ALTERNATIVE INVESTING

Investor Scale and Performance in Private Equity Investments

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Using data on the private-equity (PE) investments of defined-benefit pension plans, the authors find that investors with substantial PE holdings outperform investors with smaller PE holdings. Their interpretation of the data suggests that an increase in PE holdings may increase returns by 4% to as much as 7.4% per year. They add that this result persists in the more competitive PE industry in the 2000s.

The authors seek to explain this result by appealing to economic explanations for the impact of scale on performance. They find that cost advantages for larger plans are important contributors to the superior performance, accounting for up to one-third of the performance gain. Their tests also highlight a new fact of disintermediation by large investors with substantial internal investment at substantially lower costs. They also document superior gross returns for larger investors in PE consistent with superior information or skill for large investors.

The findings show potential benefits for a range of asset owners/managers that can make substantial investments to PE, the authors assert. Besides pension plans, such investors include sovereign wealth funds and large endowments. Fund-of-funds should be also capable of benefiting from such scale advantages, but likely to a lesser degree as they are unlikely to engage in direct investing.

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