

TUCK SCHOOL OF BUSINESS AT DARTMOUTH



CENTER FOR  
PRIVATE EQUITY  
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## Note on Private Equity Careers

Finding a position in the private equity industry is a challenging prospect for MBA students. Yet every year, MBAs are hired and post-MBAs are promoted to senior ranks. Despite issues such as the economic cycle and increasing competition within the industry, it is clear that competent motivated individuals with good investment acumen can and do succeed in private equity. This note describes the industry, compensation structures, and characteristics of successful professionals.

For a recent MBA graduate, the private equity industry offers the opportunity to exercise many of the skills developed in business school while working in a fast-paced entrepreneurial environment that has the potential to be extremely rewarding financially. The private equity industry continues to evolve as it adapts to new investment climates and becomes institutionalized. This has created challenges and opportunities.

### **Private Equity Industry Structure**

The private equity industry is generally composed of four major types of investors: Venture Capital, Leveraged Buyout, Mezzanine, and Secondaries / Funds of Funds investors. There are key distinctions between venture and buyout firms. Venture capital is about understanding the impact of products and technologies on markets while buyout is about control and deal structure. Regarding domain expertise, it is a requirement for venture capital investing, however buyout firms can and often do hire consultants to gain further understanding of a sector. A venture capitalist is by nature an optimist, often asking “What can be done?”, while a buyout investor is

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*This document was written by Jonathan Rotolo T'04 and Adjunct Assistant Professor Fred Wainwright under the supervision of Professor Colin Blaydon as a basis for class discussion rather than to illustrate either effective or ineffective management.*

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concerned about worst-case outcomes and tries to mitigate risks through deal structures. Further details of all private equity investors are described below.

### *Venture Capital*

A venture capital fund invests in early stage companies in need of capital for growth. Such an equity investment is often structured as a preferred stock security. It is rare for a venture capitalist to structure an investment in an early stage company as a straight debt instrument, as the startup with unproven products and cash flow constraints would be unable to make the interest payments. Venture capitalists will usually take a minority, non-controlling stake in the company and may often syndicate the risk of the investment among a number of firms.

Venture capital investments typically proceed according to a number of different stages. A pure startup company will obtain its initial financing through a “seed round.” This round may be far less than \$1 million in size, and may not even be sourced from a venture capitalist but rather from an angel investor. An angel investor is a wealthy individual, acting alone or in a group, that makes small investments of his or her own personal capital in early stage companies. If the seed round is successful, the company will often require several rounds of venture financing before the investors are able to exit their investment through an initial public offering (IPO) or, more commonly, a sale to a strategic investor.

### *Leveraged Buyout*

A company entering into an LBO is typically a mature but underperforming entity with a proven product and stable cash flows. Often, an LBO candidate is a subsidiary of a larger company that has been underperforming or has become non-essential to the parent company’s operations. An LBO fund is unlikely to undertake a transaction with a high growth technology company due to its unpredictable cash flows. Cash flow is essential to make interest payments on debt. Unlike a venture capitalist, an LBO investor will typically take a control position in the company, investing equity and structuring a combination of loans from various lending sources.

In analyzing a transaction, the LBO investor will typically value a business based on a certain multiple of its EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). The debt used in the transaction will be raised from the public and/or private markets through the issuance of high yield bonds and the commitments of commercial banks and other institutional lenders. The percentage of equity used in a transaction will vary depending on the investment climate and the projected cash flow of the company compared to its debt payments. Once the transaction has closed, the LBO firm will seek to improve the company’s internal processes and structure so as to maximize its free cash flow available for interest

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payments and investments in growth projects. Once value has been created, typical exits include IPO, sale to a strategic buyer or sale to another LBO fund.

### *Mezzanine*

A mezzanine investor is somewhat different from other direct private equity financiers due to its preference for investments in debt-like securities. A mezzanine investor receives securities which have greater seniority than equity in a company's capital structure, typically at the subordinated debt level. Such securities may feature an accumulating or current pay dividend and will often include equity warrants. Due to its lower risk tolerance and investment in less risky securities, the mezzanine investor typically receives a lower return than other private equity investors. These funds' ability to generate returns are somewhat dependent on the IPO market since mezzanine financing is typically used to bridge the financing gap from the time a firm decides to issue public securities to when it is actually able to execute the sale of these securities. Recently, mezzanine funds have gained popularity and multi-billion funds have been raised.

### *Secondaries / Fund of Funds*

A secondaries fund is different from other private equity vehicles in that it does not invest directly in operating companies. Rather, it purchases interests in existing private equity funds, often at deep discounts, from limited partners who choose to monetize their investment before the typical 10-year period of a partnership has been completed. Similarly, a fund of funds investor is an asset manager that allocates capital among a number of private equity funds, including both venture and LBO funds. Through this approach, the fund of funds manager offers diversification and expertise to certain types of limited partners, such as small endowments and foundations that do not have the staff to manage the investment process effectively.

## **Economics of a Private Equity Fund**

When a private equity fund is organized, the general partners (GPs), or managers of the fund, seek out a number of institutional investors that may include public or private pension funds, endowments and financial institutions. Investors in the fund are called limited partners (LPs). LPs contribute capital in return for a share of the fund's returns. A private equity partnership is typically structured to last for ten years with possible one- or two-year extensions. Throughout the fund's life, the private equity firm will receive a management fee based on the assets committed by limited partners. These management fees typically range between 1% and 3%

percent. When the fund is liquidated, the limited partners are returned their proportionate share of the fund's capital and investment profits (if any) in the form of cash or stock, depending on whether all investments were liquidated through sales or an IPO. One structure commonly used is as follows: no distribution of profits occurs until the LPs have reached their preferred rate of return (or hurdle rate) typically set at 8-10%. Returns above the hurdle rate are split on a percentage basis, often 80/20 between the GP and the LPs. A GP's share of a fund's profits is called carried interest.

### **Structure of Private Equity Firms**

While there is no typical private equity firm, the majority of firms are relatively small, often with less than a dozen professionals. The size of these firms indicates that the organizational structures are flat and that firm members must be able to contribute to the firm's operations in multiple ways. It should be noted that changes in firm structure are presently taking place. An institutionalization trend has developed since the early 1990's that has led to geographical networks of affiliate funds, families of venture capital and buyout funds, joint ventures with hedge funds, and other relatively complex structures.

Corporate venture funds are associated with larger corporations. They typically invest for strategic reasons as well as earning returns. Compensation structures vary from traditional funds and often do not include carry.

### **Roles within Private Equity Firms**

A 2002 compensation survey conducted by Thomson Financial's Venture Economics and Glocap identified and described six post-MBA roles within private equity firms, as shown in the table below.

[See table on next page]

**Table 1.** Roles within Private Equity Firms

<b>Job Title</b>	<b>Years of Post-MBA Experience</b>	<b>Compensation</b>	<b>Partner Track?</b>	<b>Comments</b>
Associate	0 - 1	Salary, Bonus, (Carry)	Sometimes	
Senior Associate	2+	Salary, Bonus, (Carry)	Yes	
Vice President	3+	Salary, Bonus, Carry	Yes	
CFO/COO	5+	Salary, Bonus, Carry	Yes	Often have CPA.
Partner/Principal	5+	Salary, Bonus, Carry	-	
General Partner	7+	Salary, Bonus, Carry	-	Often receive significant carried interest.

For a candidate, this list is a starting point in understanding the organizational structure of private equity firms. Titles and responsibilities vary significantly based on firm size, investment focus, and geographic location, among other factors.

**The Associate Role**

Since most MBA students will be seeking a position as an Associate, most of this note is focused on describing an Associate’s tasks, what the Associate title means, how this role is changing, how an Associate develops a career, and the challenges for MBA students seeking an Associate position.

*Tasks and Activities:* A successful Associate candidate must have a diverse skill set, as he or she will be called upon to participate in all phases of deal making and possibly in operations and fundraising. The three main abilities required are: technical skills to understand the industries in which the firm invests, analytical skills to assess investment opportunities, and interpersonal skills needed to build a strong network which will be a major resource throughout his/her career.

- Technical skills – firms tend to target their investments in specific sectors or domains. Much of the Associate’s job is focused on gaining expertise in a firm’s specific domain (if he/she does not have previous experience in this sector).
- Analytical Skills – These skills are largely acquired through work experience in finance, consulting or similar positions as well as an MBA education. The Associate must be able to understand business models in

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detail, produce relevant research on market trends, competitor products and customer profiles, and also be able to support an investment thesis for the specific industry sector or market. This involves due diligence such as visiting the company, speaking with customers, suppliers and competitors, and modeling the financials to determine the company's valuation.

- Interpersonal Skills – These skills will obviously be important for general success within a firm, but interpersonal skills are essential for establishing the network of contacts that will support the Associate throughout his/her career. Networking activities should seek to build two types of contacts:
  - Contacts that will provide deal flow – these will include other investors, service providers such as lawyers and bankers, trade groups, and entrepreneurs.
  - Contacts that have access to individuals with managerial capabilities – these will include entrepreneurs, industry executives and possibly management consultants.

Associates must have the ability to process various kinds of data, interpret the data effectively and reach a conclusion. The Associate must absorb a lot of information, determine trends and key issues, and then tactfully raise and address these points with investment decision makers in the firm. Associates should expect to be judged on how well they are able to assess the key factors of a deal, whether they make the right recommendation about the deal and how fast they reach a decision. Beyond execution, relationship building is extremely important for Associates and is essential to their long term career success. A more comprehensive list of the tasks Associates perform can be found in **Exhibit 1**. A sample of an Associate's typical day can be found in **Exhibit 2**.

The importance of technical skills goes beyond the intricate understanding of an industry. Increasingly, firms are targeting candidates with operating experience. Associates are being asked to move to roles in operating companies (often for significant periods of time) before being considered for more senior positions. To complicate matters further, few firms have formal procedures for tracking and repatriating former Associates into their firms once the individuals have accumulated relevant operating experience.

The Associate role is different in each firm. In general, jobseekers should expect firms to have three categories of Associate positions. Many firms have Associate positions held by individuals without MBAs. These individuals often have spent two to three years as analysts with the private equity firm following a two to three year stint with an investment bank or strategy consulting firm. Their job is mostly business development; finding deals for the firm through trade shows, tracking local

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companies and following up on leads generated by partners. These are predominantly non-partner track positions.

The second kind of Associate position is a non-partner track position for post-MBA candidates, and the last type of Associate position is a partner track position for post-MBA candidates. In all but the largest venture firms, the Associate position is becoming a non-partner track position. This trend is largely the result of the downturn in the economy and may change with the economic cycle.

*The Changing role of the Associate:* Beginning in the late 1990s and continuing through 2000, venture firms experienced a dramatic increase in deal flow. To screen the increased number of investment opportunities, firms were forced to increase the number of Associates they employed. At the same time, the number of funds firms raised increased, as well as the size of these funds. Greater assets under management meant making more investments which translated into a need for more partners. Additional partners were required for two reasons: limited partners wanted to know that a “partner” was overseeing their investment and entrepreneurs wanted the support of a “partner” to help ensure the success of their company. These trends created greater opportunities for MBA students to find Associate positions, as well as provided a condensed career path for Associates; Associates were able to make partner in three to four years instead of the historical seven to eight years. These trends have led to “title inflation” and a perceived dilution in the quality of younger professionals.

As part of the rightsizing of the venture capital industry, human capital policies have changed; the duration of the career path to partner for Associates has returned to its historical norm. Traditionally, promotions within private equity firms have been made during fund raisings. One reason for this is that firm members’ carried interest is determined at the time of a fund’s creation. The legal structure of the partnership and firm politics leave little room for changes in profit sharing once a fund has been created. It is also important for the firm to indicate to potential limited partners who the investment decision makers will be at the time of fund raising. The large cash overhang within the private equity industry, the slower growth prospects for new companies and the difficulty of exiting investments have led to a significant slowdown in venture fund raising, resulting in less hiring at funds and fewer promotion opportunities for those in the industry.

The direction of career paths to partner have also changed. With the recent economic downturn and increase in competitors, firms are reassessing the skills that are required for partner positions. It is useful to compare the roles Associates and partners play in the investment process. The Associate role described above and in **Exhibit 1** can be contrasted with the partner description below:

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Partners have several key roles within the firm. The role of an individual partner will depend on their particular skills, their tenure with the firm and what stage of the investment process the firm is in. In general, a partner's responsibilities can be divided into four tasks: managing the partnership and the firm, sourcing deals, overseeing investments, and managing partner relations<sup>1</sup>.

- *Managing the partnership and the firm.* Generally a Senior Partner is responsible for managing the firm and its employees. The day to day operating tasks are likely to be delegated to other partners and the degree of specialization will depend on the size of the firm. It is becoming more common for large firms to have a CFO and/or a COO.
- *Sourcing deals.* Partners are generally the source of the most deal flow. It is not uncommon for VPs/Principals to be involved in this process but Partners, who generally have the most experience and the most contacts, are the primary source for investment ideas.
- *Overseeing investments.* The level of oversight required for each investment varies significantly. The Partner may only be required to represent his fund by sitting on an investment's board or may need to find or provide operating assistance for the firm. This is often the most time consuming part of a Partner's position. Sourcing and evaluating deals requires a significant commitment of the firm's resources, but ensuring that its investments are successful can consume the majority of a Partner's time. A Partner may be involved with ten or more portfolio companies and may sit on the boards of six to eight of those companies.
- *Partner relations.* Partner relations break down into two parts: finding new limited partners when raising capital and maintaining relationships with existing investors. Depending on the number of funds previously raised by the firm, a Partner will dedicate a significant portion of time to building relationships with potential limited partners.

In addition to the responsibilities listed above, the Partner must find time to stay up to date on changes in key industries through attending trade shows, speaking with managers and CEOs, and reading relevant publications.<sup>2</sup> Partners must also be available to mentor the younger members of their firm. The apprenticeship

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<sup>1</sup> From the 2001 **Vault Career Guide to Venture Capital**

<sup>2</sup> Ibid.

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structure of the industry means that much of an Associate or VPs training is through informal information transfer from the partners.

VC funds have traditionally earned the majority of their returns from a few investments in their funds. At the outset of a fund's life a Partner may spend time with a number of portfolio companies. As the fund's life shortens, Partners will focus their efforts on their winners. They'll spend an increasing amount of time working with management, customers and suppliers of startups with the best chances of producing superior investment returns. Since working with portfolio companies will consume the majority of a partner's time over the life of a fund, operating experience is important for ensuring a portfolio company's success. Similarly, as the operating environment becomes more challenging, as it has for many technology companies since the year 2000, operating support is increasingly important for VC investments. Operating support can also be a differentiator for a VC firm. In light of this, some of the larger private equity firms have dedicated operating partners who focus on portfolio company support and investing partners who focus on sourcing and executing deals. Operating Partners are typically industry executives or entrepreneurs with a proven track record while investment partners are typically career venture capitalists.

What all of this means for the private equity job seeker is: operating experience is considered invaluable by venture firms. There is a strong chance an Associate candidate will need to demonstrate relevant operating experience to a firm if they intend to land a Partner track position within that firm; however, if the candidate does not have operating experience they should not be deterred from seeking a position. Instead, he or she should expect to be asked to acquire operating experience at some point in their career before being considered for an investing or Partner level position. This will likely involve leaving the firm and taking on a senior role within one of the firm's portfolio companies.

*Moving Up:* An understanding of the Partner's role in a firm allows the Associate candidate to identify the skills he/she needs to develop if he/she is to pursue a career in venture capital. Having insight into what differentiates a great investor from an average investor will ensure that aspiring professionals focus their career development efforts appropriately.

An excellent article on influential venture capitalists was published by VCJ in February of 2002. Through a survey that used investment success (in dollars), board seats, sector expertise, personal connections and a host of other criteria, VCJ identified a list of the "top ten" venture capitalists.<sup>3</sup> As most VCs, limited partners

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<sup>3</sup> "Influential VCs", VCJ, June 2002

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and industry observers will tell you, there is no one trait that is common among great venture capitalists. Rather, each VC brings to the table a unique skill set and perspective that allows he or she to be successful. In an attempt to find some tangible commonalities among VCJ's "top ten" VCs, the author of this article took the liberty of summarizing VCJ's findings.

VCs can be thought of as being one of two types of investors: business builders and idea investors. Business builders are typically serial entrepreneurs or industry veterans. They have a great understanding of the operations of the businesses they invest in. The result is that business builders earn great respect from, and are able to provide direct assistance to the management teams of their portfolio companies. A more technology driven VC may not be able to provide the same direct level of support.<sup>4</sup> Business builders will also have developed an extensive network of industry contacts from their previous industry and investing experience. Idea investors exist at the other end of the VC spectrum. They are able to identify gaps in an industry, areas of need that have not been fully serviced. The truly great idea investors are able to identify new industries in their infancy; they are able to create new markets for technology. Idea investors may have less domain expertise than business builders and will invest across industries throughout their careers, rather than choosing to specialize.<sup>5</sup>

Most VCs exist somewhere on a continuum between these two extremes, but these two types of VCs are a good starting place for thought on the different philosophies individuals can bring to venture capital. Despite differences in how VCs approach investing, there are a *set* of personal assets or traits that seemed to be common among VCJ's top ten VCs. The first of these traits is a genuine enjoyment of working with people. Whether coaching a CEO making a difficult decision, mentoring a younger member of their firm, soliciting limited partners or speaking at a conference or with the press about a new investment, VCs must have the capabilities and desire to work with people. The second trait or asset follows from being in a people business, a great network. VCs use their networks to reach investors, source investments, find management talent, find customers and suppliers, and share ideas.

A third trait that seemed to be common among successful VCs was humility. VCs need to recognize when they have the skills to accomplish a job and when they need to tap their network to find the right person for the task at hand. Similarly, VCs must find the appropriate level of support for portfolio companies to ensure that entrepreneurs are able to run their businesses. Perhaps the most common mention

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<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

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of humility was in regards to learning from investment mistakes. The fourth common trait that was found across VCJ's "top ten" was big returns (big surprise). Although some investors claimed not to be focused on returns, all of those on VCJ's list had plenty of them.<sup>6</sup> It should also be noted that the majority of VCs selected by VCJ started their careers in industries other than VC! From VCJ's article it is clear that the path to become a partner in a VC firm may have several courses.

### **Progression to Senior Positions**

As described previously in the Thomson Financials Venture Economics and Glocap's 2002 compensation survey, time is a factor in promotions, as in any industry.

One recent business school grad has described the importance of generating returns for the firm. Because an Associate will spend a significant portion of time evaluating investment opportunities, he or she must choose his battles carefully. When bringing an investment idea to senior members of the firm, the deal should "move the needle" for the fund (i.e., provide significant returns to the fund). An Associate will likely screen a number of interesting deals during their tenure, but if the investment opportunity is not large enough to impact a fund's returns, then it may not be worth the effort.

Superstar investors share these characteristics:

- Investment acuity (identifying characteristics of success and recognizing patterns of success in management teams and business models)
- Ability to find and coach talented individuals
- Sourcing and closing successful deals (including company selection, sector selection, deal structuring, legal negotiations, value added operational and financial strategies, successful exits)
- Leveraging networks of deal sources, co-investors, banks, and individuals to add to management teams
- Building and maintaining rapport with partners
- Building and maintaining rapport with employees

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<sup>6</sup> Ibid.

## The Job Search Process

*Finding an Associate Position:* Understanding the career path an Associate will travel on is essential to helping the Associate candidate design and execute their job search. Our discussions with industry participants revealed a number of insights into hiring processes that we thought were worth sharing with potential job seekers.

As discussed throughout this note, obtaining a certain amount of company building experience is important. The quantity and type of experience required seem to vary from firm to firm and depended on the stage of investment the firm focused on. For example, one early stage investor said, “There are certain stages and steps that most companies go through, regardless of industry. Having experience starting a firm allows the VC to provide insight into portfolio companies and is extremely valuable in heading off problems.” Another VC said, “If you have no operating experience you should go and get some! You’ll be handicapped if you don’t!” This VC recommended finding an operating role with a company in a location near a VC community so the candidate can stay in touch with the VC industry. The candidate should contact those firms to express his/her interest and try and get involved with a portfolio company. The candidate can use this opportunity to prove themselves while maintaining contact with perspective employers.

What is most important in landing a position within a firm is a candidate’s “fit.” Every firm has a culture and some individuals may or may not fit into it based on their background, education, and values. This suggests that firms may be willing to engage a candidate with less specific industry or investing experience if they believe he or she is the right person for the firm.

According to a Boston-based executive search firm it is clear that many business school students lack the network and the networking skills needed to land private equity interviews. First, private equity job seekers need to start building their network as early in their career as possible. This may be in business school or it may begin long before that. However, networking exclusively for the purposes of job searching is not effective. Job seekers need to be able to add value for their contacts in the same way they expect their network to provide value for them. Networking is a two way process. This means knowing exactly who you are speaking with by researching his or her background and interests and being prepared to engage in discussions regarding his or her interests as well as yours.

For those lucky enough to land an interview, there are just as many considerations. Business school students are good at preparing for consulting and finance interviews but they are not proficient in private equity interviews. Consulting and investment banking interviews are focused and structured. Private equity

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interviews are typically conversational and informal. Candidates should also expect considerable variation in interview practices across firms as well as across individuals within a firm. The infrequency of interview opportunities as well as the variation in the interview process means the candidate *must* be thoroughly prepared.

There are a number of steps that candidates can take to prepare for interviews. First, candidates should know who they are talking to. This means obtaining a true understanding of what role the interviewer plays within the firm. Using the firm's public information, try and determine how long the interviewer has been out of business school. This should provide a baseline for understanding what this individual does within the firm. The interview candidate should also talk with the firm's competitors to collect more information on the firm's organizational structure. Co-investing and networking result in a firm's peers having a good understanding of how an individual firm is organized and staffed. The flat structure and small size of private equity firms means that Associates will often have as much input in hiring decisions as more senior members of the firm.

The second step interview candidates should take to ensure their success is to understand the type of investments a firm makes. Information about investments is often available on a firm's website. Interview candidates should be familiar with a firm's portfolio companies. This means having a thorough understanding of an investment's operations, competitive position and financial position. Candidates should also consider speaking with entrepreneurs and management of the VC firm's portfolio companies. This will provide some excellent insight into how the firm works as well as provide the opportunity to learn more about the portfolio company itself. It is suggested that the interview candidate ask the VC firm for a contact within the portfolio company rather than contacting the firm directly.

One Associate candidate wrote the equivalent of a sell-side research report on each of a VC's active investments before interviewing with that firm. Candidates in today's environment need to go one step further. They should also be prepared to discuss potential investment opportunities with the firms they interview with. Having investment ideas will demonstrate an understanding of a firm's investment style as well as domain expertise. Some firms conduct final rounds of interviews by asking candidates to make presentations to partners on specific investment opportunities or themes. This is also an excellent example of networking; the interview candidate is adding value to the relationship rather than simply trying to extract value.

The third step a candidate should take to prepare for an interview is to be abreast of general industry knowledge. As previously described, the private equity industry is dynamic and currently going through a number of changes. Candidates should be

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able to demonstrate their knowledge of such issues and carefully considered opinions on what further developments may occur.

One specific private equity industry trend that candidates should understand is succession planning and the impact it may have on the Associate role in a private equity firm.<sup>7</sup> There are three trends driving changes in succession planning in the industry: lower future returns for the asset class, the aging of senior partners, and the maturing of the industry. These trends may have implications for the stability of firms, the political and work climate within the firm, and how members of the firm are compensated. Each trend is discussed briefly.

The first trend is perhaps the most disruptive and this destabilization has many limited partners concerned. As stated in the Venture Capital Journal:

VC carry is likely to shrink going forward, which means that some senior partners may decide to squeeze out their junior partners and hold on to as much wealth as possible. Moreover, many of the junior partners who made huge sums for their firms in the late '90s did not get to share in the wealth to the same extent. And...it is unlikely these partners will get rich anytime soon. The industry is rife with discontent and disruptive forces. Without a clear and equitable succession plan, these problems could be greatly exacerbated.

The VC business is a people business and if firms are unable to keep their employees motivated the industry will be destabilized until firms adjust their compensation and promotion policies. Some firms are being proactive about seeking outside advice from consultants in order to gain perspective, understand what other firms are doing and make careful, well-thought adjustments that ensure the long term success of the firm.

The second trend, the aging of senior partners, is not unique to the VC industry. The coming retirement of the baby boomers has significant human capital implications for many industries but the partnership structure and apprenticeship nature of a VC career makes the potential loss of senior partners particularly challenging for VC firms. A well articulated succession plan will help ensure that members of the firm and LPs know the future has been planned for.

The last trend driving succession is the maturation of the venture capital business. This is an essential process if the industry is to continue to grow. New VC investors will be less sophisticated and require greater transparency into a firm's processes. This means VC firms will need to make larger investments in infrastructure and be able to demonstrate how and why they are making investments

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<sup>7</sup> See the cover story of the Venture Capital Journal, June 2002 issue, "The Next Generation."

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and managing their firm. Hiring and succession planning are two internal processes that firms will need to systemize as the industry continues to mature.<sup>8</sup> Individuals searching for a position in the venture industry should be aware of the implications succession planning has for firm structure and stability.

### **The Buyout Perspective**

Several trends have impacted the buyout sector. Specifically, valuations remain inflated relative to earnings, too much capital and too many players entered the industry over the past ten years, and banks have reduced lending and lowered the leverage allowed per transaction. These trends have adversely impacted returns for buyout funds.

Since 2000 domestic firm's earnings have declined along with the economy. Valuations have become more rational. This may indicate an opportunity for buyout funds to become more active as investors but it is unlikely any renewed buyout activity will generate employment opportunities with buyout firms given the other trends impacting the industry. More recently, banks have become more active and have somewhat reduced lending restrictions.

The buyout industry, as the venture industry, is currently awash in capital. An estimated \$100 billion of buyout capital was uninvested at the end of 2002<sup>9</sup>. The large capital overhang has resulted in a decline in new commitments of buyout capital (new buyout commitments are below 1997 levels) as investors realize the implications of such an overhang; increased competition for prime deals resulting in lower returns. As with VC firms, human capital decisions at buyout firms are largely based on fund raising and the excess of capital buyout firms are contending with likely means less hiring.

Although interest rates are at historical lows, spreads on bank loans and high-yield bonds have risen significantly since the early 1990s. At the same time, the amount of equity contributed to leveraged buyouts has nearly doubled since 1990<sup>10</sup>. Lower returns have caused institutional investors to allocate away from the asset class meaning fewer new funds and thus fewer employment opportunities.

One caveat is that experienced operating managers are also in demand in the buyout sector. An effective buyout investor must be able to evaluate, motivate and manage

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<sup>8</sup> "The Next Generation", *VCI*, June 2002.

<sup>9</sup> Venture Economics. U.S. based buyout funds only.

<sup>10</sup> *Ibid.*

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operating management as well as finance a transaction. This has lead buyout firms to increasingly partner with outside operating managers to source and support deals.<sup>11</sup>

Post-MBA Associates typically have strong backgrounds in investment banking. This is important for 2 main reasons: training in financial modeling and deal structuring, and developing networks of sources of debt financing. Most buyout firms are based in or near cities with major financial markets and large numbers of institutional lenders.

The private equity job search can be a time consuming and challenging experience. Patience, preparation, and persistence are important, and the financial rewards can be very substantial.

### **Compensation in the Private Equity Industry**

The private nature of the industry has meant that there has been little compensation data available. The partnership structure of firms has meant that compensation has varied widely within firms as well as across firms. Thomson Financial's Venture Economics and Glocap's 2002 Private Equity Compensation Report is useful. The survey analyzed the compensation levels of approximately 690 industry participants from 2000 and 2001.<sup>12</sup> The survey focused on salaries paid and bonuses but did not extend its analysis to include carried interest. The report summarized its findings into six major points:

1. Cash compensation across the industry increased an average of 21.7% from 2000 to 2001 despite a slowing economy.
2. Larger funds do not pay more than smaller funds in terms of cash compensation.
3. LBO funds pay more than VC funds at all levels.
4. Investment banks and commercial bank's internal funds pay more than stand alone funds.
5. Compensation is not higher in areas with a higher cost of living suggesting a national market for compensation levels in the industry.
6. There is no meaningful relationship between the industry focus of a fund and the level of compensation.

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<sup>11</sup> "Current State of the Buyout Market", Bear Stearns Merchant Banking and Vestar Capital Partners, April, 2003.

<sup>12</sup> 2002 was the first year the survey was produced.

Excerpts from this report are listed below.

**Table 2. Base Salary by Asset Class**

Asset Class	Position	Year	Average	Maximum	Minimum	Sample
Venture Capital <sup>13</sup>	Associate	2001	\$104,587	\$350,000	\$50,000	78
		2000	\$98,138	\$300,000	\$35,000	58
	Sr. Associate	2001	\$116,437	\$225,000	\$52,000	63
		2000	\$103,250	\$200,000	\$65,000	36
	Vice President	2001	\$131,415	\$300,000	\$50,000	65
		2000	\$125,090	\$250,000	\$50,000	50
	Principle/Partner	2001	\$192,464	\$600,000	\$80,000	50
		2000	\$194,909	\$450,000	\$90,000	33
	General Partner	2001	\$785,400	\$1,000,000	\$550,000	20
		2000	\$680,769	\$840,000	\$480,000	13
Buyout <sup>14</sup>	Associate	2001	\$100,758	\$250,000	\$55,000	33
		2000	\$104,500	\$250,000	\$55,000	10
	Sr. Associate	2001	\$103,750	\$150,000	\$30,000	8
		2000	\$100,000	\$130,000	\$50,000	7
	Vice President	2001	\$148,620	\$250,000	\$70,000	33
		2000	\$125,406	\$250,000	\$70,000	17
	Principle/Partner	2001	\$186,191	\$400,000	\$50,000	23
		2000	\$187,386	\$400,000	\$44,000	14
	General Partner	2001	\$720,294	\$980,000	\$80,000	17
		2000	\$637,647	\$850,000	\$470,000	17

<sup>13</sup> The report defined venture capital as: Firms specializing in all aspects of early and later stage of investment of companies for entrepreneurial growth.

<sup>14</sup> The report defined buyout firms as: Firms that invest for controlling, majority stakes or whole acquisitions of public and private companies.

**Table 3. Bonus by Asset Class**

Asset Class	Position	Year	Average	Maximum	Minimum	Sample	
Venture Capital	Associate	2001					
			\$64,404	\$300,000	\$1,000	57	
	Sr. Associate	2000	\$43,446	\$115,000	\$1,000	46	
		2001	\$72,153	\$1,000,000	\$20,000	49	
	Vice President	2000	\$54,829	\$515,000	\$10,000	35	
		2001	\$131,720	\$2,000,000	\$1,000	50	
	Principal/Partner	2000	\$59,568	\$200,000	\$1,000	44	
		2001	\$117,807	\$500,000	\$2,000	31	
	General Partner	2000	\$175,862	\$600,000	\$5,000	26	
		2001	\$342,000	\$660,000	\$200,000	20	
	Buyout	Associate	2000	\$266,000	\$380,000	\$200,000	20
			2001	\$81,600	\$250,000	\$10,000	20
Sr. Associate		2000	\$82,222	\$250,000	\$10,000	9	
		2001	\$121,000	\$160,000	\$70,000	5	
Vice President		2000	\$80,000	\$100,000	\$60,000	5	
		2001	\$188,304	\$1,100,000	\$1,000	23	
Principal/Partner		2000	\$157,750	\$1,000,000	\$1,000	16	
		2001	\$160,720	\$375,000	\$10,000	14	
General Partner		2000	\$148,083	\$376,000	\$9,000	12	
		2001	\$385,294	\$590,000	\$250,000	17	
			2000	\$297,647	\$400,000	\$210,000	17

Since carried interest is a significant portion of total compensation in the private equity industry, below is a table detailing the carried interest distributions from a 2000 private equity compensation survey conducted by William M. Mercer Inc.

**Table 4. Carried Interest in 2000**

Position	Carried Interest %	% of Positions with Carried Interest
Associate	0.3%	24%
Senior Associates	0.4%	44%
Jr. Partner/Principal	0.8%	100%
Mid-Level Partner	1.6%	100%
Senior Partner	2.7%	100%
Managing General Partner	5.3%	100%

**Exhibit 1.** What an Associate does<sup>15</sup>

An Associate in a VC firm can generally expect his or her time to be divided among three core job requirements: sourcing deals, performing due diligence on potential investments and supporting the portfolio company.

<b>Sourcing Deals</b>	<b>Due Diligence</b>	<b>Supporting Portfolio Companies</b>
<ul style="list-style-type: none"> <li>- Consult with analysts at investment banks</li> <li>- Consult with market research firms</li> <li>- Attend trade shows</li> <li>- Read trade press releases</li> <li>- Talk with entrepreneurs</li> <li>- Make due diligence face calls</li> <li>- Network with other VCs</li> <li>- Talk with lawyers and accountants</li> <li>- Conduct Internet research</li> <li>- Attend investment conferences</li> </ul>	<ul style="list-style-type: none"> <li>- Talk to customers</li> <li>- Research and talk to the competition</li> <li>- Interview industry experts</li> <li>- Use technical consultants to evaluate technology</li> <li>- Conduct management background checks</li> <li>- Use lawyers to review IP protection</li> <li>- Use accountants to verify financials</li> <li>- Talk with previous investors</li> <li>- Spend time with management</li> <li>- Build valuation models</li> </ul>	<ul style="list-style-type: none"> <li>- Conduct research and assist in strategic planning process</li> <li>- Attend Board of Directors meetings</li> <li>- Support the management team</li> <li>- Source and screen potential management candidates</li> <li>- Negotiate and work with investment bankers</li> <li>- Negotiate and work with potential acquirers of portfolio company</li> <li>- Raise money from other equity sources</li> <li>- Negotiate terms of bank financing</li> <li>- Help acquire other companies</li> </ul>

<sup>15</sup> From the 2001 **Vault Career Guide to Venture Capital**

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**Exhibit 2. A Day in the Life of a Venture Capital Associate**<sup>16</sup>

**7:00 AM** – Arrive in the office.

**7:01 AM** – Read *The Wall Street Journal*, paying careful attention to the Marketplace section covering your industry focus.

**7:20 AM** – Read the trade press for information about new companies in your firm's domain. Cross-reference your firm's internal database to determine if your firm has contacted any of the companies that interest you. Conduct a quick internet search to get a few details on each company. One company in particular stands out and you send yourself an e-mail as a reminder to call the company during business hours.

**7:45 AM** – Drop off any interesting articles to members of your firm with expertise related to the companies in those articles. Use this as an opportunity to exchange ideas about industry players and technology with other members of the firm.

**8:00 AM** – Respond to e-mails or voice mails from the day before. Most of your communication is with entrepreneurs, other VCs and personal contacts.

**9:00 AM** – Quickly skim a business plan before it is pitched by a group of entrepreneurs to you and one GP from the firm. The company pitching its business needs additional copies of its presentation. You work with your assistant to make the needed copies while the GP talks informally with the entrepreneurs. During the presentation you sit quietly making note of what you believe are the three most critical issues facing the firm. You use the Q&A session as an opportunity to evaluate whether you would want to work with this company's management team. In the end, you decide to make some calls and gather more information about the market and the firm's competitors. The probability you would invest is low but you were impressed with the management team.

**11:00 AM** – Return calls received while you were in your 9:00 AM meeting and follow up on issues relating to another potential investment.

**12:30 PM** – You have lunch with an executive recruiter. This particular recruiter is tapped into the local pool of management talent in your domain. You have kept in touch with the recruiter after meeting her at a trade show last year. You make an effort to meet her once a quarter to hear the latest buzz and stay in her good graces. The lunch also offers an opportunity to discuss what you are seeing in your domain to fill the recruiter in on up and coming ventures.

**2:00 PM** – Call new companies you have heard about over the last few days. Ideally you are mining new invest ideas each day but find that your success is correlated with your mood so you save these calls for when you are most upbeat. These calls typically last longer than you planned so it is also important to have a block of time set aside. You leave voicemails for four CEOs but are able to get through with one and spend an hour talking with him about his firm and its market position.

**3:30 PM** – You and a partner meet with a portfolio company on a conference call. The company is facing some challenges and you offer to screen executive recruiters to help find a new CFO for the firm. The GP offers to talk to two M&A firms to get an opinion on selling the portfolio company. At the end of the call the GP gives you the name of several executive recruiters which you add to your own list of contacts.

**4:00 PM** – You call the executive recruiters and determine their ability to complete the search for your firm's portfolio company.

**4:40 PM** – Make due diligence calls for a potential investment. Last week you spent time trying to model the economics of an investment in the firm. This week you are talking with suppliers and customers to determine how realistic the assumptions of your model are. You also hope to unearth additional information about the management team.

**5:45 PM** – Make calls to the west coast. Confirm your dinner plans. Do some miscellaneous surfing on the internet to gather articles on the domain you are covering.

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<sup>16</sup> From the 2001 **Vault Career Guide to Venture Capital**

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**6:30 PM** – Stop in to talk with a few of the VPs and GPs to brainstorm some investment ideas and learn what is happening with each of the companies they are following.

**7:00 PM** – Dinner with two Associates from other firms. It is a good opportunity to network as well as gain fresh perspectives on the deals you are looking at.