Contemporary Issues in Finance
Private equity

Martin Upton

I'd like to turn now to the subject of private equity. I can't open the financial press on any occasion these days without seeing the latest acquisition planned to be undertaken using private equity. And I just wondered what's driving the use of private equity within the financial markets and what do we see in the future?

Graham Honeybourne

I think we need to segregate between what is venture capital, of which there clearly is a lot less money available in Europe than there is in America, and we do need to do a lot of effort to improve the risk taking with seed capital and early development capital in Europe. But the private equity you're referring to, Martin, when you're opening the paper; a lot of the time that is development capital, LBO kind of private equity and these are very, very different areas. The LBO team are very clearly heading for that kind of credit expansion, load the enterprise up with debt and buy an asset. My personal view is that loading debt into the company is not the be all and end all; it's only part of trying to make private equity work. And private equity does need growth; it does need to grow the organization, and management can't have the constraints of the market if they're going to experience a fundamental step change.

Marcus Davidson

In a sense private equity is an example of one of those tools which had originally a legitimate use and is now, the use of it is being expanded for situations where it's no longer so appropriate. The idea of the leverage buy-out originating in the 1980s applied to mature cash cow types of industry which were throwing off lots of cash and the obvious way to deal with the cash was to hand it back to shareholders rather than let the directors use it for their own purposes – whether it was self-aggrandizement or growing the empire. The idea of leverage buy-out now is applied pretty well indiscriminately to businesses which only very loosely meet the definition of a mature cash generative cash cow. The big difference between private equity and public equity is that public equity gives you ready access to new capital through the market at a transparently priced rate of return. That avenue is no longer available to a company which is in, if you like, in private hands. That leads to one of my ideas which is that possibly one of the motivations for private equity is indeed to keep managers under control by depriving them of access at least to one ready currency for take-overs, which is the availability of publicly priced shares as a way of taking over other companies.