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Private Equity Insider: "A Candid Chat with Tony James"

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Hamilton (Tony) E. James, President and Chief Operating Officer of Blackstone Group, gave a public lecture at LSE on the 23rd February as part of a programme of events for LSE's new MSc in Finance and Private Equity, organized by Dr Ulf Axelson, Abraaj Capital Reader in Finance and Private Equity, and G. Felda Hardymon, Professor of Management at Harvard Business School,.

Dr Axelson welcomed Mr James by reporting what one of the two founders of Blackstone, Stephen A. Schwarzman, once said, "the best decision I ever made, hiring Tony James!" and then went on to introduce the subject of the "fireside chat" between Prof Hardymon (Chair) and Mr James: the controversial role of private equity in the economy. Does private equity create or destroy value? Those against private equity refer to it as a "swarm of locusts" – they say that it relies on too much leverage, that it strips-off firms' assets and that it prioritizes short-term profits. Its supporters advocate that it helps society, it helps firms' governance and that it provides investors with both a risk sharing advantage – though diversification – and mitigates the free rider problem in monitoring through concentrated ownership.

The conversation opened with Mr James describing the role occupied by private equity within the Blackstone group. Though not the firm's biggest business (their hedge fund is the biggest in terms of assets under management), it is among the largest private equity partnerships in the world and its profits have been in the industry's top quartile for over 27 years. Of the main competitors, two have recently collapsed (Lehman Brother and Bear Stearns) and two have downsized (Goldman Sachs and Morgan Stanley). But what is their recipe for long-lasting success? According to Mr James, the sharing of information and intellect is the key ingredient for a successful private equity business, and the reason that Blackstone has developed different businesses with their own focuses. Other key ingredients are to learn from mistakes – though "hopefully not too many" – and "not to let the successes go to your head".

Blackstone's private equity is unique: Blackstone went public in 2007, right before the crisis hit; "Was it sheer luck and what has changed since the IPO?" Prof Hardymon asked. Surprisingly the answer was that nothing has changed: "the public market scares the heck out of me," Mr James replied; the firm went public to be globally competitive and achieved it! Their fund returns 14 per cent more than the S&P index and, he added, since profits get arbitraged away, the 14 per cent is all value creation.

Prof Hardymon went deeper into the theme of value creation, putting forward a few questions. Before the crisis, credit was cheap and private equity was showing stellar revenues. Will private equity return the success it had before the Great Recession? Mr James says yes, because the industry is less dependent upon cheap credit than its critics would have us believe. He said that low interest rates benefit not assets

buyers so much as their sellers, since they increase prices. He thus dismissed the underlying criticism that cheap credit is detrimental for economic stability because it generates excessive leverage.

Prof. Hardymon proceeded to challenge Mr James by demanding that he defend his business against a series of fiery accusations made by former Danish Prime Minister, Poul Nyrup Rasmussen. Mr James was prepared. He responded to each in turn with wit and aplomb. Mr Rasmussen has asserted that private equity is “a menace to healthy companies, to worker rights…[that] leaves the company saddled with debt and interest payments, its workers are laid off and its assets are sold.” Of his firm, Mr James answered matter-of-factly with data: Blackstone has increased employment, managed funds for half of the US pension funds, invested in start-ups that otherwise would have never been funded, and restructured many troubled firms.

Before closing, Prof. Hardymon raised a final sensitive and topical issue, asking “should any aspect of private equity be regulated?” Mr James’s answer was no surprise from an industry leader: a (slightly qualified) “no”. He suggested that since private equity firms are all independent of one another, standing alone, there is no possibility of a domino effect and thus no opportunity to regulate systemic risk. Nor should leverage restrictions be imposed, since, in free capital markets, bond buyers should themselves enforce margins—he added, “debt holders are better regulators than bureaucrats.”