For the lack of a Bloomberg

Private equity remains opaque, but regulation will improve transparency. However, argues Cyril Demaria, that could result in consolidation and rising fees for investors

Commentary **Information Accessibility**

Mitt Romney's race to the Republican party endorsement for the next US presidential election has already had an impact on the opaque world of private equity. The debate is raging around social responsibility, but also on the performance and characteristics of the private equity sector. Unfortunately, the odds are that the debate will remain political, in the pejorative sense of that word – that is to say, partisan and without any conclusion. Why? Because nobody really knows what happens in private equity. In a nutshell, there is no 'Bloomberg' of private equity.

This sector lacks transparency partly because it is young: modern private equity general partners (GPs) emerged in the 1970s in the US, their European equivalents in the 1990s. Furthermore, private companies provide only scarce information.

Producing this information is expensive. It is not through lack of goodwill that a firm like Bain Capital – ex-employer of Mitt Romney – does not provide definitive answers to the employment situation in companies from its past portfolios: these companies themselves may not have documented this information.

Before investing, GPs have often to collect, structure and analyse this kind of information themselves. Most small and medium-sized businesses have no real enterprise resource planning software and their financial indicators are at best basic: having analytical accounts available is already proof of advanced management for many of these businesses.

It is no surprise, therefore, that public information about private equity, often itself a synthesis of private information, is poor. Our analysis, based on the websites of most of the industry's information providers, demonstrates this: information is scarce, non-systematic, expensive and difficult to gather (see table below).

But against this background GPs face pressure to improve their information management significantly – for at least three reasons. The first, and most pressing, is regulatory. European (Alternative Investment Fund Manager Directive, Solvency II Directive), US (Foreign Account Tax Compliance Act, Volcker Rule, Dodd-Frank Act) and international (Basel III, pension and insurance regulations) have introduced new obligations that can be summed up as follows: always faster (insurance groups request quarterly reports within 45-60 days of the quarter-end); always more comprehensive (the CalPERS vs San Jose Mercury News case kick-started this trend in 2002); and always more objective (as in AIFMD's requirement for third-party valuations of funds). Adopting a state-of-the-art IT system will be necessary to provide this level of detail.

The second reason is fundraising (and communication). The increasing number of limited partners (LPs) new to the asset class and the scarcity of information in private equity are a strong motivation permanently and persistently to document the activity of the GPs. It will support GP's longer-term fundraising activity, particularly after the 2007-09 crisis has emphasised the importance of thorough manager due diligence.

The third reason is operational risk management, which is a new risk for an asset class that is used to small teams managed as boutiques. Cases of potential conflicts of interests in these 'asset management houses' (as large private equity fund managers increasingly describe themselves) will dramatically increase as they operate in various interconnected sectors (private real estate, distressed debt, leveraged buy-outs, private investments in public entities, and so on). But insider trading has also become an increasing risk as leveraged buy-out have begun to target listed groups. This should argue in favour of advanced monitoring and reporting systems to protect GPs themselves in case of legal procedures.

The logical conclusion is that management fees, which are at the heart of the relationships between GPs and LPs, may not decrease – at least in the short term.

The requirement for big, sophisticated IT systems, for new financial and resource-sapping regulation, and the increasing difficulty of creating captive firms in banks and insurance companies, will push GPs into mergers and consolidation, and subsequently raise barriers to entry.

The balance of power will stay with existing GPs – whether good or not – and the fees will continue to be set to their advantage.

Cyril Demaria is CIO of Tiaré Investment Management, a professor at HEIG-VD, EDHEC and EADA and author of Introduction to Private Equity (Wiley 2010)

Sources and categories of information in private equity

	Paying ■ / Free ●	North America	Europe	Israel	Lat America	APAC	Africa	VC Mid East	Growth	LBO	Mezzan / Vent. Lend.	Funds of funds	Turn-around	Sec.	Index	Activity Prim. market	Sec. market
			Performance (benchmarks) of general partners														
Database providers	Thomson Reuters	■	■	■ Rest of the world				■	■	■	■					■	
	AVCJ					■		■	■	■	■	?	?	?	●	■	
	Initiative Europe		■					■	■	■	■	?	■	?	●	■	
	Preqin	■	■	?	?	■	?	■	■	■	■	■	?		●	■	■
	EurekaHedge	■	■	?	■	■	■	?	?	■	?	■	?	?			
	Pitchbook	■	■	?	?	?	?	■	■	■	■	■			●	■	
	Dow Jones	■	■	■	?	?	?	■	■	■	?	?		?	●	■	
	Capital IQ															■	■
	PEI Connect																
Associations	EVCA		●					●	●	●	●				●	●	
	IVA															●	
	LAVCA															■	
	AVCAL					Australia		●	●	●	●				●		
	EMPEA				■	■	■	■	■	■	?	?	?	?		●	
	NVCA	●						●							●	●	
Universities	CMBOR		■							■	?					●	
Intermediaries & gatekeepers	Cambridge Assoc.	●	■	?				●		●		?	?	?		?	?
	State Street														●		
	Cogent Partners																●

Sources: Websites of providers; the author

Note: The table lists the sources of information in private equity (four categories), and matches them with the type of data provided (performances by region, index of performances and activity statistics). When lines and columns cross, either the data is free ●, has to be purchased ■, or is left blank if not available. If the data provider has not provided information about the availability of the data, we have put a question mark