DISCUSSION OF "PRIVATE EQUITY: PERFORMANCE AND DISECONOMIES OF SCALE"

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Main Idea

- Use private equity industry as a setting to test theories of diseconomies of scale from the I/O literature
  - As the firm scales up, the utilization rate of knowledge increases, but
  - So do costs of communication and hierarchy costs.

- Secondary: new dataset on buyout transactions and performance

Findings

- Performance of PE investments is negatively related to number of parallel investments under management (NUM) and the $ volume of those investments (AUM)
  - Robust to controlling for specialization/focus of the firm and projects per manager
  - Mitigated in firms with higher experience, lower communications costs and flatter hierarchies
- Stylized facts on PE deal performance, persistence of returns

First-Order: Intrinsic Differences

- Are there intrinsic differences between larger and smaller PE firms?
  - Types of investments (growth, platform roll-up, traditional?)
  - Risk of investments
  - Skill/characteristics of managers
- Author attempt: betas, firm FE, manager backgrounds
  - Can this bee pushed more?

First Order: Intrinsic Differences

- Models with firm FE are perhaps the most interesting:
  - Tells us about what happens within a given firm when it scales
- Still doesn't fully address the first-order concern
  - As firms grow their size, may change the nature of their investments, people they hire

Thinking about Return

- LPs and GPs are always talking about cash on cash multiples
  - IRRs can be troublesome: assume cash can be reinvested at same rate
  - Short durations can bump up IRRs considerably
- Is this same effect present for straight cash-on-cash multiples?
- Are durations shorter in funds with lower AUM/NUM?

Investment vs. Fund

- Is looking at performance of individual investments the right way to go?
  - LPs care more about fund performance
  - 1-2 investments can drive the entire fund return
    - High return, large share of fund
- Using average IRR of individual investments doesn't really address this
  - Value-weight by capital invested

Organization Characteristics

- Table 7 compares regressions of sub groups: high X in one column, low X in the other
  - Is this the best way to identify differences?
- Why not use one model controlling for variable/group indicator of interest and interactions between it and AUM/NUM
  - Test cleanly for differences in magnitude of coefficients / effect

Quality of Marginal Investments

- Test in the paper tries to distinguish between value-added and selection channels by looking at number of investments at time of investment vs. over life of the fund
- But if I know that a fixed opportunity set leads me to take more marginal projects when I expand, this could lead me *ex-ante* to set my threshold for an "acceptable" investment lower, and thus the number of investments of the life of the fund is what will matter.
- Not sure this test can differentiate between the two channels.

Manager Backgrounds

- Some of these tests seem unrelated to the working hypothesis
  - Interesting to know whether manager backgrounds matter for performance, but
  - Unclear how it relates to issue of scale economies
    - Except as a control variable

- Seems like some of the things you are looking at could either be expanded to be a separate paper or just belong as natural control variables in the models.

Other Comments

- Is number of projects per manager the right measure for workload, or should you count all professionals in the firm?
  - VPs, principals, senior associates carry a lot of the load
- Is there a difference in the amount of leverage used in smaller vs. larger firms?
- Control for type of deal (rollup, buyout, growth)

Other Comments

- Expand on the intuition of the working hypothesis
  - Lots of literature on this in I/O
  - Paper has nice results, deserve better explanation of intuitions, so reader can understand contribution
- Is there a better database than TVE to compare to? Unclear how good their coverage is

Summation

- PE is a nice laboratory for testing the diseconomies of scale hypotheses
- Paper has interesting findings that I believe
- Additionally provides some very interesting and detailed statistics on PE deal performance

- Nice paper, recommend it.