

In Focus

Fortune favours the small...and brave

“Small opportunities are often the beginning of great enterprises” - Demosthenes



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It is a truism that generating a return over the risk-free rate requires taking risk. Some amount of risk aversion is part of prudent investing. But at what point does it work against the interests of investors? At what point does it poison the chalice?

Recent research¹ suggests that loss avoidance is not correlated with higher returns.

This can be understood through the prism of loss ratios, defined as the realised or latest value of an investment below invested capital. If you invest \$1 into a company, this covers the probability of receiving, or valuing the investment at, anywhere from 0 to 99c.

According to authors Maria N. Borysoff of George Mason University School of Business and Gregory W. Brown of UNC Institute for Private Capital:

“While loss avoidance during the fundraising period benefits fund managers, investors get a lower fund return from loss-avoiding GPs after the fund is fully realized. ...we show that the use of loss ratios as a risk metric is suspect, as there is no observable correlation between loss ratios and the standard deviation of deal MOICs [Money on Invested Capital] at the fund-level.”¹

In other words, low loss ratios do not themselves contribute to higher returns for investors, and chasing them for their own sake can lead to sub-optimal results.

By corollary, when undertaken with the appropriate skills and capabilities, operating in a riskier part of the market is justified when it offers more attractive returns over the long-term.

Schroders Capital exists to deliver return for its investors over the long term, and that is why we invest in the small and middle markets. Small and mid-caps exhibit higher than average risk ratios, but they also offer more opportunity to outperform. Crucially, though, we do it with a platform that is proven, repeatable, and helps offset the risk inherent in this part of the market.

¹Source: Borysoff (Nykyforovych), Maria and Brown, Gregory W., Loss Avoidance in Private Equity (January 26, 2024). Donald G. Costello College of Business at George Mason University Research Paper, Kenan Institute of Private Enterprise Research Paper No. 4707873, Available at SSRN: <https://ssrn.com/abstract=4707873> or <http://dx.doi.org/10.2139/ssrn.4707873>


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Schroders
capital

The juice is worth the squeeze

Global Private equity exhibits an overall loss ratio of 8.31%. The small and mid-cap segment of the market, defined as companies with an enterprise value of less than US\$1bn, exhibit a loss ratio of roughly 100bps above that average, while large caps have a loss ratio roughly 300bps below it.

Figure 1: Preqin stats on industry loss rates

 % of Aggregated Deal Amount			
Loss amount	Overall	Large Cap (\geq USD \$1bn)	Small/Mid Cap ($<$ USD \$1bn)
Global	8.31%	5.34%	9.37%
North America Focused	8.03%	5.55%	8.97%
Europe Focused	8.15%	4.11%	9.64%

Source: Preqin, September 2024. PE Buyout deal level loss ratios covering all investments between 2004 –September 2024. % of Aggregated Deal amount: Loss amount total / Invested capital total. Past performance is not an indicator of future performance and may not be repeated.

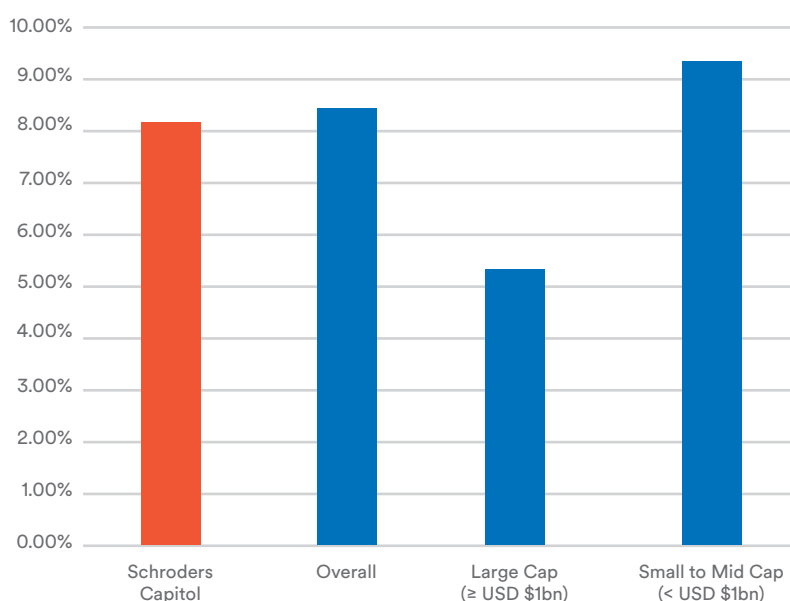
Schroders Capital's direct/co-investment book lives in the small and mid-cap part of the market and has incurred a loss ratio of 8.1%.

Achieving a low loss ratio in a part of the market with a higher than average loss ratio is not reason enough to invest.

Indeed, why would one invest in a market segment that has a higher chance of loss? Only if you believe the manager can outperform the benchmark and/or the potential rewards are greater.

And they are greater.

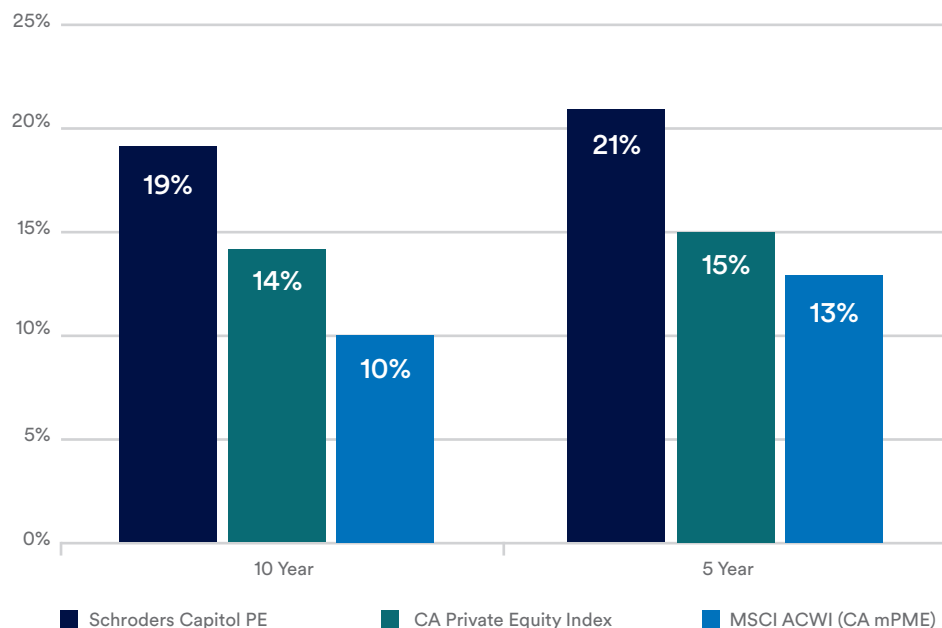
Figure 2. Schroders Capital's loss ratio versus Preqin industry averages



Source: Preqin, Schroders Capital, 2024. Preqin PE Buyout deal level loss ratios covering all investments between 2004 –September 2024. Schroders Capital's loss ratio consistently defined as total loss amount value below 1x divided by total invested capital of all 199 growth and buyout direct/co-investments Schroders Capital has completed as of Q3 2024. All 199 growth and buyout direct/co-investments made by Schroders Capital have been included in the analysis. Past performance is not an indicator of future performance and may not be repeated.

Schroders Capital's direct/co-investments have outperformed both the broader private equity market, defined using the Cambridge Associate Private Equity Index, and listed markets over 5 and 10 year time horizons.

Figure 3. Comparison of public, private and Schroders Capital returns



Source: Cambridge Associates LLC, Schroders Capital, 2025.

The index is a horizon calculation based on data compiled from 2,879 private equity funds, including fully liquidated partnerships, formed between 1986 and 2024. CA Modified Public Market Equivalent (CA mPME) replicates private investment performance under public market conditions. The public index's shares are purchased and sold according to the private fund cash flow schedule, with distributions calculated in the same proportion as the private fund, and mPME NAV is a function of mPME cash flows and public index returns.

Schroders Capital 5/10-year horizon performance shown are as of Q3 2024 and net of underlying fund fees, expenses and performance fees and gross of Schroders Capital's fund fees, expenses and performance fees. Figures include 199 buyout and growth co-investments since 2013, the date of the first co-investment made by Schroders Capital. Past performance is not a reliable indicator of future performance.

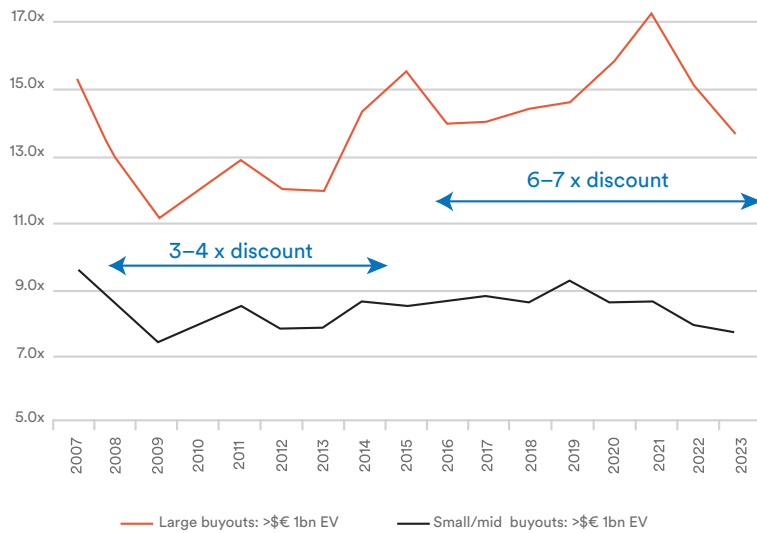
Having highlighted the outperformance Schroders Capital is able to generate in the small and mid-cap private equity market, let's now dig into the factors driving this performance.

We've [written previously](#) about the benefits of the small to mid-cap segment of the private equity universe, and why this part of the market generally outperforms the large cap part of the market.

Small and mid-cap private equity covers only 30% of capital by dollar, but 99% of companies by number. In other words, in the large-cap segment more than 3x the amount of capital is fishing in an opportunity set which is approximately one hundred times smaller. This imbalance between capital supply and demand provides fertile ground for investment based on a far larger opportunity set and relatively less competition, providing high quality investments at lower entry multiples (typically expressed as EV/EBITDA).

This has been particularly pronounced over the last 5 years, which saw large-cap private equity capture an even greater share of fundraising. While small and mid-sized companies have always traded at a discount to large companies, this valuation gap has significantly widened over the last few years. Given prevailing record dry powder levels of large-cap private equity intensifying competition for the best opportunities, we expect the valuation spread to remain at those levels. While absolute valuation levels are fluctuating over time, small- and mid-sized companies have been acquired for a relatively consistent valuation discount of 3-4x EV/EBITDA historically. As the large-cap segment has attracted disproportionately more capital over the last years, the described capital demand and supply imbalance further widens the valuation spread to 6-7x EV/EBITDA.

Figure 4. Industry EV/EBITDA purchase multiples – US and European buyouts



In short, we get exposure to companies at lower entry multiples while they're small or mid-sized. We grow, transform and professionalise those businesses and sell them upmarket to large strategic buyers or large-cap private equity funds, who are more willing than ever to pay higher valuations for good companies as a result of strong competition in a concentrated opportunity set. The structural advantages of the small/mid-market combined with Schroders Capital's superior investment selection capability has driven strong results of 3.0x money on invested capital (MOIC) and 26% IRR (internal rate of return) on 69 realised investments as of Q3 2024 (net of underlying fees and expenses and gross of Schroders Capital's fund fees and expenses).

Past performance is not a guide to future performance. Source: CapitalIQ, Baird Global M&A report, Schroders Capital, 2025.

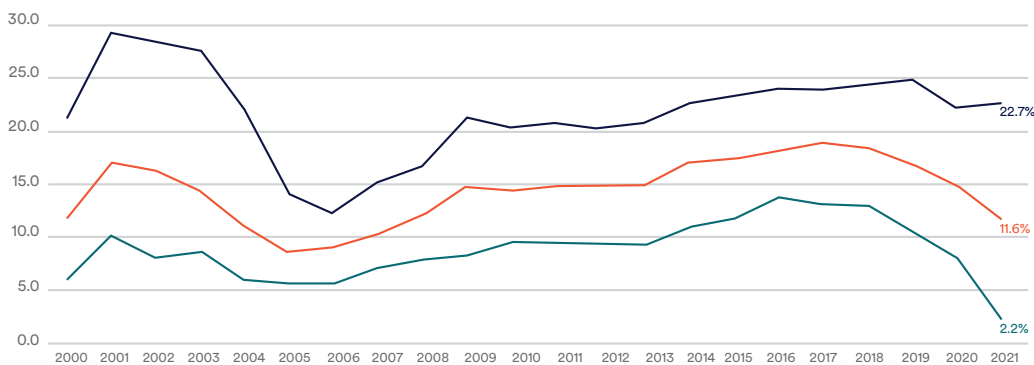
We invest with star managers...

A large relationship network to strong General Partners (GPs) is a key requirement for a successful direct/co-investment program, as the return dispersion is significant.

Schroders Capital's private equity investment platform taps into small- and mid-sized universe through a broad

relationship network of over 300 specialist General Partners (GPs). While a broad network is a prerequisite for an outperforming direct/co-investment program, it alone is not sufficient.

Figure 5. The performance gap between top and bottle quartile PE funds is stark



Past performance is not a guide to future performance. Source: Preqin Pro, Schroders

...into their best performing companies


An important attribute of the small and mid-cap segment is the meaningfully higher number of high money multiples which can overcompensate for underperformers and drive alpha at the portfolio level.

When we look at the ratio of "star performers," defined as

investments that return more than 5x times money, 3.8% of all global private equity deal volume has achieved this statistic.

Breaking it down by transaction size, 3.0% of deal volume in the large cap end of the market has produced a total value to paid-in (TVPI) of greater than or equal to 5x money, whereas global small to mid-cap has achieved this on 4.15% of transactions.

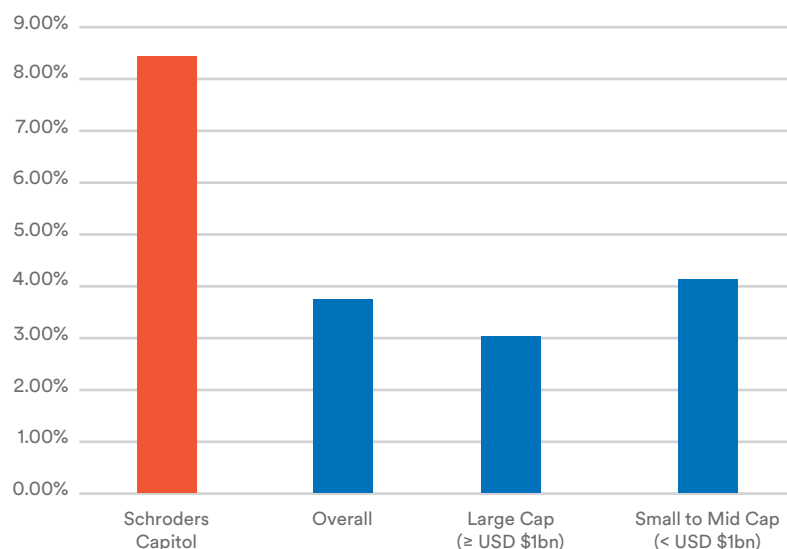
Figure 6. Preqin stats on industry “star performers”

 % of Aggregated Deal Amount			
Buyout TVPI \geq 5	Overall	Large Cap (\geq USD \$1bn)	Small/Mid Cap ($<$ USD \$1bn)
Global	3.81%	3.00%	4.15%
North America	4.18%	2.79%	4.72%
Europe	3.46%	3.55%	3.42%

Source: Preqin, September 2024. PE Buyout deal level loss ratios covering all deals between 2004 –September 2024. % of Aggregated Deal amount: Loss amount total / Invested capital total. Past performance is not an indicator of future performance and may not be repeated.

At Schrodgers Capital, we are doing significantly better in selecting such star investments. 8.5% of our direct/co-investments can be defined as “star performers”, more than twice the number compared to both the overall private equity and the small- to mid-cap market and almost three times the rate of large cap.

Figure 7. Schrodgers Capital’s “star performers” versus Preqin industry averages



Past performance is not a guide to future performance.
 Source: Preqin, Schrodgers Capital, 2024. All 199 growth and buyout direct/co-investments made by Schrodgers Capital have been included in the analysis.

The value generated from those star performers alone, ignoring all the other positive investments between 2x and 5x MOIC, has delivered 3.3x more value than what we have lost on underperformers below cost.

What does it take?

In order to access the most compelling opportunities, co-investors have to be well-positioned as an efficient investment partner at the co-underwriting stage. Sector expertise and deep transactional expertise are essential in that regard. We deem the focus on co-underwriting as critical given that the best opportunities often don’t reach

the syndication stage and co-investors have significantly deeper insights when working with GPs side by side on the investment due diligence. At Schrodgers Capital, more than 85% of our direct/co-investments have been at the co-underwriting stage.

The combination of a large primary platform with sophisticated direct/co-investment capabilities allows for a highly selective investment approach based on a strong deal flow of 500-700 direct/co-investment opportunities per annum, empowered by a triple due diligence approach.

Figure 8. Schroders Capital’s deal selection process



Past performance is not a guide to future performance.

Source: Schroders Capital, 2024. Based on deals presented annually as prequalification’s in the Investment Committee in 2021–2023 and transactions closed annually in 2021–2023.

As a result, Schroders Capital’s direct/co-investment program has historically been able to deliver structural positive selection to our investors. 71% of our realised direct/co-investments have been alongside GP funds ranking in

the 1st or 2nd vintage year quartile and 70% of the realised co-investments have outperformed other investments made by those GPs 12 months before and after our co-investment completed.

Figure 9. Proven ability of co-investing into outperforming portfolio companies of outperforming GPs

Lead GP funds vs Cambridge Associates benchmark¹

71%

of the GP funds Schroders Capital co-invested alongside are in the 1st or 2nd vintage quartile

# of funds	
Above/equal median TVPI	36
Below median TVPI	15

Our co-investments vs lead GP’s other investments +/- 12 months²

70%

of Schroders Capital realized direct/co-investments outperformed the GP’s other investments

# of co-investments	
Outperformed	30
Equal/underperformed	13

Source: Preqin, Schroders Capital, 2024.

¹ 51 of 69 realized co-investments included in the analysis. 18 excluded were either alongside fundless sponsors or alongside GP funds into which Schroders Capital did not commit primary capital and hence has no ability to track fund performance over time. In the more recent years, Schroders Capital’s co-investments alongside core GPs with primary commitment has increased to >90% as a result of the expanding co-investment platform, further increasing the deal flow quality and selectiveness. ² Analysis benchmarks performance of Schroders Capital co-investment vs other investments the GP has made 12 months before and after the closing of the co-investment. 43 of 69 realized co-investments included in analysis as 18 were excluded as explained in footnote 1 and an additional 8 because the GP did not make any other investment in the +/- 12 months period under review. Analysis as of December 2024.

Conclusion

The small to mid-cap segment of private equity carries a higher loss ratio than both the industry average and large caps. But this is still where Schroders Capital chooses to invest.

Investors don't entrust us with their capital in order to chase a low loss ratio. They entrust us with their capital in order to generate attractive risk-adjusted returns over the long term. Generating a better return for clients over the long term is our Northern Star, not to 'play it safe' for its own sake.

An approach that embraces and minimises calculated risk is essential to a healthy return profile. Schroders Capital's investment strategy and process embody this approach. With an unwavering focus on selecting the best managers and the best investments, in a part of the market with the most attractive supply and demand for deals, we have been able to consistently generate attractive returns for our investors irrespective of the market cycle.

More information

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