Prequin Compensation and Employment Outlook: Private Equity

December 2011

A survey of over 180 leading private equity firms into their compensation practices and levels of remuneration, as well as an overview of the number of firms and employment levels in the industry.
Methodology:

Prequin, the alternative assets industry’s leading source of data and intelligence, welcomes you to the H2 2011 edition of Prequin Compensation and Employment Outlook: Private Equity, a unique look at current trends in staffing levels, remuneration and the outlook for the future.

Prequin Compensation and Employment Outlook draws on the results of a study conducted in mid to late 2011 of over 180 private equity firms from around the world. The sample of private equity firms was selected from Prequin’s Fund Manager Profiles, the most comprehensive and accurate source of information on private equity GPs, their investment preferences, funds raised, available capital and more.

We hope that you find the information in this report useful and interesting. All feedback and suggestions you may have for improvements to future editions of this survey are welcome.

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The private equity industry, and in particular fundraising, has continued to suffer as a result of the prolonged global economic uncertainty and volatility. The peak years for private equity fundraising were 2007 and 2008, with more than 1,300 funds reaching a final close in each, having raised aggregate commitments of $665.9 billion and $679.5 billion respectively, as Fig. 1 shows. In the three years that have followed, fundraising has declined significantly, with just over $300bn raised in 2009, followed by another fall in 2010. The final figure for 2011 looks likely to be similar.

The fall in fundraising over the past three years has affected the number of new firms entering the private equity market to raise a fund for the first time. Fig. 2 shows the number of new fund managers joining the sector each year (calculated using the vintage of their first fund to represent their year of establishment). Any firms that have not raised a fund in the past 10 years are considered to have become inactive.

At the height of the fundraising boom in 2007 a large number of firms were establishing private equity funds for the first time. More than 450 new firms joined the sector in that year, the highest number of any year. Since then, however, the number of firms raising a fund for the first time has fallen significantly, with only around 150 new firms in 2011 as of November. (The 2011 figure only includes firms that have reached one or more interim closes on their debut funds in order to begin making investments.) With a number of firms becoming inactive due to last having raised a fund 10 years ago, this means that the total number of active firms in the industry has remained at a similar level to 2010, at around 4,500 managers.

The analysis contained within the body of the 2012 Preqin Private Equity Compensation and Employment Review drills down into the number of firms over time by fund type and geographic location, and reveals that a significant proportion of the firms dropping out of the industry were venture capital firms that last raised funds in the tech bubble and have been unable to raise further capital from investors since.

When private equity firms that do not raise, or have not yet raised, distinct private equity funds (i.e. those that manage corporate or personal capital and those that manage third-party capital without pooling into commingled private investment vehicles) are included, the total number of active firms under consideration increases from the 4,500 previously mentioned to more than 7,500.
The number of employees at private equity firms naturally varies significantly with the assets under management of the firms in question, as Fig. 3 shows. Firms with less than $250 million in assets under management have an average of 9.2 employees, while firms with more than $10 billion in total assets employ an average of more than 230 people. However, the larger firms tend to have far fewer employees per $1 billion in assets under management than the smaller firms, thus benefiting from economies of scale when it comes to charging asset management fees to their funds’ investors, which are usually based on a percentage of investor commitments.

When looking at employment levels by fund type, it is unsurprising given their prevalence that buyout firms employ the largest number of people, with an estimated 24,500 employees worldwide working at such firms. Primarily venture-focused firms also employ more than 20,000 people worldwide. Real estate firms employ an estimated 13,500 people, while the figure stands at 6,500 for private equity fund of funds managers. The management fees of the largest funds are very favourable and the management fees earned by these vehicles have become a significant source of income for their managers.

Firms with assets under management of $10 billion or more have an average of 10.5 members of staff per $1 billion in assets, or approximately $95 million managed per employee. For firms with less than $250 million in total assets, the figure rises to 86.8 employees per $1 billion, or around $11.5 million managed per employee. While larger funds tend to have somewhat lower management fees than smaller funds, the operating economics of the largest funds are very favourable and the management fees earned by these vehicles have become a significant source of income for their managers.

In total, private equity firms employ an estimated 85,000 people. It is important to note that our estimate here constitutes the “core” of the industry, taking into consideration firms managing capital committed by institutional and other large investors. Beneath this lies a further tranche of smaller firms that invest lesser sums of capital, raising money from private sources.

### Employment Levels at Private Equity Firms and Assets under Management

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Changes in Individual Remuneration

A firm’s assets under management also have a significant effect on the remuneration available to individuals at the firm, as one would expect. For example, the average total remuneration for a managing general partner at firms participating in the study with less than $100 million in assets under management is over $1.5 million, while the equivalent figure at the average firm with more than $800 million in total assets is more than $5 million.

Chapter 7 of the 2012 Preqin Private Equity Compensation and Employment Review contains base salary, total annual cash compensation, long-term incentive/carried interest award, and total remuneration data for 23 different positions, including all levels of seniority for deal-making positions as well as senior executive and administrative/corporate positions. Where possible, in addition to the aggregate figures, the information is broken out by assets under management, geographic market, and the strategy employed (buyout, venture, etc). Figures are provided for the 25th percentile, median, average, and 75th percentile benchmarks in each case.

“Most firms have kept average base salary levels unchanged or given relatively modest increases of up to 10%.”

Fig. 5 shows a breakdown of how base salaries have changed at participating firms between 2010 and 2011. Most firms have kept average base salary levels unchanged or given relatively modest increases of up to 10%. In addition, approximately 7% actually decreased base salary levels over the year. Given the uncertain economic outlook and the knock-on effect this has on the private equity industry, the changes in bonus payouts at firms participating in the survey have also been mixed. Payouts in 2011 (based on performance in calendar/fiscal year 2010) decreased compared to the previous year at 16% of firms. However, the proportion of firms reporting an increase was larger, at 39%.

The projected average firm-wide changes in base salaries for participating firms between 2010 and 2011 are shown in Fig. 6. Again, the most commonly reported bracket was a 1-10% increase, while 36% of firms stated no change. A further 6% noted a projected 21-50% average increase in base salaries on a firm-wide basis.

Bonus payouts remained at the same level overall as the previous year at nearly half of participating firms; however, nearly 40% of firms reported an increase in bonus payouts from the previous year, and 16% reported a decrease. This represents a shift from last year, when the proportion of firms reporting an increase in bonus payouts for performance in calendar/fiscal year 2009 was similar to the proportion reporting a decrease.

In addition to the individual compensation data, the Review also contains a detailed survey of various compensation practices at private equity firms, including employee eligibility for carried interest awards and how they are granted, carried interest vesting schedules, co-investment programs, additional benefits/perquisites, and more.

Fig. 5: Breakdown of Average Firm-Wide Changes in Base Salaries at Participating Firms between 2010 and 2011

![Fig. 5: Breakdown of Average Firm-Wide Changes in Base Salaries at Participating Firms between 2010 and 2011](source)

Fig. 6: Breakdown of Projected Average Firm-Wide Changes in Base Salaries at Participating Firms between 2010 and 2011

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Carried Interest

The distribution of carried interest is a key part of private equity firms’ compensation structures, with nearly 90% of firms participating in the study stating that they have a promote/carried interest program. Eighteen percent of firms include all of their employees in such a program, while at 54% of firms 40-80% of employees are eligible. Carried interest can be obtained by management (employees) in various ways, with some firms using multiple methods.

The most common method of carried interest being granted is by the company, with this method used by all firms active in Australia and South America that participated in the study, as well as over 90% of firms active in Asia/Pacific, over 80% of firms active in the US, and over 70% of firms active in Europe. Carried interest being acquired through co-investment is also common amongst participating firms active in the US and Europe, with 24% and 38% of firms active in these regions using this method respectively.

The most common method of granting promote/carried interest awards to employees is to grant up front for the life of the fund, which is used by 69% of firms. Fourteen percent of firms grant promote/carried interest annually, and 11% grant on a deal-by-deal basis, as Fig. 7 shows. Around 46% of participating firms set aside a ‘reserve’ of the promote/carried interest in order to use it in the future for purposes such as promotions, good performance and new hires. The average amount set aside as a proportion of the GP’s (company/sponsor) share by firms that do employ a ‘reserve’ is 11%. The average amount as a proportion of management’s (employees) share is 15%.

By far the most popular approach of how promote/carried interest awards vest at firms that participated in the study was fund-based vesting, whereby vesting is based on the fund close date. More than 80% of participating firms stated that they use this method of vesting for carried interest awards. The next most popular approach is for each deal to vest from its investment date, a method used by 11% of participating firms. A small proportion of firms (2%) use a method whereby each deal vests from the year the investment was made. For the average firm in Europe, the final 9% of the award does not vest until the date of the fund’s disposition. The figure is the same for firms active in Asia/Pacific, while for the US the figure stands at 7%. For firms active in the US, 81% of the award is vested by the end of year 5, while the figure for Europe is 73%.

The majority of participating firms in all geographic markets make promote/carried interest awards payments at the sale of the investment when the promote/carried interest is generated. A significant minority make the awards at the end of the fund life, however, with 40% of firms active in both Asia/Pacific and South America using this method. In most geographic markets, the proportion of firms with a clawback reserve of the promote/carried interest stands at about 50%, while the median levels of reserve as a proportion of the total promote/carried interest in each geographic market is as follows: Asia/Pacific 28%; Australia 25%; Europe 25%; US 30%.

At the majority (54%) of participating firms, once an employee has left his/her position, the retained interest – vested and/or unvested portions – continues to grow over time with the fund or account. At 24% of firms, the firm has the right to purchase the retained interest at fair market value. At 8% of firms, the firm has the right to purchase the retained interest at a discounted value.
Managing Director/Partner Info and Co-Investment Opportunities

The mean number of managing directors/partners at participating firms is three, while the median stands at four. Fig. 10 shows the average number of active investments and boards served on by managing directors/partners at participating firms, with median figures of seven and five respectively.

The mean number of managing directors/partners promoted from within the company is two, while the median stands at one; these figures are the same as the mean and median numbers recruited externally. For those promoted from within, the mean age at the time of promotion is 37 and the median is 40. The mean length of time at the firm before promotion is six years and the median is five years.

The breakdown of how managing directors/partners allocate their time between their various responsibilities is shown in Fig. 11. Work on new deals takes up an average of 36% of managing directors’/partners’ time, while managing the active portfolio takes up an average of 40%, with 20% of time used for corporate/general firm responsibilities. In terms of the median number of days of paid leave receive by employees at participating firms, split by seniority and by length of service, the average number of days of vacation increases with both seniority and length of service.

More than 40% of firms participating in the survey allow for co-investment by members of management (employees). Of these firms, 21% require co-investment, while 73% offer co-investment as an opportunity on a non-compulsory basis. Six percent of firms with a co-investment program have other arrangements, including requiring it of some employees and offering it to others.

Of the participating firms that do allow for co-investment, 23% have a loan program to help fund such co-investment. The most common borrowing ratio mentioned by participating firms was 1:1, i.e. that loans are used to fund 50% of the co-investment.

Fig. 9: Number of Active Investments and Boards Served on by Managing Directors/Partners at Participating Firms

Fig. 10: Average Division of Time Allocated to Various Responsibilities by Managing Directors/Partners at Participating Firms
2012 Preqin Private Equity Compensation and Employment Review

Produced in collaboration with leading compensation specialists FPL Associates, the 2012 Preqin Private Equity Compensation and Employment Review is the industry’s most comprehensive guide to compensation practices, featuring detailed benchmark remuneration data for 23 positions, split where possible by size, type and region using data provided by over 180 leading firms. A source of reliable and accurate information on the latest trends in private equity compensation and employment is a vital tool enabling decision-makers and advisors to examine existing compensation practices against wider industry benchmarks.

Key content includes:

- Compensation data by position, including base salary, bonus, carry, and quartile splits.
- Compensation data split by firm type, region and size where possible.
- Survey of compensation practices at private equity firms.
- Current employment within the private equity industry.
- Growth of the industry over time.
- Plus much more...

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