BANK & TRUST INSIGHTS

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For the past two decades, a unique trend has changed the shape and size of the US equities market. Since 1996, the number of publicly listed companies in the US has decreased by more than 50%. This significant decline is unmatched in history and throughout the rest of the world. Over the same period, non-US listings have *increased* by nearly 50%.

Many explanations have been proposed for this phenomenon. One popular explanation is the increased cost of compliance brought on by more restrictive regulations. This could account for the difference between the US and other countries with fewer regulations. A more compelling explanation for the decline of public companies is the evolving private market, which can offer companies many of the benefits of being public while staying private. This phenomenon could represent a fundamental shift in the way companies raise capital.

What is the difference between public and private markets for companies?

Instead of utilizing public markets, which in the past held the benefits of a more liquid, “democratic” system, firms are moving towards private markets. In private markets, companies can reduce their compliance costs and avoid some of the short-term thinking that quarterly reports and a 24/7 news cycle can elicit. Through private capital, companies gain access to seasoned fund managers and institutional investors who don’t mind locking in capital for the long haul.

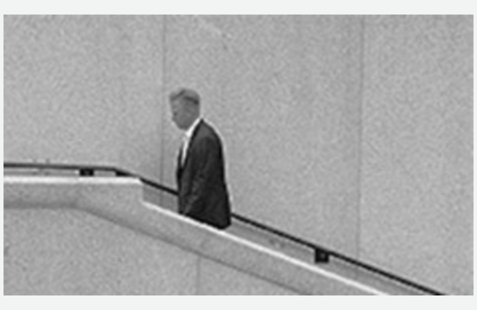
What is the difference between public and private markets for investors?

The main differences between public and private markets lie in the liquidity, returns, and risks of the investments. A key element an investor must consider is the illiquidity that accompanies private investments. Most private funds and direct investments require a minimum amount to invest and don’t allow exits for a period of several years. Often, the longevity of the investment limits participation to high-net-worth individuals.

These investments also come with a more significant downside risk, which may not be appropriate for some investors. Illiquidity and higher risk does offer the potential for higher returns. When deployed into a carefully balanced and diversified portfolio, private placement investments can lead to higher risk-adjusted returns.

What are some types of private placement investments, and what are their key features?

PRIVATE EQUITY



Private Equity covers a wide range of activities and strategies. A more common strategy involves identifying distressed or underperforming companies with opportunity for improvement and buying them. Once purchased, appropriate steps are taken to improve the company and maximize its value. After a period of several years (likely more than five), the company(ies) are liquidated and capital is returned to investors less any management fees. This leads to a very sporadic cash distribution profile. A way to avoid this is to continue to invest in new funds annually, so distributions become more regular.

MEZZANINE DEBT

Mezzanine Debt is typically unsecured debt with a lower claim to cash flow than senior debt, but higher claims than equity. Middle market companies who are either not large enough to issue bonds or have access to other capital markets are the most frequent issuers of mezzanine debt. To issue mezzanine debt, companies usually work out private deals directly with the investing party. They supply information and often grant board viewing rights to the investing party so the company can be evaluated. This process takes weeks or months to complete, so a direct mezzanine investment for an individual is impractical.

The best route for an individual investor is through a mezzanine debt fund. These funds perform all the deal making and due diligence themselves, and use the pooled resources of their investors to secure larger loans with more favorable terms. There is more risk involved with this unsecured debt, but the returns are also often higher.

DIRECT REAL ESTATE

Direct real estate follows a similar structure to mezzanine debt. Fund managers use the pooled resources of investors to invest in real estate projects. These can range from single and multi-family units to industrial and commercial properties. The payoff structure for these investments varies.

Want to learn more?

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