Private equity demystified
An explanatory guide
THIRD EDITION
John Gilligan and Mike Wright
Private Equity Demystified – An Explanatory Guide
An initiative from the ICAEW Corporate Finance Faculty

Private Equity Demystified provides an objective explanation of private equity, recognising that for public scrutiny of this sector to be effective it must be conducted on an informed basis. This is recognised by the work featuring on reading lists of leading business schools.

Since the publication in 2008 of the first edition of Private Equity Demystified the major economies have moved from growth to recession to evidence of emergence from recession. We have seen the enactment and subsequent implementation of the European Commission’s Alternative Investment Fund Managers Directive which covers private equity funds. In addition, the academic world has applied new techniques to old questions as new data sets have become available. Earlier editions reflected the turmoil of the recession and examined the way in which the banking market changed its approach to private equity investments as well as the dynamics of the restructuring industry.

This third edition picks up as many western economies show signs of a resurgence of growth. It examines further developments in private equity, such as its methodologies, management of funds and relationships with limited partners.

The value of the work will continue to be measured in better-informed debate, in private equity’s effective engagement with wider stakeholders, in well thought out public policies and in awareness among business owners of private equity as a potential source of sustainable finance for growth.

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Private Equity Demystified is issued under Financing Change, the thought leadership programme of the faculty. Financing Change aims to advance the economic and social contribution of corporate finance activity by promoting better understanding and practice.

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This work, which includes a summary of academic studies and references, is also available to download from icaew.com/cff.

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Preface to the third edition

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Preface to the third edition

For over two decades, from the early 1980s, the developing private equity industry largely flew below the radar of public scrutiny. In 2007 the private equity industry came under intense public scrutiny including a House of Commons Select Committee enquiry. We published the first edition of *Private Equity Demystified* in August 2008. There followed a period of unprecedented financial turmoil. The second edition built on the first edition to reflect the effects of the recession and examined the way in which the banking market changed its approach to private equity investments. It also included more discussion of both mid-market buy-outs and the dynamics of the restructuring industry. There was an update to the second edition in 2012 to reflect the developments in private equity as the recession came to an end. This third edition examines further developments in private equity, as many western economies again experience economic growth. The European Commission’s Alternative Investment Fund Managers Directive which covers private equity funds is also being implemented. A burgeoning body of academic evidence also continues to provide systematic insights as to the impact of private equity.

In this third edition we have taken the opportunity to make a thorough revision of earlier editions. Two major innovations are particularly notable.

First, as the industry has become increasingly international we have extended the coverage of the trends in private equity beyond the UK;

Second, as the economy and the industry emerge from recession, we have developed a new section revisiting the accusations laid at the feet of private equity by its critics at the height of the last boom in 2007. Drawing on the increasing evidence now available, we show that many of the criticisms of private equity were misplaced. We argue that in contrast to the forecasts of the critics, private equity has acted to contain risk, not disseminate it; has created alignment between managers and shareholders, not a misaligned bonus culture; and provides important models for corporate governance and risk management that have a wider applicability.

Nevertheless, some challenges remain regarding the relationships between private equity firms and their investors, notably regarding fees and the valuation of unrealised investments.

*John Gilligan*

*Mike Wright*

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All errors and omissions are entirely our own responsibility.

In the absence of any tangible reward we offer our sincere thanks to all of these people.
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5. CRITICS AND THE RESEARCH

Figure 5.1: Buy-out types, strategy and timescale