

DIRECTED RISK RESEARCH PROBLEM STATEMENT

Risk Theme	Investment/Liquidity Risk	Problem Nr.	PS16017
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PROJECT TITLE: What additional return premium should private equity earn over listed equity?

PROJECT GOAL:

To quantify (with supporting reasons and caveats) the additional return premium that private equity as an asset class should earn over listed equities in the South African market.

HIGH LEVEL DESCRIPTION OF PROBLEM:

Equity investment, in general, essentially involves taking a stake in a company by buying a certain amount of the company's outstanding shares. The financial gain comes from receiving the dividends gained over the life of the investment, as well as the appreciation of the share price at the time of sale/exit. Public equity investment and private equity investment are often listed as separate asset classes however, due to further distinguishing characteristics.

Investment in private equity (amongst other things), broadly involves buying a stake in unlisted companies, and combining this with a greater degree of involvement in the company operations during the holding period. The PE investment holding period is also often longer than that of a listed company. Investment in public/listed companies can be classified as more "passive" with respect to operational involvement during the holding period, and there is the likelihood of a much more liquid entry/exit.

The above differences point to different asset characteristics, and with that a different accompanying risk/return profile. This ultimately means that private equity should command a different risk premium relative to listed equity - and the research aims to capture that.

PROJECT OBJECTIVES:

The main objective is to try and quantify the risk premium that private equity should attract relative to public equities, together with accompanying reasons, caveats and mitigating factors. This risk premium should allow for differentiating factors such as gearing, and the research should be done in a SA specific context.

OUTPUTS REQUIRED:

- A paper in the academic financial literature
- Factors to be incorporated into the valuation guidelines regarding private equity as an investment class

STRATEGIC VALUE TO DIRECTED RISK RESEARCH:

The paper will help to quantify (with accompanying reasons) the risk premium that private equity as an asset class should earn – relative to listed equities and/or the risk free rate. This will help in areas such as the appropriate pricing private equity investments, portfolio risk management, formulating an appropriate strategic asset allocation and portfolio optimization and diversification, amongst other things.