Unlocking the power of private equity

With the cost of living crisis impacting more and more Australian households, an increasing number of investors and their advisers are investing in private equity.

But what is private equity and why are Australian investors drawn to these investments?

Private equity refers to equity investments in privately held companies, whereas public or listed equities are investments in companies with shares that are readily tradeable on public exchanges.

Private equity investments span from headline-grabbing privatisations of listed companies, through investments in high growth small-to-mid market enterprises, to venture capital investments designed to nurture early-stage companies.

Rarely are private equity investments passive. Most commonly, the private equity investor seeks to actively improve the underlying value of their investment.

To do this well, the private equity investor is often expert at working directly with management teams and any other owners of the business to improve its operations and other features of the business. The active nature of this work is a key differentiator between private equity investors and many investors who focus only on listed market opportunities.

Due to the expertise required, many people prefer to allocate their capital to expert private equity firms to do this work on their behalf.

Today firms such as KKR, Partners Group and Australia's Federation Asset Management offer Australian households with access to private equity opportunities that were previously only able to be accessed by their institutional clients.

They do this because of increasing demand from Australian investors for the products that they offer.

There are three key reasons why an increasing number of investors are investing with these firms:

WEALTH CREATION.

There is plenty of data over a very long period of time that demonstrates that private equity investments outperform listed equities investments.

According to the Australian Investment Council's Funding the Future 2023 report, Australia's private capital industry achieved an average return of 18% over the past ten years. This is significantly more than twice the level of return achieved by the ASX200 over that period of time (even when you take dividends into account).

At this rate, every $1 invested in an average private equity investment ten years ago is worth over $5 today. If that same $1 was invested in ASX200 stocks, it would be worth about $2.

Imagine this degree of difference being applied to your superannuation balance.

According to AustralianSuper's website, the average Australian superannuation balance for 55-59 year old men is $359,100 and for 55-59 year old women is $233,200.

Ten years ago, it is likely that many of these portfolios had little or no opportunity to invest in private equity. But if they were invested in private equity instead of listed equities – all other things being equal – their respective balances would be over $700,000 for 55-59 year old men and over $490,000 for women of the same age.

The same analysis can be done for any investment savings held outside of superannuation portfolios.

Plainly, private equity brings with it the opportunity for a greater standard of living in retirement.

LIQUIDITY.

A range of private equity firms – KKR, Partners and Federation included – now offer the ability for Australian households to enter and exit their funds on a monthly or quarterly basis, subject to a range of manageable restrictions.

Gone are the days where private equity was the realm of institutional investors who were willing to lock their money up for 5 or 10 years, or even longer.

This new-found liquidity is an exciting development for Australian investors , because it enables non-institutional

investors with the opportunity for greater wealth creation whilst preserving access to their capital in case they need it.

DIVERSIFICATION.

Even the most sceptical of investors recognises the benefits of diversification.

In its latest published results, the Future Fund – the closest thing Australia has to a sovereign wealth fund – reported that roughly two-thirds of its portfolio is invested in unlisted assets, like private equity.

Yet many Australian households maintain an allocation between 0-5% of private equity, either through their own investments, those managed by their financial adviser, or those managed by the superannuation fund.

As a result, more and more investors are sensibly thinking to themselves:

"If the propensity for wealth generation is better and liquidity is now available from private equity, why should my investment portfolio – or that of my super fund – be so heavily allocated towards listed equities and away from private equity?"

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