1. **What is Private Equity ('simply speaking')?**

Private Equity refers to a specific form of institutional investments in privately owned companies with the objective to finance their transformation, restructuring or expansion.

The most prominent forms of private equity are venture capital (VC), i.e. equity investments in the creation and growth of innovative 'start-up' companies and leveraged buyouts (LBO), i.e. acquisitions of majority-stake equity positions in mature businesses using additional debt funding.

2. **How is Private Equity different from public equity?**

Unlike public equity, private equity participations are not traded on the stock exchange but owned by dedicated private equity funds. These hold their so-called "portfolio companies" until the investment objectives have been reached, typical over a period of 3-8 years, and then sell them to other financial or industrial buyers or list them on the stock exchange. Private equity investments are thus longer-term in nature than the typical investment on the stock market and it is not possible to 'short-sell' or 'arbitrage' with private equity. Also, private equity funds are generally subject to fewer disclosure requirements than publicly listed companies because they are closed vehicles in which the general public cannot invest (except specific funds as FCPI or FIP, that are vehicles dedicated to general public). It is also important to point out that the private equity industry is under the watch of regulators (AMF, SEC, FSA,...) and associations such as the Institutional Limited Partners Association that focus on the convergence of interest between investors and private equity managers.

3. **Why do people invest in Private Equity Funds?**

Investments in PE funds are generally restricted to large and sophisticated institutional investors, such as banks, insurances, pension funds, foundations, sovereign wealth funds and high-net-worth individuals. These investors, often called 'limited partners' are attracted to private equity funds as a possibility to further diversify their investment portfolio and by the opportunity, to earn attractive return generated by the best PE funds. The benefit of private equity also relies in the stable growth it provides to the investors versus the boom and bust of financial market.

4. **What investments do Private Equity funds make?**

Venture capital (VC) funds invest in small, young and innovative start-up companies with risky however exceptional growth potential, typically in areas such as Information Technologies, LifeSciences or Cleantec. Investments are staged in several investment rounds to gradually finance the growth of these companies. Typically, a start-up has several VC funds as shareholders, who provide not only cash, but also operational and strategic support to support its development.

Buyout funds invest in larger, mature businesses from all sectors of the economy. These acquisitions are typically structured so that additional debt (leverage) is used to finance the deal. Following the acquisition, the investing buyout fund(s) support the management of the portfolio company to increase company value based on a variety of initiatives, such as enhancing operational efficiency, improving strategic distinctiveness and a focus on optimizing cash flows.

5. **What differentiates Private Equity and Hedge Funds?**

While both Private Equity and Hedge funds are classified as 'alternative' investments, i.e. different from traditional bonds and stocks, the two have little in common. As stated above, Private Equity funds make long-term pure equity investments and seek to earn returns based on the growth or the transformation of the underlying companies, hedge-funds employ a range of investment strategies, including short-term arbitrage and short-selling, in many different underlying assets (rather than only equity). Both seek to provide attractive returns to investors and to offer diversification benefits, but they do so based on completely different approaches.

6. **How 'big' is Private Equity?**

Private Equity, which started in its current form over 30 years ago in the US, has been growing substantially in most developed and developing economies since then. However, Private Equity activity also underwent marked cycles over that period. At the peak of the last boom (early 2007), PE was responsible for roughly 25% of all M&A activity worldwide. It is estimated that PE funds currently own businesses worth over US$ 1,000B in enterprise value worldwide. The largest Private Equity Firms each own businesses totalling hundreds of billions in sales with hundreds of thousands of employees. Still, compared to the overall economic activity, PE remains in a niche position, as the total amount of PE investment in Europe 2010 (€43bn) is little over 1% of the total market cap of the London Stock Exchange alone and on average across the EU, annual Private Equity activity represents less than 1% of GDP

7. **Why do some people criticize Private Equity?**

Private equity, and in particular the buyout segment (LBO), is sometimes criticized in the public debate.These people often equate buyout investment with restructuring, layoffs and a focus on short-term gains at the expense of long-term prospects for the acquired entity. This image is partly due to the nature of buyout investments, which aim to increase company value based on an accelerated transformation process. However, the data on buyouts show that most of these transformation processes combine initial restructuring efforts with subsequent growth and expansion strategies. While sometimes one observes initially a reduction in the workforce and in the scope of activities, the typical buyout target companies will soon thereafter become more profitable and competitive and expand its activities and workforce again, often beyond original levels. At the same time, Private Equity fund managers are generally perceived as generating excessive profits and fees income for themselves, while paying minimal taxes. Several aspects of this general perception are not in line with the facts (see point 9 below), which can be explained by the general desire in Private Equity not to disclose any information about the acquired companies and investor returns. Accordingly, the press and the general public tend to observe only extreme events (bankruptcies and reports about exceptional returns earned), which then coin the general public perception.

Critics against Private Equity are also due to the fact that people often ignore the management role and involvement of Private Equity teams in true partnership with the acquired company.

8. Why do advanced economies need Private Equity?

Both segments of Private Equity (VC and LBOs) perform an important function in advanced economies. VCs provide urgently needed funding to innovative businesses with great potential for growth and job creation which are too risky for other forms of financing, such as bank debt. At the same time the specific skill set of VCs helps these businesses realize their growth ambitions and facilitate their development. Similarly, LBOs provide a governance structure that is proven to be superior to, for example, publicly listed firms, with respect to its ability to support mature businesses through restructuring processes and to deal with specific forms of business risk. Private Equity Funds are often the only investors who are willing and able to initiate the entrepreneurial revitalization of mature businesses who ceased to perform at their full potential. Here, the strong alignment of incentives between the owning Private Equity fund and company management, as well as the ability to implement transformation strategies without the need to justify these on a quarterly basis to the investor community constitute clear advantages of Private Equity. A successful buyout generates not only returns to Private Equity fund investors, but also creates more competitive businesses with a motivated and qualified workforce and management who are better able to strive and grow in an increasingly competitive international marketplace.

9. What is the social and economic impact of Private Equity?

There are substantial challenges to providing a complete account of the social and economic impact of Private Equity due to the difficulty to obtain accurate and comprehensive data on all Private Equity investments. The public debate on this point has largely focused on buyout investments and has long been characterized by extreme and sometimes ideological positions, often based on little facts or few case studies of extremely successful or unsuccessful buyouts. According to the available unbiased academic research on these questions, however, there seems to be strong evidence that, on the average, buyouts have a positive; or at least neutral impact on the competitiveness, profitability and long-term prospects of the acquired entities. Regarding the impact of Private Equity on employment, the evidence suggests that compared to similar businesses, buyout target companies undergo restructuring and transformation processes at an accelerated pace. This implies no more layoffs as such, but rather a process in which initially one observes to more/faster layoffs than for comparable companies, but also that buyout companies are more rapidly hiring new staff after the restructuring. Many Private Equity Firms have endorsed the Principles for Responsible Investment (UN PRI) and adhere to these whenever they support companies they own through such transformation processes.

10. **What is the relationship between Private Equity and the recent economic crisis?**

While the peak of the last Private Equity boom coincided with the beginning of the recent economic crisis, Private Equity activity is not directly related to either the burst of the bubble in sub-prime-mortgage based lending, which triggered the collapse of Lehman in 2008 or the most recent crisis in sovereign debt. Hence Private Equity is in no way responsible for the recent economic difficulties. Conversely, Private Equity activity (and especially the buyout segment with its reliance on debt funding) has suffered substantially from the crisis, which made it difficult if not impossible to obtain debt funding for new acquisitions and affected the prospects of the business they own. However, contrary to what some experts predicted at the beginning of the crisis, the ratio of default rates for Private Equity backed business remained (relatively) low during the crisis, which may indeed reflect the advantages of the Private Equity governance structure to guide businesses through difficult economic conditions. Considering the difficulty of many SMEs to obtain other forms of financing (eg, bank debt) since the beginning of the crisis, the role of Private Equity as a source of funding for new strategic initiatives of these businesses has become even more important and Private Equity funds continues to provide large amounts of such capital throughout the crisis.

Two factors also explain the growing place for private equity in the future. The necessity for banks to master their exposure combined with the extreme volatility of stock exchange market, gives to the private equity industry even more place and responsibility to finance companies.

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AXA Private Equity

Axa Private Equity is a diversified private equity firm with an international reach covering eight offices in Paris, Frankfurt, London, New York, Singapore, Milan, Zurich and Vienna.

For further reading, see, for example:

- EU Parliament Expertise on PE, available at http://www.peracs.de/report/doc.pdf
- Understanding Buyout Value Generation, available at : https://studies2.hec.fr/jahia/webdav/site/hec/shared/sites/buyoutresearch/acces_eleves/2003-42.pdf