Less pomp and circumstance

A useful industry that will probably become more useful as it becomes less grandiose.

IF PRIVATE-EQUITY outfits were once the kings of capitalism then during the credit crunch they behaved a bit like George III. Gripped by a bout of madness, they overpaid for firms at the top of the economic cycle and loaded them with too much debt. Today private-equity types are quick to admit things got out of control, just as in the buy-out booms of the late 1980s and 1990s. Most big shops, including Blackstone (see article), are keen to clean up the mess and move on. Yet it will take the industry a long time to rebuild its credibility.

Capitalism still needs private equity in its pure form. The stockmarket is not good at dealing with some firms—those that need surgery, are in the grip of bad bosses, or in industries that fund managers sniff at. Then it can make sense to have a lone, obsessive owner—particularly if it uses a dollop of debt to concentrate managers' minds and locks in its own investors so long-term decisions can be made. The mere threat of a buy-out also helps keep managers at all listed firms on their toes.

The 2005-07 boom was damaging because it was so wild. Some $1.6 trillion of buy-outs took place—not far off the total for the preceding three decades, after adjusting for inflation. There was also a shameless degree of mission creep, with buy-out firms investing in volatile industries that are allergic to debt, such as semiconductors, and taking stakes in listed firms much as any investor might. A few private-equity outfits even listed their own shares and managed to keep a straight face.

Unsurprisingly, clients are disillusioned. Measuring performance is a depressingly murky affair, but the typical endowment or pension fund saw its private-equity holdings drop by 20-30% in fiscal 2009 alone, and their illiquidity also proved a serious pain during the crisis. There has been a bounceback since then, but many investors think that a breach of trust took place. All but the best buy-out firms are struggling to raise new funds and are under pressure to cut their fees.

Buy-out bosses rightly point out that at least their firms did not pose the deadly threat to the financial system that many feared. All the same, write-downs on leveraged loans in 2007-09 were over $40 billion for big banks and played a significant, although not dominant, role in the downfalls of firms such as Citigroup and Royal Bank of Scotland. Although there have been few bankruptcies at private-equity-owned firms, there have been lots of debt restructurings; and with a massive $360 billion of borrowing to refinance by 2014 there could yet be more bad debts. New capital rules should mean that banks never again lend so generously and that they stop sponsoring the structured-credit vehicles that bought lots of buy-out debt.

Mucking in with the common people

Faced with all this, most private-equity firms are doing a decent job of getting the companies they own into better shape. There is a spate of flotations planned so that these businesses can cut their debt. How healthy the buy-out shops themselves are is less clear. Their core business, sorting out weak or unloved firms, is not enough to feed an industry that grew fat on the boom. Many firms are trying to diversify—into fund management and deal-advisory work. No doubt some will succeed but others will find, just as the sloppy companies they target often have, that it is best to stick to your core competence. The prickly inner confidence that most buy-out firms have in their DNA can seem insular when applied to other fields. Most firms have also yet to replace their ageing founders.

Private equity is still a vital industry. It can offer a more focused alternative to the public limited company (see Schumpeter). Still, like many ex-monarchs, it may have to settle for reduced circumstances.

Fonte: The Economist, Auf. 19th 2010. Disponpivel em: <www.economist.com>. Acesso em: 23 ago. 2010.