EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR WEEKLY ECONOMIC UPDATE

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FROM BANKS TO BLACKSTONE: HOW PRIVATE EQUITY CONTINUES TO CHANGE THE BANKING SPACE

In 2007, on the eve of the global financial crisis (GFC), Hilton Worldwide announced that it was being bought by the private equity (PE) behemoth Blackstone. After the acquisition, Hilton's fortunes changed abruptly under its new owner. Almost overnight, Blackstone managed to double the amount of Hilton rooms while tripling its own return on investment. Hilton Worldwide is only one of many PE success stories. PE giants with their fortress balance sheets, established contacts, and rare know-how are unrivalled in their ability to identify opportunities. That is why it is no surprise that they are now laser-focussed on the lending gap that has been left open by struggling banks.

Investors who wanted in on the PE bonanza had to wait an eternity. PE had its origins back in 1946 and it did not take long for the corporate world to discover how lucrative PE is. By the 1980s, PE was known for its hostile practices during corporate takeovers. It was not until the 1990s that PE firms regained investors' trust. In fact, by 2007, PE regained so much trust that Blackstone, the biggest PE company in the world, managed to raise the largest sum of money in New York Stock Exchange history during their initial public offering. Endowments, family offices, institutions, and individual investors dashed to be part of the PE bonanza.

Why were investors so determined to get front-row seats to the PE experience? Superior returns prior to and during the GFC boosted PE's appeal. From 1990 to 2010, PE managed to outperform the largest 500 companies by market capitalisation in the United States (US) (S&P 500) by 6.3% annually. Even amid the GFC, in 2008, PE gained 11% while the S&P 500 lost 38% in a single year. These returns improved even further between 2010 and 2020 when PE firms delivered returns of more than 13.5% per annum. Over the same period, their assets under management increased by a staggering 170%. These stellar returns were largely because of PE firms' ability to identify opportunities during tumultuous times.

Today, the entire PE industry encompasses more than $11 trillion in assets while these firms sit on more than $3.5 trillion in cash, waiting to be spent on the 'next big thing'. That 'next big thing' might be assisting failing banks. And Blackstone is doing just that: It is already in discussions with large US regional banks about providing them with extra firepower to lend to companies amid signs that the recent banking industry turmoil is morphing into a credit crunch. This follows the collapse of US lenders Silicon Valley Bank, Signature, and First Republic Bank.

The PE phenomenon is, however, not new. PE groups have been happy to fill the gap in the need for lending for decades. Over the past few decades, they have enjoyed regulatory freedom while regulators were busy regulating banks. Commercial banks are subject to a long list of restrictions, which is leading to an ever-shrinking market of global banks, and PE firms are all too happy to fill the gap.

While PE is still a relatively new phenomenon in the world of portfolio management, investors should be mindful of its existence and its ability to be agile and to provide value during difficult times. These firms are known to emerge stronger after periods of chaos and disorder, much like the period that we are currently in.

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