



The whole private equity business model is based on "profit sharing" i.e. sharing the profits made from the investments. Therefore, compensation is quite different from what you would encounter in a typical corporate environment, or within investment banking.

How do Private Equity firms get paid?

Private equity firms get paid in two main ways: management fees and carried interest.

- Management fees are paid regularly by the Limited Partners (i.e. the people who gave the money to the firm to invest) to the fund. This is calculated as a % of the assets under management. For example, if the Limited Partners invested \$1 billion with a private equity fund, they will pay something around 2% of that amount (1bn x 2% = \$20 million) per year to the fund as a management fee. Why do they have to pay this given that they already gave the fund money to invest? This is because the private equity funds have a lot of ongoing expenses that they need to cover: salaries, deal fees (that they pay to investment banks, consultants), travel, etc.

- Carried interest: this is a percentage of the profits that the fund gains on the investments. For example, if a company is bought for \$100 million and sold for \$300 million, the profit is \$200 million. The private equity firm usually takes about 20% of that amount (\$40 million), and the rest goes to the investors. However, it is not that straightforward in reality - there is often a "hurdle" rate of return that the fund has to make before they get paid anything. For example, the Limited Partners may ask that the fund only gets paid if the return is over 8% per annum. In addition, the profit is calculated for the performance as a whole for the whole amount invested (that may be 10 to 15 deals), not on a deal-by-deal basis.

- "Others": some private equity firms charge "deal fees". That means that each time they buy a company, they may charge some extra money to the investors. This is in theory to cover the extra expenses incurred during a deal.

How do Private Equity professionals get paid? Private equity professionals' compensation reflects the way the overall firm gets paid:

- Base salaries: usually on par with investment banking or consulting (sometimes slightly lower)

- Year-end bonuses: usually lower than what you would get in investment banking
- A "carry" component: represents the individual's share of profits. The more senior your level in the fund, the larger percentage you will receive of the overall carried interest. This profit share is always paid when all the profits in the fund have been realised (which can take five to seven years), and this can be very substantial because private equity funds are small, but they can manage very large amounts of money.
- Coinvestments: some private equity firms allow employees to invest their own money in some deals, and if the deal is successful, you could realise a significant profit as well.

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