Finance

Blackstone Wants to Be More Like Berkshire Hathaway

With perpetual capital vehicles, private equity firms are buying and holding, much like Warren Buffett. It's a dramatic shift from the rapid turnaround typical of the industry.

By

Anjani Trivedi

May 13, 2021, 6:30 PM EDT

Are private-equity firms taking to the Berkshire Hathaway Inc.'s buy-and-hold model? It sure looks like it.

Alternative asset managers are increasingly diversifying into what is called perpetual capital. Such vehicles are "fueling a powerful transformation in the assets we manage and the earnings we generate," Jonathan Gray, president and chief operation officer of Blackstone said on a recent results call. The Warren Buffett-style forever time horizon is a stark shift from the traditional private-equity model, where exiting investments is central to maximum profits and minimum time.

At Blackstone Group Inc., perpetual capital rose 47% to $149.1 billion in the first quarter of the year, at a faster pace than overall assets under management. At KKR & Co. Inc., it made up over 30% of the total.

Traditional private equity in its most basic sense is about buying assets to sell them at an opportune time. It's all about turnarounds: buy a company and pad it with debt. Then, fix it up, cut costs, manage governance and rejigger operations for growth, greater efficiencies and returns. Typical funds run anywhere from seven to 10 years. Investors provide capital and pay management fees, then the money is put to work and in the final years of the fund, it's harvested.

Buffet's approach is almost entirely diametrically opposed to that. The Berkshire way "induces cost minimization" without needing to impose discipline on the companies it buys, George Washington University Law School's Lawrence A. Cunningham noted in his 2015 paper on Berkshire versus KKR. He also noted, "The idea of selling a business is antithetical to the sense of permanence intended to hold Berkshire together in perpetuity."

Berkshire has long-prided itself in investing its own earnings into companies that it doesn't see the need to restructure or intervene in operations, adding little to no debt. As the firm wrote in a 1979 annual letter to shareholders, "'turnarounds' seldom turn."

The evolution Gray spoke of is likely to change the way firms like his invest and divest — and how they price assets over the long run. Alternative asset managers could hold assets through one, two or more cycles. Because the assets aren't being primped and gussied up for a relatively fast profit, returns from these vehicles will be lower. That hasn't deterred alternative asset managers from offering this product as investments to their clients.

What's the advantage? Covid-19 hamstrung private-equity firms from exiting investments. The likes of Blackstone, however, have realized that pools of long-term, patient capital give them the luxury of time. There's no requirement to return money to investors, except in certain circumstances like terminating investment management agreements. There isn't an obligation to

sell assets at prices they don't like, either. Commitments are longer, removing the onerous fundraising and capital allocation processes.

Just look at Blackstone’s stock price. Shareholders are rewarding it for this shift: Public equity markets love the safety of a constant stream of management fees that this kind of capital brings since it ensures sustainable revenues. Other types of fees that asset managers’ generate like performance-driven ones or those associated with transactions, aren’t rewarded as handsomely.

With the shift to longer-term capital, alternative funds are taking a bigger share of the broader multi-trillion dollar asset management industry’s pie. Can the thrifty ethos of Buffet converge with that of private-equity firms habituated to imposing discipline on portfolio companies?

Like Berkshire’s ever-growing pile of cash, private-equity giants are sitting on a record amount of unused capital or dry powder. That’s worked well through normal business cycles. But the average age of such capital is rising alongside the wait. Deploying capital and finding assets isn’t getting any easier.

As the process of investing gets longer and harder, alternative-asset managers may be admitting that they can no longer guarantee the high-octane returns they used to produce. At the same time, they are discovering that it may pay to be patient.