The Life Cycle of Private Equity

Private Equity managers aim to create value by providing investment capital to a wide range of businesses.

Private equity differs from public equity investing in several important ways. Here we explain the life cycle and key features of a private equity investment. In the three sections below, we examine private equity’s (1) structure, (2) time horizon, and (3) differentiated performance measurements, each of which are critical to understanding the life cycle of private equity funds.

I. Building a Private Equity Fund: Structure Matters

Generally when a private equity fund is launched, the General Partner (GP) assumes responsibility for managing the fund and identifying investments. Limited Partners (LPs) are investors who contribute capital, but do not necessarily have discretion over the choice of investments. Performance incentives give the GP motivation to aim for strong performance, which, if successful, benefits both the GP and LPs. The alignment of interests to a certain extent between the two parties differentiates private equity from traditional investing. In their pursuit of returns, private equity managers typically aim to provide various resources to a portfolio company and work closely with them to foster operational improvements.

Figure 1: The Structure of Private Equity Funds

The information herein is provided for educational purposes only and should not be construed as financial or investment advice, nor should any information in this document be relied on when making an investment decision. Recipients should consult their own financial advisers regarding the information herein. There can be no assurance that an allocation to alternatives would yield returns or protect capital. There may be occasions when a fund’s general partner and/or the investment advisor, and their affiliates will encounter potential conflicts of interest in connection with such fund’s activities. Past performance does not guarantee future results.
II. Staging the Time Horizon: Capital Calls, Investment Period and Harvest Period

The term of private equity funds can be upwards of 7-10 years. One way of thinking about the term is by dividing it into three stages: the fundraising period, the investment period, and the harvest period. After investors have committed capital during the fundraising cycle, the fund will begin to incrementally call this capital during the early stages of the investment period. This stage may span the first few years of the fund. Simultaneously, capital will begin to be deployed by investing in opportunities selected by the GP in the first 3-5 years. The final 3-7 years, the harvest period, is generally when most investments are realized, and the fund, if successful, returns any cash to investors.¹

![Figure 2: Illustrative Example of the Timeline of Private Equity Funds](image)

III. Analyzing Performance: The J Curve Effect

The J-Curve characterizes an investor’s potential performance experience through the life cycle of a fund. In the first few years, investors are providing capital while also paying management fees. As the fund deploys the capital, returns are not high enough to overcome fees, which results in a negative return. As time passes and if investments are successful, returns can improve. When this process is mapped out, it creates a “J” shaped curve as illustrated in Figure 3.

![Figure 3: Illustrative Example of the J-Curve](image)

¹. The amount and priority of distributions will vary depending upon the terms of the specific fund.

For informational purposes only. A fund’s offering materials provide specifics around terms and expenses. A fund’s expenses may offset or exceed its profits. This information is not meant to be predictive of the performance of any particular fund, nor are they meant to suggest that all private funds result in positive returns or may avoid loss of principal. Private equity investments involve significant risk and typically high levels of leverage. Hypothetical performance results have many inherent limitations and no representation is made that any investor will, or is likely to achieve, results similar to those shown. Each investor’s cash flows and returns will differ and may result in a total loss of principal. There can be no assurance that an allocation to alternatives would yield returns or protect capital. Past performance does not guarantee future results.
Important Disclosures

The views expressed in this commentary are the views of Private Wealth Solutions group of The Blackstone Group Inc. (together with its affiliates, "Blackstone") and do not necessarily reflect the views of Blackstone itself. All information in this commentary is believed to be reliable as of the date on which this commentary was issued, and has been obtained from public sources believed to be reliable. No representation or warranty, either express or implied, is provided in relation to the accuracy or completeness of the information contained herein.

Investment concepts mentioned in this commentary may be unsuitable for investors depending on their specific investment objectives and financial position. Tax considerations, margin requirements, commissions and other transaction costs may significantly affect the economic consequences of any transaction concepts referenced in this commentary and should be reviewed carefully with one’s investment and tax advisors.

This commentary is provided for informational and educational purposes only and does not constitute an offer to sell any securities or the solicitation of an offer to purchase any securities. This commentary discusses broad market, industry or sector trends, or other general economic, market or political conditions and should not be construed as research, legal, tax or investment advice, or any other general economic, market or political conditions and should not

The activity of identifying, completing and realizing attractive investments is highly competitive, and involves a high degree of uncertainty. There can be no assurance that a fund will achieve comparable results, implement its investment strategy, achieve its objectives or avoid substantial losses or that any expected returns will be met.

The success of a fund will depend, in large part, upon the skill and expertise of certain key professionals. In the event of the death, disability or departure of any key professionals, the business and the performance of a fund may be adversely affected.

Blackstone Securities Partners L.P. ("BSP") is a broker-dealer whose purpose is to distribute Blackstone managed or affiliated products. BSP provides services to its Blackstone affiliates, not to investors in its funds, strategies or other products. BSP does not make any recommendation regarding, and will not monitor, any investment. As such, when BSP presents an investment strategy or product to an investor, BSP does not collect the information necessary to determine—and BSP does not engage in a determination regarding—whether an investment in the strategy or product is in the best interests of, or is suitable for, the investor. You should exercise your own judgment and/or consult with a professional advisor to determine whether it is advisable for you to invest in any Blackstone strategy or product. Please note that BSP may not provide the kinds of financial services that you might expect from another financial intermediary, such as overseeing any brokerage or similar account. For financial advice relating to an investment in any Blackstone strategy or product, contact your own professional advisor.

In the United Kingdom and the European Economic Area: issued by The Blackstone Group International Partners LLP ("BGIP"), authorised and regulated by the Financial Conduct Authority (FRN: 520839) in the United Kingdom. This communication does not constitute a solicitation to buy any security or instrument, or a solicitation of interest in any Blackstone fund, account or strategy. The content of this communication should not be construed as legal, tax or investment advice.

In Europe, this material is exclusively for use by persons who are Professional Clients or Eligible Counterparties for the purposes of the European Markets in Financial Instruments Directive (Directive 2014/65/EU) and must not be distributed to retail clients or distributed onward.

Blackstone Securities Partners L.P., a subsidiary of The Blackstone Group Inc. ("Blackstone") through which Blackstone conducts its capital markets business and certain of its fund marketing and distribution, member FINRA