A once-in-a-decade fundraising market

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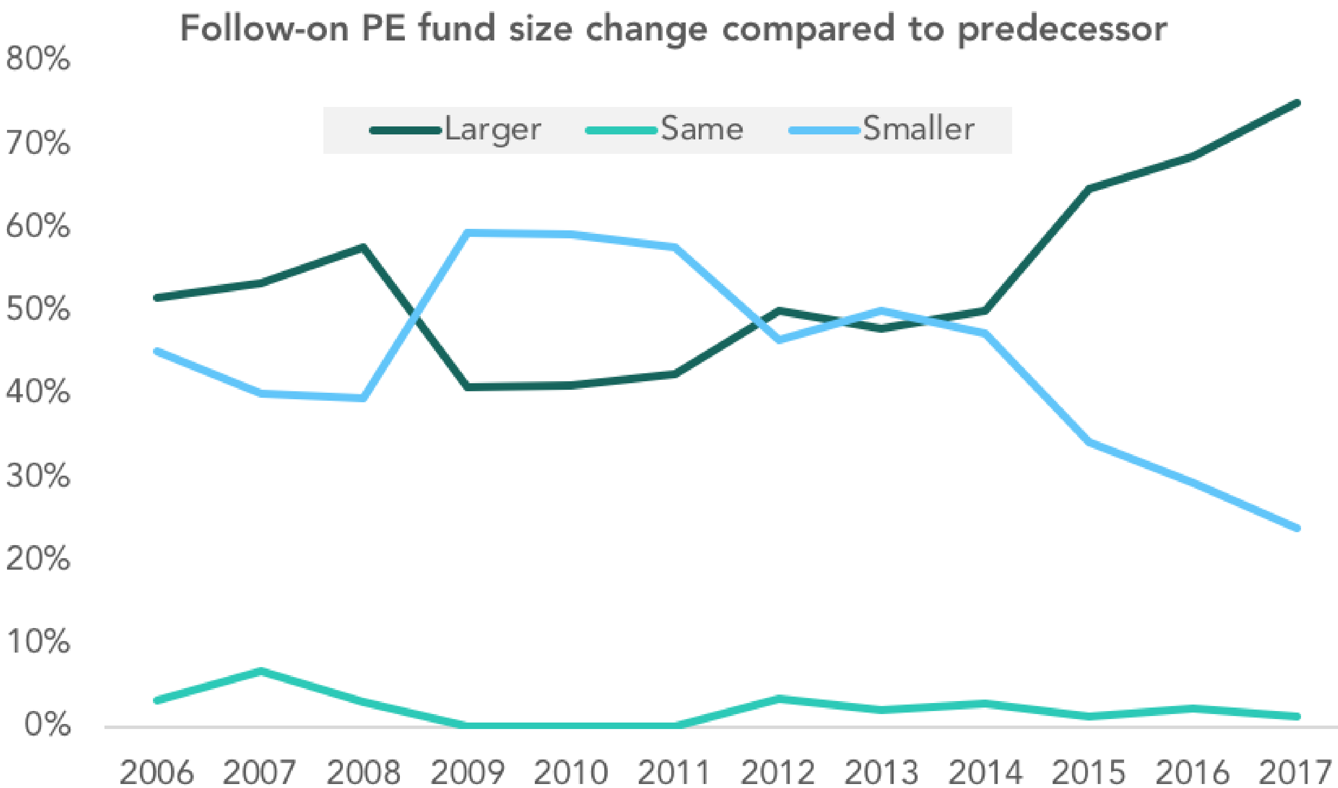

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Private equity is a scalable asset class. The same isn't true for every asset class in the private market – venture funds, for example, tend to lose effectiveness if they grow too large, regardless of sector. Not so with PE, which broadens its target range with more capital commitments. A 2012 study published by Oxford found that the largest 25% of PE funds earned IRRs of 5.17% when they backed companies in the same size quartile. When those largest funds backed the smallest quarter of companies, IRRs went negative, to -2.98%. Size matters quite a bit.

It's not surprising, then, that PE funds keep getting bigger across the board. As our just-released US PE Breakdown notes, 75% of follow-on funds that closed in 2017 were bigger than their predecessors. That datapoint has been trending north for the past three years: 69% of 2016 closings were larger than their predecessors, as were 65% of funds in 2015 and 50% in 2014. To be sure, there is an element of opportunism at play—the median time between fundraises has hovered around three years for 2015-and-later vintages, a quick pace compared to ~four-year intervals for 2010-2012 vintages. Still, there's an argument to be made that it's not just about management fees. If the Oxford study is true, larger funds work better when making larger investments. As it happened, the fundraising trail improved for large funds at the same time LPs decided to start consolidating their PE holdings, backing fewer firms with bigger commitments. If larger funds do perform better with larger deals, that might ease some LP concerns around today's quicker timeline. From PE's standpoint, however, these types of fundraising markets don't come around too often, so they scale up when they can.

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