



## **THE PRIVATE EQUITY VENTURE CAPITAL CLUB'S PRIVATE EQUITY & VENTURE CAPITAL INDUSTRY SNAPSHOT**

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### **Introduction**

Widespread use of the phrase “private equity” dates back to the late 1980s. For most of the decade, leveraged buyout firms had routinely tried to profit by breaking the companies they had acquired into pieces and then selling them off. The theory was that by breaking companies apart, a firm could awaken buyers to the true value of a company’s assets, and then profit from their sale, one by one. The strategy proved a financial success, but a public relations debacle. By the late-1980s, the business press was regularly lambasting leveraged buyout firms for what they perceived as their rampant greed and arrogance. By the early 1990s, few leveraged buyout firms were pursuing “buy-and-bust” strategies anymore, but the damage to their image had been done. Many leveraged buyout shops decided that the answer was to call themselves something new. They settled on “private equity firms” — an innocuous sounding moniker that, as with most euphemisms, is less descriptive and more ambiguous than the phrase it replaced.

For buyout firms, the attempt to rename their business was only a partial success. The press by and large still refers to leveraged buyout firms as leveraged buyout firms, or LBO firms. However, firms did succeed in getting “private equity” into the lexicon. Some people, as it was intended, use the term private equity as a synonym for leveraged buyout. More commonly, however, people use private equity in a broader sense, as we do, to describe any investment strategy that involves the purchase of equity in a private company. Along with leveraged buyouts, these strategies include venture capital investments, distressed debt investments and mezzanine debt financings.

The private equity market has experienced unprecedented growth during the past decade, and it is still growing. Since 1991, venture capital, LBO and other private equity firms have raised record amounts of money to finance private, entrepreneurial companies. The rise in capital raised and deployed has been astounding. At the beginning of the decade, in 1991, private equity firms raised just \$8 billion for their investments, from individual and institutional investors. By 2000, private equity firms succeeded in raising more than 20 times that amount, \$175 billion, on the strength of double-digit investment returns through much of the decade. However, the recent decline in the overall economy and lower transaction volume has made capital difficult to deploy. The year 2003 remained difficult for private equity fundraising. Private equity firms raised \$43.9 billion for new investments in 2003, falling 26% from the 2002 level.

The companies that private equity firms finance span the spectrum of technologies, from cutting-edge medical and Internet start-ups to established, old-line manufacturing companies. They include service companies as well, such as retail stores, health care management companies, money management firms and similar businesses. The common denominators for these businesses include sophisticated financial investors, highly motivated owner-managers, and the opportunity for both to earn exceptional investment returns.

### **Leveraged Buyouts**

Leveraged buyout firms specialize in helping entrepreneurs finance the purchase of established companies. The approach of such firms is to provide a management team with enough equity to make a small down payment on the purchase of a business, and then to pay the rest of the purchase price with borrowed money. The assets of the company are used as collateral for the loans, and the cash flow of the company is used to pay off the debt. Because the acquired company itself is paying the freight for its own acquisition, these investments were originally known as “boot-strap” deals. Eventually they became known as leveraged buyouts (LBOs), or management buyouts (MBOs, in which the company’s management, typically alongside some sort of financial sponsor, leads the buyout).

The LBO business has changed dramatically since the buy-and-bust days of the 1980s. Largely because companies today are so highly priced, the buy-and-bust approach rarely works anymore. In addition, banks and other lenders today are much more conservative about lending money for leveraged buyouts (typically lenders will provide debt to

a company according to a multiple of the company's cash flow). As a result, buyouts today are financed with more equity. The companies acquired are usually divisions being sold by corporations that are refocusing on their core businesses, or businesses owned by families who wish to cash out. To earn an attractive return on their investment, LBO firms today must build value in the companies they acquire. Typically, they do this by improving the acquired company's profitability, growing the acquired company's sales, purchasing related businesses and combining the pieces to make a bigger company, or some combination of those techniques. One of those most popular techniques these days is the consolidation, or "buy-and-build." The consolidation is the polar opposite of the buy-and-bust. It involves not the breaking up of large companies, but the merging of small ones into an organization that, in theory, at least equals more than the sum of its parts. Buyout firms pursuing consolidations have a number of ways of increasing their returns — through leverage, cost-cutting measures, and internal growth. They also can benefit from the fact that small companies, because they attract fewer potential buyers, generally command lower purchase multiples than large companies. Consolidators can therefore pay low multiples of cash flow on the companies they buy, but sell the large company they create at high multiples -- depending, of course, on market conditions.

### **Venture Capital**

Risk capital for starting, expanding and acquiring companies is critical to the growth of any economy. During most of the history of the United States, the market for arranging such financing was fairly informal, relying primarily on the resources of wealthy families. After the Second World War, the system started to change. Specialized investment management firms began to be formed with the specific purpose of financing start-up companies that entrepreneurs were launching. Two of the earliest such firms were Boston-based American Research & Development Corp. (ARD) and Connecticut-based J.H. Whitney & Co. ARD's best known investment was the start-up financing it provided in 1958 for computer maker Digital Equipment Corp. One of J.H. Whitney's seminal investments was financing that helped to transform a military technology intended to provide a nutritious beverage for troops in the field into a product that today is a household name: Minute Maid Orange Juice.

The number of such specialized investment firms, eventually to be called venture capital firms, began to boom in the late 1950s. The growth was aided in large part by the creation in 1958 of the federal Small Business Investment Company program. SBICs are federally licensed venture capital firms that can borrow money with a government guarantee of repayment. That guarantee allows SBICs to raise money inexpensively. They must then invest the money in entrepreneurial companies. Hundreds of SBICs were formed in the 1960s, and many remain in operation today. They have been surpassed in number, however, by more than a thousand independent private venture capital companies that don't rely on government support.

During the 1960s and 1970s, venture capital firms focused their investment activity primarily on starting and expanding companies. More often than not, these companies were exploiting breakthroughs in electronic, medical or data-processing technology. Early successes include, for example, Intel Corp., Apple Computer Corp., Lotus Development Corp., Genentech Corp. and Federal Express Corp. As a result, venture capital came to be almost synonymous with technology finance.

Today, an estimated 900 venture capital firms in the United States raise outside capital from individual and institutional investors to finance their activities. Most are quite specialized, often investing in a single field, such as telecommunications or health care, and often only in one part of the country, such as the San Francisco Bay area, or Texas. Venture capital firms also tend to specialize by stage of investing. There are no hard and fast definitions for these stages. Roughly speaking, however, seed-stage firms tend to provide a few hundred thousand dollars, and perhaps some office space, to an entrepreneur who needs to flesh out a business plan. Early-stage investors back companies at a point where they have a completed business plan, at least part of a management team in place, and perhaps a working prototype. Late stage-round investors typically provide a second or third-round of financing, often of \$10 million or more, that funds production, sales and marketing, and carries the company into the revenue-producing stage. Mezzanine, or pre-IPO-stage, investors provide a final round of financing that helps carry the company to an initial public offering.

The advent of the Internet as a new medium for both personal and business communications and commerce created an avalanche of opportunities for venture capitalists in the mid- and late-1990s. As a result, the industry experienced extraordinary growth, both in the number of firms, and in the amount of capital they raised. In 2000, for example, 494 venture firms raised \$92.3 billion for new investments, a 57% increase from the \$59.8 billion

raised the year before. Yet, the activity peaked in 2000, with 6587 companies obtaining venture funding through 8303 deals, with a total investment of \$108 billion. After the bubble burst, investment activity returned to less exuberant levels. In 2004, 1364 companies received venture capital investment through 1447 deals, with a total investment of \$10.6 billion.

### **Mezzanine Debt**

Just as mezzanine seating is in the middle balcony of a theater, mezzanine debt firms provide a middle level of financing in leveraged buyouts — below the senior debt layer and above the equity layer. A typical mezzanine investment includes a loan to the borrower, in addition to the borrower's issuance of equity in the form of warrants, common stock, preferred stock, or some other equity investment. Often, the loan is contractually subordinated to a loan made by one or more senior secured lending institutions. Typically, the note evidencing the loan has a maturity of between six and 10 years, with interest paid only during the first five years. Because the loan is subordinated, the interest rate generally is higher than the rate on the senior debt, and a limited amount of equity is issued to the mezzanine investor for nominal consideration.

Mezzanine investments have been used extensively to help fund the purchase and recapitalization of private, middle-market companies. Mezzanine investors also invest in smaller public companies and in foreign entities. Often, the borrower is highly leveraged after the investment is made. Because mezzanine investments include both debt and equity portions, mezzanine investors have defied the traditional classifications of lenders, on the one hand, and equity investors, on the other. The flexible nature permits a mezzanine investor to emphasize the capital preservation and current-pay features of a loan and, at the same time, seek significant upside on its investment through the equity participation.

It is the combination of the two features which form the economic rationale for the investment and which justifies investor involvement in the mezzanine market. The subordination of the loan creates risk that cannot be compensated solely by the coupon on the debt. The equity portion should provide enough upside potential to make the mezzanine investment attractive to the investor. The mezzanine investor has determined not to take equity risk, otherwise it would buy only equity securities and price the investment for an equity return.

### **Distressed Debt**

Distressed debt firms, as their name implies, buy corporate bonds of companies that have either filed for bankruptcy or appear likely to do so in the near future. Their penchant for seeking out highly troubled companies has led some in the financial press to refer to them as “vulture capitalists.” The unflattering metaphor only goes so far, however. Distressed debt firms do, of course, sniff out the sick and weak. But they generally have no taste for carrion. They make their highest returns not by liquidating a company, but by nursing it back to health. The strategy of distressed debt firms involves first becoming a major creditor of the target company by snapping up the company's bonds at pennies on the dollar. This gives them the leverage they need to call most of the shots during either the reorganization, or the liquidation, of the company. In the event of a liquidation, distressed debt firms, by standing ahead of the equity holders in the line to be repaid, often recover all of their money, if not a healthy return on their investment. Usually, however, the more desirable outcome is a reorganization that allows the company to emerge from bankruptcy protection. As part of these reorganizations, distressed debt firms often forgive the debt obligations of the company, in return for enough equity in the company to compensate them. (This strategy explains why distressed debt firms are considered to be private equity firms.) Unburdened of the interest payments on the forgiven debt, the company becomes better positioned to rejuvenate itself. In addition, distressed debt firms typically employ people expert in effecting “workouts,” or company turnarounds. When the newly healthy company is later sold or taken public, distressed debt firms stand to profit handsomely from cashing out their equity positions.

### **Funds-of-Funds**

For any number of reasons, investing directly in private equity funds can be difficult — particularly for individual investors and small institutional investors. Information about the performance of private equity managers is generally difficult to find. Gaining investment access to what are perceived to be the top-performing venture capital and buyout funds is problematic, since the fund managers often have more demand for their funds than they can accommodate. Finally, the relatively high investment minimums that fund managers generally require -- \$20

million isn't uncommon for a large buyout fund — make it challenging for a small institutional or high-net-worth investor to gain sufficient diversification.

For these and other reasons, private equity funds of funds have grown rapidly in popularity during the past few years. The fund of fund manager co-mingles the investments of many small investors into a single pool, and then uses it to assemble a portfolio of private equity funds. The minimum commitment to a fund of funds for individual investors is often in the \$250,000 to \$500,000 range — a single, manageable investment that gives investors an instantly diversified set of private equity investments. As the fund of funds industry has matured, managers have begun creating more specialized investment pools that provide investors with more targeted exposure — say, for example, to a portfolio of venture capital funds. For this reason, even many large institutional investors have found the fund of funds to be a useful vehicle for giving them additional exposure to areas of private equity in which they have been under-weighted.

The main drawback of investing in a fund of funds is the added layer of fees. Fund of fund managers generally charge a 1 percent annual fee for their services. Many also take a small carried interest, or share of profits, in the 5 percent to 10 percent range. This layer of fees exists in addition to the management fees (typically 1.5 percent to 2.5 percent) and carried interest (typically 20 percent to 30 percent) charged by the underlying fund managers.

Private equity funds of funds have been in existence for more than 20 years, but the past three years have seen a sudden surge in their numbers and capital under management.

### **Secondary Purchases**

Private equity investments are generally considered illiquid. There are no public stock exchanges, as there are for publicly-traded securities, on which to buy and sell interests in private equity funds. However, a small secondary market for these interests has developed over the years, giving investors the chance to sell if they desire to. This, in turn, has led to the creation of additional investment opportunities for individual and institutional investors.

A small group of private equity firms specialize in purchasing secondary interests in private equity partnership interests. Managers of secondary funds are not altogether different from those of funds of funds. They don't generally invest directly in companies, but rather in the private equity funds managed by buyout firms or venture capital firms. The big difference is that they are buying their interests in a fund after the fund has been at least partially deployed in underlying portfolio companies. So unlike fund of fund managers, which generally invest in blind pools, secondary buyers can evaluate the underlying companies in which they are indirectly investing.

The secondary market remains a relatively small part of the private equity world with \$1.8 billion raised exclusively for secondary purchases in 2000, compared with \$1.6 billion the year before. However, as mentioned, investors in funds of funds often gain exposure to the secondary market, as fund of fund managers who have secondary allocations generally set those allocations at up to 20 percent.

## **Commonly Asked Questions About Private Equity**

### **How are private equity funds structured?**

Private equity funds typically are structured as private limited partnerships. The individual managers of a fund make up the general partner. The providers of capital—the individual and institutional investors—are the limited partners. Elaborately detailed private equity partnership agreements signed by the parties involved govern the actions, and carve out the roles, of both the general and limited partners. For example, most partnership agreements allow for the general partner to draw down capital as needed for individual investments, rather than establishing a fixed timetable for draw-downs. Agreements typically provide for an investment period of five to seven years, and for a partnership term of 10 to 12 years, at the end of which any remaining holdings in the portfolio are liquidated, and the cash and stock are distributed to the limited partners.

### **How do investments in private equity funds differ from those in public securities?**

The main difference is that private equity investments are illiquid. Limited partners in a private equity fund agree to make their capital commitments available for draw-downs by the general partner over a period of five to seven years. There is no public exchange for the trading of limited partnership interests. Although some firms specialize in buying secondary interests in limited partnerships (see “Secondary Purchases”), such firms generally demand an illiquidity discount that cuts into the returns of the seller. Depending on how skillfully the general partner invests, limited partners begin receiving cash or stock distributions a few years into the life of a partnership. They generally won’t receive their final distributions until the last years of what typically is a 10-year partnership term.

### **How are fund managers compensated?**

The general partner has two main sources of income. One is the annual management fee, which is calculated as a percentage of total capital commitments to the fund—generally in the 1.5 percent to 2.5 percent range. The second is the carried interest, or share of profits. Traditionally, the carried interest has been 20 percent. However, in recent years, several top-performing venture capital firms have raised their carried interests to 25 percent, or even 30 percent. In some cases, the general partner will guarantee a minimum internal rate of return to the limited partners before sharing in profits. This is referred to as a preferred return. The preferred return is a far more common feature of buyout funds than it is of venture capital funds.

### **What is the typical private equity job description (Post-MBA)?**

Most MBA’s enter private equity firms as associates. Typical primary responsibilities of an associate include: screen incoming business plans and ideas, perform financial analysis and due diligence on potential investments, and assist existing portfolio companies in developing their businesses (including various strategic, financial, marketing, and operational advice as needed). The goal of every associate is to make it to the coveted partner level, where he/she begins to share in the equity gains of the firm’s investments, commonly referred to as carried interest. Some firms offer equity stakes (or “carried interest”) to senior associates.

### **What are the typical private equity qualifications and experience?**

The skills that are important for success are demonstrated leadership, analytical skills, interpersonal skills, strategic thinking ability, initiative, creative problem solving skills, and an ability to work in an unstructured environment. There is no typical professional background for private equity professionals. MBA’s, doctors, lawyers, PhD’s, and various other professionals have made their way into private equity firms.

### **Why is private equity so sought after?**

It is often claimed that private equity professionals can have more reasonable lifestyles, as compared to other careers (i.e. investment banking and consulting). This, to a certain extent, is a myth. When the deal flow is high, private equity professionals work extremely hard. They may not put in the 120-hour weeks that bankers do, but they will certainly average over 60 hrs/week. However, private equity can be an extremely rewarding career. The industry offers both the potential for incredible wealth creation and an extremely intellectually stimulating work environment that combines many of the skills of both consulting and investment banking. In addition, early stage private equity professionals boast the ability to affect the economy by funding new industries and technologies. Finally, the industry is a true meritocracy. In the end, what is important is your ability to source and close deals that return significant value to the firm and the limited partners.

**Why do institutional and wealthy individual investors generally allocate a portion of their portfolios to alternative assets such as private equity?**

Private equity is considered to be a high-risk, high-return asset class that, in moderation, can enhance the overall return of a well-diversified investment portfolio. Studies also have shown that private equity returns don't correlate closely with returns from other asset classes, such as bonds and public equities. Having an allocation to private equity therefore can help smooth out the returns of a balanced portfolio. Institutional investors generally set target allocations to private equity of anywhere from 1 percent to 25 percent, depending on their appetite for risk and their need for liquidity.

**What are the minimum requirements to invest in a private equity fund?**

The minimum commitments that private equity firms set for their funds generally run from \$1 million to \$25 million or more. Typically, they range from \$5 million to \$10 million. Fund of fund managers generally set minimum commitments in the \$250,000 to \$500,000 range for individuals, and significantly higher for institutions. At their discretion, general partners can make exceptions to these minimum commitments, and they often do. Amendments made in 1996 to The Investment Company Act of 1940 give private equity firms an incentive to accept individual investors if they have investable assets of \$5 million or more and institutional investors if they have investable assets of \$25 million. The incentive is that private equity firms can accept up to 499 so-called "qualified investors" as limited partners in their partnerships; otherwise, they can accept a maximum of 99 limited partners. Under Regulation D of the Securities and Exchange Commission's rules, which govern the private placement of funds, private equity firms under most circumstances can't have more than 35 unaccredited investors as limited partners. To be accredited, an individual investor must have a net worth of \$1 million (or joint net worth with spouse), or have made at least \$200,000 in each of the prior two years (or joint income with spouse of at least \$300,000), and have a reasonable expectation of making at least the same amount the next year.

### **How do I best position myself for a private equity job?**

- Determine your stage preference. For example, in early-stage funds, there is less financial modeling and a heavier emphasis on operating experience. Late stage and leveraged buyouts tend to be more quantitative.
- Thoroughly research the firms. Each firm has a specific focus, investment strategy, and culture. Understand these elements before contacting the firm.
- Decide on an industry focus. Direct experience and knowledge in a specific area are advantages when competing for a position.
- Use your networks. The road to a private equity job is a long one that requires commitment and creativity. The best way to get in front of a private equity professional is to be introduced by someone whom they respect. Use your classmates and the Columbia alumni network!
- Start the process early. Finding a position in the private equity world can be a full-time job. It takes time to find the right firm, get the initial meeting and build a rapport that could lead to an offer.
- Get involved with the Private Equity Club. One of the best ways to meet private equity professionals is through our annual conferences and by meeting guest lectures organized by the club.
- Read industry publications to stay abreast of developments in the industry. If you see that someone is starting a new fund, it could mean a few associate positions available. Red Herring, the Daily Deal, Private Equity Analyst and Buyouts are some key publications. *Venture Capital At The Crossroads* and *Done Deals* are good books to learn the history and structure of the industry.
- Be geography flexible: Many of the big firms are located in major cities, usually in close proximity to the industries they focus on or financing sources. However, many of the other firms are located in Boston, Washington DC and Texas.

### **Terms commonly used in private equity:**

**Angel Investor:** A person who provides backing to very early-stage businesses or business concepts. Angel investors are typically entrepreneurs who have become wealthy, often in technology-related industries.

**Board seats:** Venture firms often acquire positions on the board of directors of their portfolio companies. A board seat gives a venture firm a means of monitoring and managing a company they invest in.

**Bridge financing:** As the name implies, bridge financing is intended as temporary funding that eventually will be replaced with permanent capital. In some cases, lenders will provide buyout firms and venture capital firms with bridge loans so that they can begin investing, before they have closed on capital for their funds. Likewise, a buyout or venture firm might provide a portfolio company with a temporary financing until permanent financing is in place.

**Capital Take-Down:** The schedule by which the general partner of a fund draws down capital from the limited partners to be used for investments. Most general partners today call down capital only as they require it, rather than in pre-set amounts according to a rigid timetable.

**Carried interest:** The general partner's share of the profits generated through a private equity fund. The carried interest, rather than the management fee, is designed to be the general partner's chief incentive to strong performance. A 20 percent carried interest—meaning that the remaining 80 percent reverts to the limited partners—has been the industry norm, although some firms now take 25 percent or even 30 percent, based on very strong performance on past funds.

**Catch-up:** This is a common term of the private equity partnership agreement. Once the general partner provides its limited partners with their preferred return, if any, it then typically enters a catch-up period in which it receives the majority or all of the profits until the agreed upon profit-split, as determined by the carried interest, is reached.

**Co-investor:** Although used loosely to describe any two parties that invest alongside each other in the same company, this term has a special meaning in relation to limited partners in a fund. By having co-investment rights, a limited partner in a fund can invest directly in a company also backed by the fund managers itself. In this way, the limited partner ends up with two separate stakes in the company; one, indirectly, through the private equity fund to which the limited partner has contributed; another, through its direct investment. Some private equity firms offer co-investment rights to encourage limited partners to invest in their funds.

**Consolidation:** Also called a leveraged rollup, this is an investment strategy in which an LBO firm acquires a series of companies in the same or complementary fields, with the goal of becoming a dominant regional or nationwide player in that industry. In some cases, a holding company will be created, into which the various acquisitions will be folded. In other cases, an initial acquisition may serve as the platform through which the other acquisitions will be made.

**Direct investment:** See co-investor

**Distributions:** Cash or stock returned to the limited partners after the general partner has exited from an investment. Stock distributions are sometimes referred to as “in-kind” distributions. The partnership agreement governs the timing of distributions to the limited partner, as well as how any profits are divided among the limited partners and the general partner.

**Due diligence:** A process of inspection that a venture capital or other private equity firm carries out before closing on a deal. Venture capitalists, for example, might review a company's accounting practices and managerial structure.

**Evergreen fund:** A fund in which returns generated on investments are automatically returned to the general pool, with the aim of keeping a continuous supply of capital on hand for investments.

**Exit:** The means by which a private equity firm realizes a return on its investment. For venture capitalists, this typically comes when a portfolio company goes public, or when it merges with or is acquired by another company.

**Fund raising:** The process through which a firm solicits financial commitments from Limited partners for a private equity fund. Firms typically set a target when they begin raising the fund, and ultimately announce that the fund has closed at such-and-such amount, meaning that no additional capital will be accepted. Sometimes, however, the firms distinguish between interim closings (first closings, second closings, etc.) and final closings. The term cap is used to describe the maximum amount of capital a firm is willing to accept into its fund.

**Fund of funds:** A private equity fund that, instead of being used to make direct investments in companies, is distributed among a number of other private equity fund managers, who in turn invest the capital directly. Funds of funds often give individual limited partners access to funds from which they would otherwise be excluded. Also, by spreading the capital more widely, the risk to limited partners is reduced.

**General partner:** In addition to being used as a title for top-ranking partners at a private equity firm, general partner (or general partnership) is used to distinguish the firm managing the private equity fund from the limited partners, the individual or institutional investors who contribute to the fund.

**General partner clawback:** This is a common term of the private equity partnership agreement. To the extent that the general partner receives more than its fair share of profits, as determined by the carried interest, the general partner clawback holds the individual partners responsible for paying back the limited partners what they are owed.

**General partner contribution:** The amount of capital that the fund manager contributes to its own fund in the same way that a limited partner does. This is an important way in which limited partners can ensure that their interests are aligned with those of the general partner. The U.S. Department of Treasury recently removed the legal requirement of the general partner to contribute at least 1 percent of fund capital. However, a 1 percent general partner contribution remains common, particularly among venture capital funds.

**Incubator:** An entity designed to nurture business concepts or new technologies to the point that they become attractive to venture capitalists. An incubator typically provides both physical space and some or all of the services—legal, managerial, technical—needed for a business concept to be developed. Incubators often are backed by venture firms, which use them to generate early-stage investment opportunities.

**Initial public offering (IPO):** When a privately held company—owned, for example, by its founders and its venture capital investors—offers shares of its stock to the public.

**Lead investor:** The firm or individual that organizes a round of financing, and usually contributes the largest amount of capital to the deal.

**Leveraged buyout (LBO):** The acquisition of a company in which the purchase is leveraged through loan financing, rather than being paid for entirely with equity funding. The assets of the company being acquired are put up as collateral to secure the loan.

**Leveraged roll-up:** See consolidation.

**Limited partners:** Institutions or individuals who contribute capital to a private equity fund. Limited partners typically are pension funds, private foundations, and university endowments. However, private equity firms themselves may serve as limited partners in other firms' funds, as, for example, when a large buyout firm channels money to a fund managed by a venture capital firm. See also general partner.

**Limited partner clawback:** This is a common term of the private equity partnership agreement. It is intended to protect the general partner against future claims, should the general partner or the limited partnership become the subject of a lawsuit. Under this provision, a fund's limited partners commit to pay for any legal judgment imposed upon the limited partnership or the general partner. Typically, this clause includes limitations on the timing or amount of the judgment, such as that it cannot exceed the limited partners' committed capital to the fund.

**Management buyout:** The acquisition of a company by its management, often with the assistance of a private equity investor.

**Market capitalization:** The overall value of a publicly traded company, derived by multiplying the total number of shares by the share price.

**Mezzanine fund:** Used to provide a middle layer of financing in some leveraged buyouts, subordinated to the senior debt layer, but above the equity layer. Mezzanine financing shares characteristics of both debt and equity financing.

**Management fee:** This annual fee, typically a percentage of limited partner commitments to the fund, is meant to cover the basic costs of running and administering a fund. Management fees tend to run in the 1.5 percent to 2.5 percent range, and often scale down in the later years of a partnership to reflect the reduced work load of the general partner. The management fee is not intended to be the primary source of incentive compensation for the investment team. That is the job of the carried interest.

**PIPEs:** An acronym for “private investing in public equities.” See private placement.

**Placement agent:** An outside firm hired by a general partner to market its fund to institutional investors. The general partner typically pays a 2 percent fee of the capital raised from new sources by the placement agent.

**Portfolio company:** A company in which a venture capital firm or buyout firm invests. All of the companies currently backed by a private equity firm can be spoken of as the firm’s portfolio.

**Preferred return:** The preferred return is a minimum annual internal rate of return sometimes promised to the limited partners before the general partner shares in profits. In effect, the preferred return ensures that the general partner shares in the profits of the partnership only to the extent that the investments perform well. Once the preferred return is met, there is often a catch-up period in which the general partner receives the majority or all of the profits until it reaches the agreed upon profit-split, as determined by the carried interest.

**Preferred stock:** This is one of the most common classes of shares for venture capital and buyout firms to hold. Preferred stock pays dividends at a set rate, and holders get paid before common stock holders in the event of a liquidation. Convertible preferred stock is convertible into common stock at a pre-determined price per share.

**Private equity advisor:** An outside firm hired by an institutional investor, such as a state retirement system, to handle the selection, negotiation and monitoring of private equity funds. An advisory assignment can be non-discretionary, in which the institutional investor retains the final say on investment decisions, or discretionary, in which the advisor has the legal authority to make investment decisions on the client’s behalf.

**Private placement:** This term is used specifically to denote a private investment in a company that is publicly held. Private equity firms that invest in publicly traded companies sometimes use the acronym PIPEs to describe the activity—private investing in public equities. Occasionally, private investors will acquire 100 percent of the shares of a publicly traded company, a process known as a “going-private” deal.

**Seed-stage fund:** A pool of money used to back companies too small to attract mainstream venture firms.

**Small Business Investment Company:** A licensed member of a U.S. Small Business Administration program that entitles an investment firm to obtain matching federal loans for its private equity investments. Typically, a firm will have access to \$2 in credit for every \$1 that it invests in a company. If an SBIC raises \$20 million, it will have access to up to \$40 million in low-interest loans, drawn down on a deal-by-deal basis.

**Spin out:** A division or subsidiary of a company that becomes an independent business. Typically, private equity investors will provide the necessary capital to allow the division to “spin out” on its own; the parent company may retain a minority stake.

**Strategic investment:** An investment that a corporation or affiliated firm makes in a young company that offers to bring something of value to the corporation itself. The aim may be to gain access to a particular product or technology that the start-up company is developing, or to support young companies that could become customers for

the corporation's products. In venture capital rounds, strategic investors typically are sometimes distinguished from financial investors—venture capitalists and others who invest primarily with the aim of generating a large return on their investment.

**Venture capital rounds:** Portfolio companies typically receive several rounds of venture capital before going public. The first round is usually smaller than subsequent rounds, and likely to involve fewer investors. Note that first-round funding does not necessarily mean that the company has received no previous outside backing. The term “first round” is still appropriate if previous backing consisted of, say, \$500,000 from an angel investor. A first round typically is the first round involving participation by a venture capital firm.

**Warrant:** An option to purchase stock in a company, typically exercised over an extended period.

## **References For A Private Equity Job Search**

### **Books in the CRC**

- Wet Feet Press “*The Insider’s Guide to Venture Capital*”. Excellent source of information. Provides a ‘day in the life of a venture capitalist’ plus other helpful hints on landing a job in VC. Also has a list of the larger VC firms.
- Vault Career Guide to Venture Capital (CRC – overnight loan)
- Inside the Minds: Venture Capitalists (CRC – three day loan)
- The VC Way: Investment Secrets from the Wizards of Venture Capital (CRC – seven day loan)
- Done Deals (CRC – seven day loan)

### **Magazines/Journals in the CRC and/or Watson Library**

#### Technology Related Information

- *Business 2.0* – one of the few tech/business magazines to survive the .com bubble.
- *Fast Company* – more general; interesting articles on emerging companies (CRC)
- *Red Herring* – one of the hottest magazines covering technology, had closed and is now back (CRC)
- *Wired* – another popular technology magazine (CRC)

#### Other Directories/Trade Journals

- The Daily Deal (CRC)
- **The Private Equity Analyst (CRC)**
- Venture Capital Analyst (Health Care, Technology) (Watson)
- Buyouts (Watson)
- Nelson’s Directory of Investment Managers (Watson)
- Asian Venture Capital Journal (Watson)
- European Venture Capital Journal (Watson)
- Institutional Investor (Watson)

### **Related Web Sites**

The internet is one of the BEST places to look for current information on Venture Capital and developments within the industry.

- [www.thedeal.com](http://www.thedeal.com) (Daily Deal website)
- [www.venturewire.com](http://www.venturewire.com) (VentureWire website)
- [www.privateequityonline.com](http://www.privateequityonline.com) (PrivateEquityOnline.com)
- [www.nvca.org](http://www.nvca.org) (National Venture Capital Association)
- [www.yvcs.org](http://www.yvcs.org) (Young Venture Capital Society)
- [www.pwcmoneytree.com](http://www.pwcmoneytree.com) (PriceWaterhouseCoopers MoneyTree – survey providing info on VC financing)
- [www.vfinance.com](http://www.vfinance.com) (Home of the Venture Capital Resource Directory)
- [www.ventureeconomics.com](http://www.ventureeconomics.com) (Venture Economics)
- [www.garage.com](http://www.garage.com) (Garage.com)
- [www.redherring.com](http://www.redherring.com) (Red Herring website)
- [www.thestandard.com](http://www.thestandard.com) (Industry Standard Website)
- [www.assetnews.com](http://www.assetnews.com) (Asset Alternatives website)
- [www.privateequity.com](http://www.privateequity.com) (Links to firm websites)
- [www.thevc.com](http://www.thevc.com) (The VC Comic)
- [www.buyoutsnewsletter.com](http://www.buyoutsnewsletter.com) (Buyouts)

### **E-mail Lists and Newsletters**

- Private Capital Wire – <http://thedeal.exactis.com/cgi/subscribe.html> (daily in depth look at venture capital and private equity, with special weekly features, produced by the Daily Deal)

- DealMonitor – <http://www.vfinance.com/home.asp?ToolPage=emailnews.asp> (daily news on venture capital and investment banking)
- Venture Capital Newsletter – <http://www.nvst.com> (receive private market and news data)
- Private Equity Central News Update – <http://www.privateequitycentral.net//index2.cfm> (weekly update to news available on privateequitycentral.net)
- Venture Wire Alert – <http://www.venturewire.com/register.asp> (daily news and information about venture capital and private companies)
- The VC Buzz – <http://vcexperts.com/vce/news/buzz/subscribe.asp> (newsletter with information about the industry)
- Institutional Investor E-mail Newsletters – <http://www.institutionalinvestor.com> (after registering with the site for free, you can sign up for a number of industry-specific email newsletters)

### **Watson Library**

There is a lot of information in the library. Use CLIO to conduct a search to get specific information on what you are looking for. The information is separated by countries as well, if you are looking for opportunities in specific countries. Some of the directories in the reference section include *Pratt's Guide to Venture Capital Sources*, *Galante's Venture Capital and Private Equity Directory*, and *Directory of Private Equity Investors* (Venture Economics, Inc). There is also a binder that holds the trailing twelve months of issues of the Buyouts newsletter, a late-stage private equity focused publication.

Also, the NY Public Library Branch of Science, Industry, and Business in Murray Hill (34<sup>th</sup> & Madison) can be used for further research on this industry, including trade publications on financial services and the private equity sector; call 212-592-7000 for hours.