Executive Summary

In recent years private equity enjoyed the reputation to outperform public markets regularly. This is the case despite the inherent lack of market prices, transparency, or open access to transaction and performance data in private equity for a broader investor community. The paper aims at answering the implicated question of how European private equity has performed in comparison to publicly listed companies over the last 25 years and why this asset class is attracting so much attention and interest among investors. As a general approach, the paper intends to find an adequate method for a correct and fair comparison between the performances of private equity funds in Europe and a corresponding benchmark index representing the European public market, despite their different reporting schemes. The paper develops a method to compare private equity markets with public markets in Europe and assesses the performance over a 25-year time period. The comparison made by using the developed method puts special focus on the resilience of private equity funds during crises (such as the dotcom, the subprime and the pandemic). Subsequently, the thesis discusses the mechanisms supporting crisis resilience of private equities in general.

The thesis is structured in the following major parts.

The introductory part provides the reader with the necessary theoretical background and focuses on explaining the respective characteristics, historical performance and development and explains the main drivers from the investor perspective such as liquidity, return expectation, risk and time horizon.

In the analytical part of the paper a unique methodology for a fair comparison between the performances of the two asset classes is established. For this purpose, the IRR is converted to yearly returns based on predefined average durations of private equity investments. This approach makes a direct comparison between the performances of the two asset classes possible.

The data set for private equity transactions is provided by CEPRES and consists of internal rate of return (IRR) data for several industries. The MSCI Europe served as a benchmark for the public market, based upon data taken from Bloomberg. Several methods for

performance comparison were taken into consideration but could not be applied due to different characteristics of public- and private equity investments. such as timing differences between capital allocation and return, illiquidity, etc. Consequently, the IRR versus EV/EBITDA criteria was eliminated. Due to the difference in time horizons the usage of the IRR, which would have been preferred for a direct comparison between private- and public market investments appears inappropriate. Timing of the earned cash flows for private equity follows a J-curve, and return data seem upward biased, especially for venture capital and buyout funds (Phalippou, 2008).

In the core part of the paper the established methodology is applied for a comparison of the yearly returns for private equity versus those of public markets. Special attention is laid upon the resilience during the three significant crises which occurred during 1995-2020. Private equity displays solely positive averaged yearly returns throughout the entire assessed time periods (20 years, 15 years, ten years, five years), whereas the European MSCI index shows negative returns during certain periods. Remarkably so, private equity showed a better resilience than the European MSCI index during crises. A more differentiated analysis of the private equity investments, under consideration of specific industry sectors yields, however, a higher fluctuation and sectors with negative returns throughout crises.

Taking also a long-term perspective, private equity performed better than the European MSCI counterpart and had superior stability. Over the last 20 years, it was found that private equity yielded a surplus of 3.65% compared to the benchmark index. This appears logical given the fact that private equity entrains a) illiquidity and b) a risk allocation bonus. Franzoni et al. (2012) found that this illiquidity yields about 2-3% on average. The two "negatives" show downside potential, which needs to be considered.

The tendency of superior performance and resilience of private equity allocations appears amplified during the crises. Averaged performance of the private equity portfolio stayed positive even during the low points of the downturns. (1.36% during the dotcom-, 1.84% during the subprime-, and 6.11% during the pandemic crisis). Also, many of the specific industry sectors, with the exception of those directly impacted by the root causes of the crisis, performed well. As an example of negative performers during the dotcom crisis, technology displayed -6.29% p.a. and media & telecommunications -3.05% p.a. In contrast, public markets were affected more severely. The outperformance of private equity compared to public markets was higher during crises. The MSCI Europe lost -32.21% p.a. during the dotcom bubble, -45.52% p.a. during the subprime crisis, and -5.37% p.a. during the pandemic.

The resilience analysis leads to several inherent advantages leading to the superior yearly return of private equity allocation: a) the illiquidity provides better stability during downturns, b) the interests between investors and management are better aligned, c) the access to institutional investors for providing fresh capital is better. These and other specific factors enable the industry to react quickly and efficiently during downturns or to grab new business opportunities (Bernstein et al., 2019; D. Meyer (personal communication 30 November 2021)). Taking a longer-term perspective (over the five-, ten-, 15- and 20-year periods), private equity reported stable averaged returns of around 4.5% - 5.5% p.a. In comparison, the public market delivered lower and more volatile returns between 1.75% - 4.30% p.a. when considered over the same time intervals.

The last chapter of the thesis focuses on possible future developments and related portfolio strategies. The basic assumption derived from the previous analysis is that private equity will play a greater role in the overall portfolio of investors. In general, positive factors such as technology, digitization and ESG are additional driving forces, but increasing inflation and interest rates must be taken into consideration, because they might affect the asset allocation away from private equity. Stricter regulations for protecting investors' interests pose another strain on private markets.

Asset allocation for the private market requires a carefully-assembled strategy based on a good understanding of the respective business combined with sector diversification and a true replication of the investor risk profile (core/satellite investments).