OPINION

The time for innovation in Private Equity has arrived

by Fabio Sattin*

*The most **qualified** international operators are **evaluating** alternatives in order to structure investment **vehicles** and **agreements** in a different, more **appropriate** and **flexible** way. Will Italy follow?*

The need for risk capital is increasingly evident, especially in Europe, due to the current shortage of bank financing and the chronic undercapitalization and lack of internationalization of many companies, in particular SMEs. Yet the investment instruments that have been adopted up to now haven't always been able to provide an effective answer to the changing needs of companies and investors. Actually, many discussions held by experts regarding Private Equity do not address the issue of the real needs and of the essence of Private Equity itself, an activity which has always been recognised to be beneficial to the economy at almost all levels. These discussions mostly tend to deal with the technical characteristics of the investment instruments, mainly closed-end funds, and the risk of misalignment of interest deriving from their operating rules. But what are the key issues? An important one regards the rigidity of the investment and divestment period. Due to its peculiar characteristics, a typical closed-end fund has a pre-defined investment and divestment period, mainly based on a 10-year prediction of market dynamics. Recent market volatility has clearly demonstrated that predictions may not always be confirmed and opportunities in terms of optimal investment or divestment periods may change significantly. Being obliged to invest during certain periods and divest in others may not maximize the interest and return of the investors. Moreover the fact that fees are normally calculated on the committed capital rather than on the invested amount, may create a significant misalignment between fund managers and investors in case of sudden market changes. In order to mitigate the divergence of interest between LP's and GPs and to reduce the risks, many fund managers have decided to reduce the amount of their funds or to extend their investment period. Nevertheless in the long run a more structural solution to those rigid operating characteristics will have to be found. The most qualified and expert international operators (Italy will be certainly following this new trend soon) are evaluating various possibilities and alternatives in order to structure investment vehicles and agreements in a different, more appropriate and flexible way. As usual, a change of standard market practices and conditions carries some risks, but I believe the need for something new is essential today in order to create the basis for the future development of the PE industry and for its long-term stability and development. Of course, flexibility and need for regulation are often conflicting concepts. And this is the real challenge that the PE industry and regulators will have to face. These new instruments and agreements should be creatively designed and put in place to allow the necessary flexibility to adapt to different situations, with particular attention to the needs of international investors, whose collaboration is vital for our country. At the same time such new instruments should necessarily be fully compliant with local rules and regulations but these should not be too onerous from a bureaucratic and an economic point of view. These solutions will not be easily found but all parties involved, GPs and LPs first, should be prepared to explore new paths and manage the inevitable uncertainties. But if all parties will act in good faith the solution we all need can be found and PE will be more than ready to face a new era of development and growth, capitalizing at best on past experiences (including learning from the errors made) and putting in place a solid foundation to release its great potential to support economic and social growth.

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