These results indicate that private equity investments can help to boost total fund returns and ensure retirement security.

Figure 5: Median 10-Year Annualized U.S. Public Pension Fund Returns, by Asset Class, 2011



Source: Private Equity Growth Capital Council: “Public Pension Analysis” September 2012.

These returns stem from the active and committed ownership and development practices that private equity and venture capital funds offer to the companies in which they invest over a period of years.

Between 2007 and 2012 European private equity fund managers invested some €271 billion in about 22,000 European companies of which 18,000 are still actively private equity backed. About 8 million people work for private equity backed companies in Europe.

The average private equity investment in a portfolio company lasts for around 5 years, but the key contribution that this industry makes to the long term health of the economy comes not only from the long-term nature of its investments but from its capacity to improve and sustainably develop the companies benefitting from its investment expertise and networks.

Inherent to the private equity and venture capital model of active ownership is the necessity to develop the company in which an investment has been made, so that it is a sustainable business. This makes it an attractive long-term investment proposition for the next owner and provides a firm foundation for the business to continue to thrive during the next development phase of corporate life.

There is compelling evidence for the value that this model of ownership can realise:

- ***Innovation***: Private equity investments stimulate innovation and in particular contribute to a significant increase in patent filings *(Source: Popov and Roosenboom., 2009, ECB Working Paper)*

- ***Growth***: Private equity backing of companies can be an engine of growth for SMEs. They experience greater growth in sales, assets and employment than those not backed by a private equity fund *(Source: Boucly et al 2011., Journal of Financial Economics)*

- ***Access to Finance***: Following a private equity majority investment, companies are typically able to increase their capital expenditure and become more profitable than their competitors (*Source: Boucly et al., 2011, Journal of Financial Economics)*

- ***Secure***: Private equity backed businesses are less likely to default than other companies (3% compared to 6% during the 2008-2009 recession in Europe) *(Source: Thomas., 2011,SSRN Working Paper)*

- ***Productivity:*** Private equity investments in large European companies improved the latter's productivity by 7% per year *(Source: Ernst and Young., 2012)*

- ***Operational Improvement:*** About 66% of the value created by private equity funds' investments comes from operational improvement. In particular, from sales growth, improved margins and freed up cash which then becomes available for, for example, value enhancing operational investments or debt repayments. (*Source: Kaserer C., 2011, Return Attribution in Mid-Market Buy-Out Transactions)*

- Venture capital injects economic dynamism: An increase in venture capital investments of 0.1% of GDP is statistically associated with an increase in real GDP growth of 0.30 %. Early-stage investments have an even bigger impact of 0.96 %. (*Source:* Deutsche Bank Research, 2010[3])

- Venture capital-backed companies benefit from sales growth: Venture capital has an "unequivocally positive" impact on the productivity and growth of companies, particularly when investment is received at seed stage (*Source:* VICO, 2011)

The debate on long-term investment that policymakers have initiated globally, and in which the OECD is playing a leading role, is welcomed by the private equity and venture capital industry. Government interventions - whether regulatory, supervisory or fiscal - can either help promote long-term investment, or, if poorly designed, act counter-productively. It is therefore essential that the overall impacts of such interventions are well-understood.

Certain types of project, such as large infrastructure developments, have a particular role to play in this debate, given the multi-decade time horizons for their planning, development, and delivery of revenue streams. However, across the economy - not just in infrastructure - there is a need for government policies that will promote the development of firms and sectors over the long term.

We welcome the opportunity to comment on the OECD's draft High Level Principles and encourage their adoption and pursuit by policymakers. We look forward to remaining engaged in this debate as the OECD, and in due course the G20, consider and develop it further.

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[3] http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000262487.PDF