

# Unlisted equity investments

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## Unlisted equity

An ongoing discussion: Should the fund expand into unlisted asset classes?

Examples

- ▶ Real estate
- ▶ Infrastructure investments (providing debt capital to long-term projects)
- ▶ Private Equity (active management of companies)

Real estate, Infrastructure investments already part of the fund's asset mix.

Controversial part: Private equity.

# Private Equity in general

What goes into a discussion of whether to include private equity?

- ▶ Expectations of returns
  - ▶ Excess risk-adjusted expected returns?
  - ▶ Other return properties
    - ▶ diversification
    - ▶ volatility
    - ▶ factor exposure
- ▶ Issues with the asset class
  - ▶ *Costs* high.
  - ▶ *Illiquid* investment.
  - ▶ *Transparency* low.
  - ▶ *Talent* of investor matters.

# What is private equity?

Equity investment in unlisted stocks.

Example strategies

- ▶ Buyout funds
- ▶ Venture capital
- ▶ Distressed firms

Easy characterization

- ▶ Smaller firms
- ▶ Need input to firm operations  
Venture-PE takes on operational roles
- ▶ High risk of failure  
Startup – 9 out of 10 fails. But if 1 of 10 succeeds spectacularly, enough to generate huge profits.

## Return expectations

Typical argument: Expected returns high.

Empirical evidence: Qualified Yes.

Potential problems with empirics:

- ▶ Measurement of return when assets not traded - rely on estimates
- ▶ Survivorship bias

Diversification: Private Equity behave differently relative to the business cycle?

Again qualified yes.

Volatile - yes

Factor exposure –yes

# Issues

## **Costs**

Direct costs – high.

Indirect cost: High need of investor involvement – Time spent on this investment by investor limits time available to evaluate other investments.

**Scaling** (ease with which firms can expand)

Hard

## **Liquidity**

Low. Typical time of PE investment - 10 years.

Limited secondary market – information issues (lemons)

## **Transparency**

Low

Small companies, limited public reporting, owners have information they can not share (obligation).

# Discussion about unlisted equity in GPFG

Question: Include PE in the asset mix of GPFG

Ongoing discussion

Political decision. NBIM only give input to decision.

## **Happenings**

- ▶ 2018 – Report by two academics (Døskeland and Strömberg, 2018)  
Advice → positive to including PE.  
Norges Bank → positive to PE  
Decision by ministry: No – Prime Minister Solberg (Siv Jensen)  
(Meld.St - Statens Pensjonsfond 2018) -

# Discussion about unlisted equity in GPF (ctd)

## Happenings (ctd)

- ▶ 2022 - Expert commission - future of the fund.  
PE is part of the asset mix of comparable funds. Why not allow it for us too?  
(NOU 2022 12 Fondet i en Brytningstid)
- ▶ 2023  
Norges Bank - letter to Ministry of Finance. Positive to PE.  
(Norges Bank, 2023)  
2023 - An update from Døskeland and Strömberg (2023).  
Look at recent research, say previous advise to include unlisted equity still stands.  
Decision by ministry: No Prime Minister Støre (Trygve Slagsvold Vedum)  
(Meld St. Statens Pensjonsfond 2024)
- ▶ 2024  
Ministry still asking for input (MSCI, 2024)

# Why do Ministry of finance keep saying no?

## Characteristics of GPFG suited for PE

- ▶ Large → money available for PE investment (but PE does not scale, so this less of an advantage)
- ▶ Long term → can be patient, no problem that investments are illiquid.

## Characteristics of GPFG not suited for PE

- ▶ Need to be transparent
- ▶ Need to legitimize investments in parliament on an ongoing basis

## Why do Ministry of finance keep saying no?

Speculate → there are a number of political downsides that speaks against PE

- ▶ GPFG may end up as owner of politically sensitive companies, which they can not get out of (illiquidity of investment)  
ref: Yale University – sudden need for cash post-Trump, stuck with large PE investments.
- ▶ GPFG may become owners with information they can not share with public
- ▶ Need to recruit personell from Private Equity space, with expectations of bonus-based compensation → Possibility of embarrassingly high compensation (ref Argentum)

With clear risk of political downsides, and benefits unclear, easy to see why Ministry hesitates to take on PE.

Trond M Døskeland and Per Strömberg. Evaluating investments in unlisted equity for the Norwegian Government Pension Fund Global (GPFG). Technical report, Report to Norwegian Ministry of Finance, 2018.

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MSCI. On the global market portfolio, private-equity markets and chinese public-equity markets, April 2024. Report to Norwegian Ministry of Finance.

Norges Bank. Investeringsstrategi statens pensjonsfond utland – unoterte aksjer. Letter from Norges Bank to Finansdepartementet (Ministry of Finance), November 2023.