

The Pulse of Private Equity – 11/21/2016

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Size Doesn't Matter in PE Fund Performance Over the Long Term

Despite the dueling claims that smaller PE fund managers lack sophistication or sufficient scale, or that larger fund managers lack the nimbleness and operational focus and expertise necessary to improve portfolio companies, returns across different sizes of funds are relatively uniform in the long term. 10-year horizon IRRs (which use changes in NAV in addition to industry-wide net contributions over time as the cash flow inputs in an IRR calculation) for PE funds of any size bucket are between 10% and 11%.

Global PE horizon IRR by Size Bucket



When comparing returns on a horizon basis, it's important to remember that the data are indicative of market conditions over time, and not the returns of any one vintage. For example, a lower IRR across the industry between the five and 10-year horizon is not indicative of a loss of alpha-generating capacity after the five-year mark, but rather a reflection of the stretched hold periods and asset write-offs that plagued many PE portfolios during the recession. Similarly, the three-year horizon IRR is the highest we observe, due to the fact that these investments were made before the recent run-up in valuations and have been subsequently marked as such—even though many of these returns have yet to be fully realized through an exit.

Interestingly, funds with less than \$250 million in AUM have underperformed the rest of the asset class on a one and three-year horizon. This is at least partially due to the aforementioned run-up in valuations which stemmed from cash-heavy corporate balance sheets that went looking for inorganic growth through strategic acquisition—a strategy that often doesn't reach the lower middle market (LMM) of PE. Only in the last few months have valuations started to rise in the LMM and below, as PE firms of all stripes increasingly look for value plays through add-ons and smaller portfolio companies.

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