

## COMMENTARY

### PCRI Aims to Bring Sunshine to Private Equity and Venture Capital



Harvard Business School professor **Josh Lerner** writes about the challenges the Private Capital Research Institute faces and how it is working to overcome them.

The worlds of venture capital and private equity have long been obscured in shadows. Answers to even basic questions about these investments and investors have been hard to come by. For instance, do these investment outperform public markets or not, whether on an absolute or risk-adjusted basis? Do groups that raise funds that are winners continue to outperform their peers, or instead “revert to the mean”? And what are the consequences of raising private capital for the competitiveness and employment of companies?

The answers to these and other important questions are central to the determination of whether private capital is worthwhile both from an investment performance and economic contribution standpoint. The mystery reflects two fundamental problems. First, consistent data about venture and buyout funds have been difficult to obtain. Second, the limited data that is available about the industry has been challenging in many cases for new researchers to access.

The Private Capital Research Institute, a non-profit established in 2010 with the backing of the Ewing Marion Kauffman Foundation, seeks to address these two issues in the hopes of providing fact-based context to better understand private capital.

Regarding the challenge of data, a recent comparison by **Bob Harris**, **Tim Jenkinson**, and **Steve Kaplan** of four major commercial data sources frequently used by institutional investors and private capital groups to construct benchmarks highlights the extent to which each database only gives a partial view of industry activity. Moreover, each is a carefully guarded commercial product. As a result, it is impossible to compare the strengths and limitations of each, and the ways that these features may affect the conclusions reached with them.

Then there is the slow pace of analytical progress. In the world of public equity, the databases of the Center for Research

rate of progress for the entire field.

Essentially, the vision of the Private Capital Research Institute has been to create an unimpeachable and comprehensive database of private equity transactions and funds, collected from industry players and verified for accuracy. The database will be widely available to the academic community, and would serve as the springboard for many studies that should shed more light on private capital's role in the global economy.

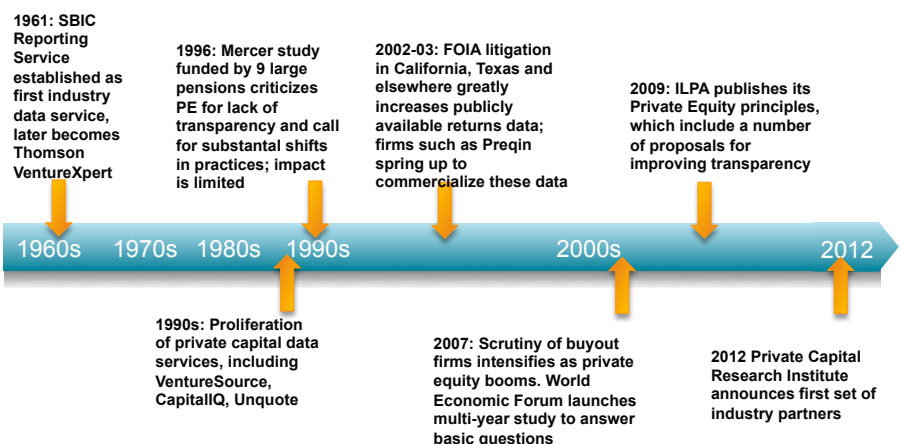
We anticipated – and our initial conversations confirmed – that the general partner community would have legitimate concerns about this effort. The security and confidentiality of the data were paramount.

Private capital is by its nature a closed-in industry, where information is tightly guarded and frequently competitively valuable. How could we ensure that the information would not leak out beyond its intended academic audience? Even if we de-identified the information, would it be possible to figure out which deal was which?

To address these concerns, we made a number of critical design decisions.

The database will be housed at the University of Chicago's National Opinion Research Center, the premiere host of highly secure databases for academic research. Academics will need to submit a project plan before they obtain data access, which they will do through dedicated, stripped-down devices that will have neither USB connections nor screen print capabilities. To ensure security, the database will not be “touched” by researchers. Rather, they will only be able to upload commands and receive output such as regressions and cross-tabulations (after the log files are reviewed to ensure

#### Milestones in Private Capital Disclosure



Source: Josh Lerner; Bloomberg

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into Security Prices at the University of Chicago have been a tremendous shared resource for the past half-century. These databases have allowed young researchers to rapidly begin work in the field, and quickly build on each other's findings. The discoveries have since deepened our understanding of how public markets work, and benefited institutional investors and public market investors alike. In private equity, because access to similar data has been hard to come by, the entry of new scholars into the field has been modest. Since invariably many of the most creative ideas originate with young scholars, this difficulty has slowed the

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that no firm- or deal-level information is revealed). The data will be blinded – without group or company name – to further ensure security.

We have made considerable progress to date on a variety of fronts. On the data-collection front, we have received agreements in principle from more than 20 general partners to provide us with their data, including firms such as **Apollo Global Management**, the **Carlyle Group**, **Clayton Dubilier & Rice**, and **KKR & Co.** The Institute received a formal endorsement from the Institutional Limited Partners Association and active support from a number of individual limited partners around the world. We have undertaken agreements with several commercial data providers, including the Emerging Markets Private Equity Association, Unquote/Incisive Media, and Thomson Reuters, for information that will complement what we gather directly from the general partners.

One natural question relates to the limitation of the scope of the Private Capital Research Institute to academic research. Isn't there a need for more general transparency in the industry? There are two answers to this query. First, the PCRI effort is very much dependent on the eager participation of the general partner and limited partner community. In an industry where confidentiality remains a major consideration, the highly limited disclosure and ample protections that the Institute offers are reassuring. Surely, a database open to many other parties, like gatekeepers and investment banks, would attract less participation. Second, high quality, independent academic research should be able to credibly answer many of the concerns that surround private capital today, whether being asked by institutional investors or policymakers.

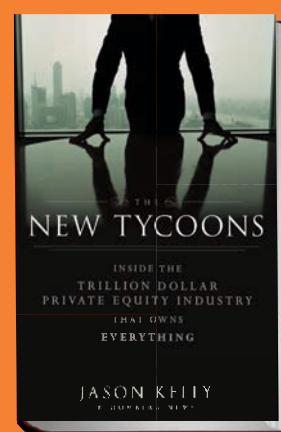
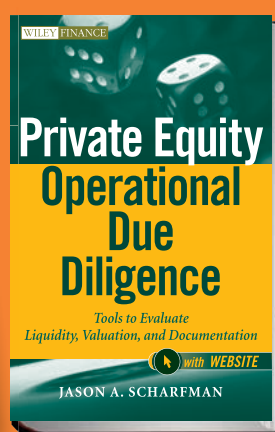
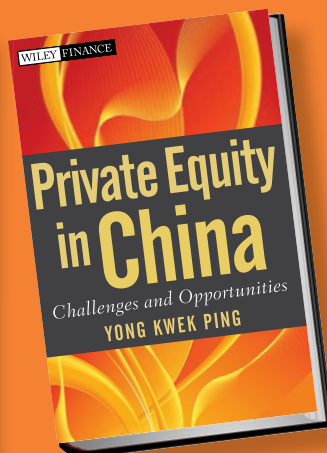
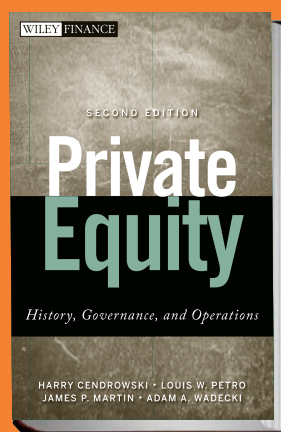
Another question is whether there will be any control over the output of the research. What if, for instance, some

findings paint the industry in an unflattering light? The answer is that for the Institute to be credible, there will need to be full academic freedom to pursue and publish research. Looking over the bulk of the research done on private capital to date, it is hard not to feel there is a compelling factual case about the economic impact of venture capital and private equity.

What are the next steps for the Institute? We are continuing to expand the pool of groups with which we work; we are reaching out to a number of national and regional private equity organizations in the hopes that they will communicate with their membership; and we are compiling the data we have gathered to date into a form usable to researchers. We are eager to expand the PCRI network of industry participants, and would be glad to talk more about what we are doing with parties interested in participating in this endeavor.

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