Skill and Luck in Private Equity Performance

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Abstract

A striking feature of private equity (PE) is that performance is persistent, with many PE firms consistently producing high (or low) returns net of fees. We use a new variance decomposition model to isolate three components of performance persistence. We find a large amount of *long-term persistence*: the spread in expected net-of-fee future returns between top- and bottom-quartile PE firms is 7 to 8 percentage points annually. This spread is after controlling for substantial *spurious persistence*, which arises mechanically from the overlap of contemporaneous funds. Performance is noisy, however, and we find little *investable persistence*, meaning that it is difficult for investors in PE funds to identify top-quartile funds with top-quartile expected future performance.

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