Getting that Venture Capital
Part 4: Roles and structure of VC firm

Part 4: Role and structure of VC firm is part of the book **Getting that Venture Capital.** This is Mousuf Zaman.C's **Knowledge series**.

This is the conclusion of industry research, allowing the reader to gain knowledge on venture capital which is possessed by the top 20% of the population.

This book will be regularly updated to reflect industry change.

How to read this book

If going chapter by chapter and want to quickly finish… This will be a long read! I believe that you should implement what you learn, rather than try to collect information for "just in case" situation.

My hope is that you will pick up the book, start the chapter which you would like to learn about. That you will accumulate in your daily practice.

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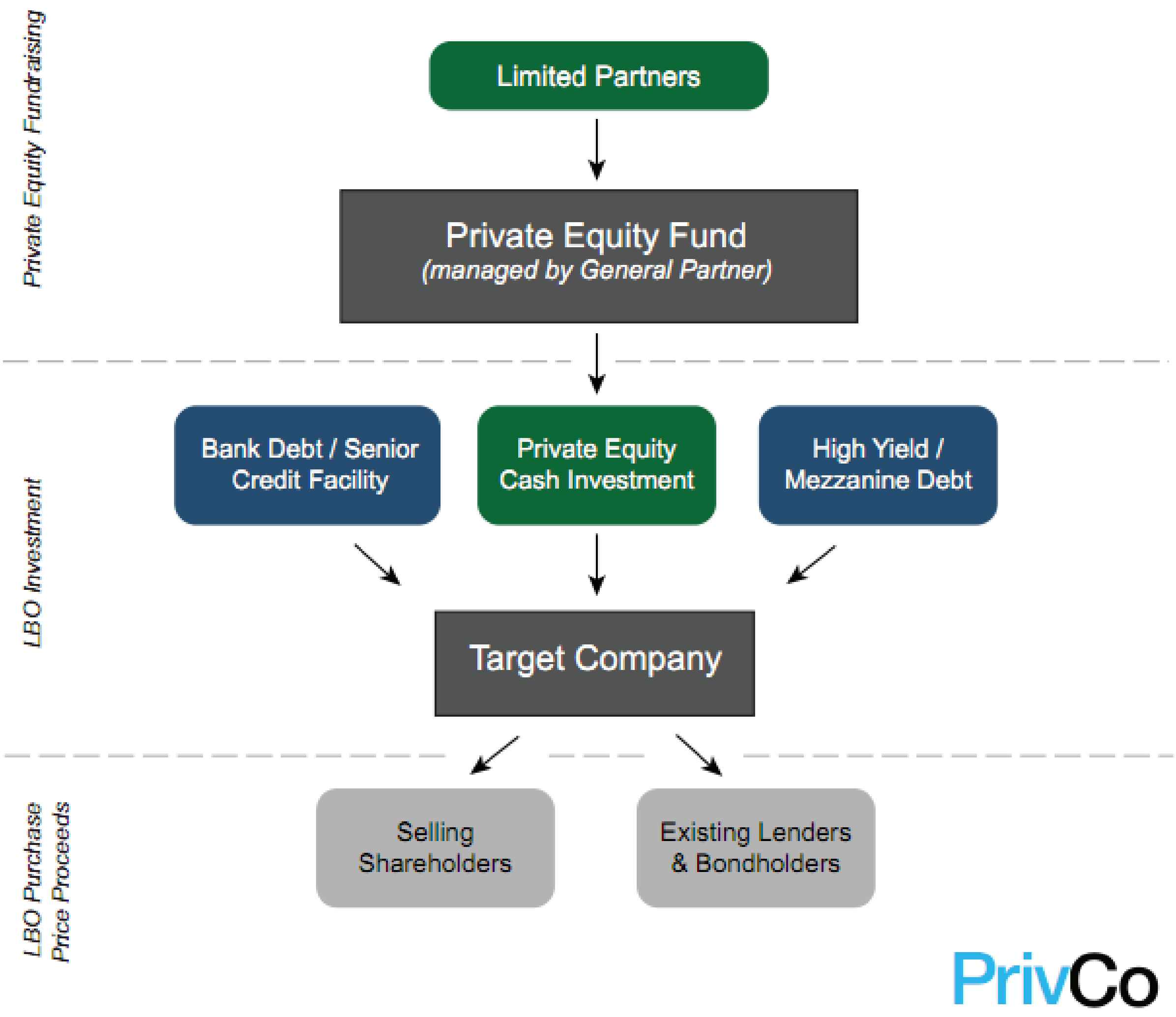
Part 4 – Roles and Structure of VC firm

VC – Role and Structure of a VC firm

Venture Capital organisation structure



- **Management Buyout (MBO)**—In a Management Buyout (MBO), the private company's existing managers acquire a huge chunk of the private company. The mangers attempt a buyout for multiple reasons including, to save their jobs, when the business is at risk for bankruptcy or if a third party external purchaser would bring about new, undesired, management changes. Management Buyouts would also be used to ward off hostile buyers.
- **Management Buy-In (MBI)**—In a Management Buy-in (MBI), an external entity accumulates the required capital to become the new management of the private

company. The difference between a management buyout and management buy-in is that in a MBO, the purchaser is already a part of the private company and in the case of a MBI, the purchaser is an external party.

- **Buy-In MBO (BIMBO)**—A Buy-in Management Buyout (BIMBO), the situation is a mix of both MBO and MBI. The outside parties and the existing managers or individuals form the new management team of the private company.
- **Institutional Buyout**—An institutional investor, like a private equity firm, acquires a major controlling stake in a private company. Unlike a MBO, wherein the management has a majority stake, in an Institutional Buyout, the private equity firm becomes the controlling shareholder. In some cases, the private equity firm which acquires the private company may sometimes retain the current management or hire new/additional management by offering stakes in the private company.
- **Secondary Buyout**—A Secondary Buyout is a leveraged buyout in which the private equity firm, which owns a major stake in the private company, may offer to sell its investment in a given private company to another external party, such as another private equity firm. Akin to the passing of a baton to a new owner, Secondary Buyouts are popular due to the liquidity they offer.
- **Add-On**—In a typical Add-On transaction, private companies are acquired as part of a consolidation investment strategy. A consortium of private equity firms acquires private companies that are active in the same or a related industry with the intention to merge or combine them together via an Add-On transaction, thus often increasing value, fostering revenue growth, and gaining a larger market share.
- **Dividend Recapitalization**—In a Dividend Recapitalization ("dividend recap"), a private company (most often post-buyout) takes on additional debt to issue a special dividend to private investors or shareholders. A private equity firms' portfolio private company can authorize a dividend recapitalization as a substitute for selling an equity stake in the private company. It serves as an opportunity for private equity firms to recoup a portion or the complete amount of their investment used to purchase their initial stake. However, since a Dividend Recapitalization reduces the credit quality of the private company, common shareholders and creditors often do not consider it a favourable option.

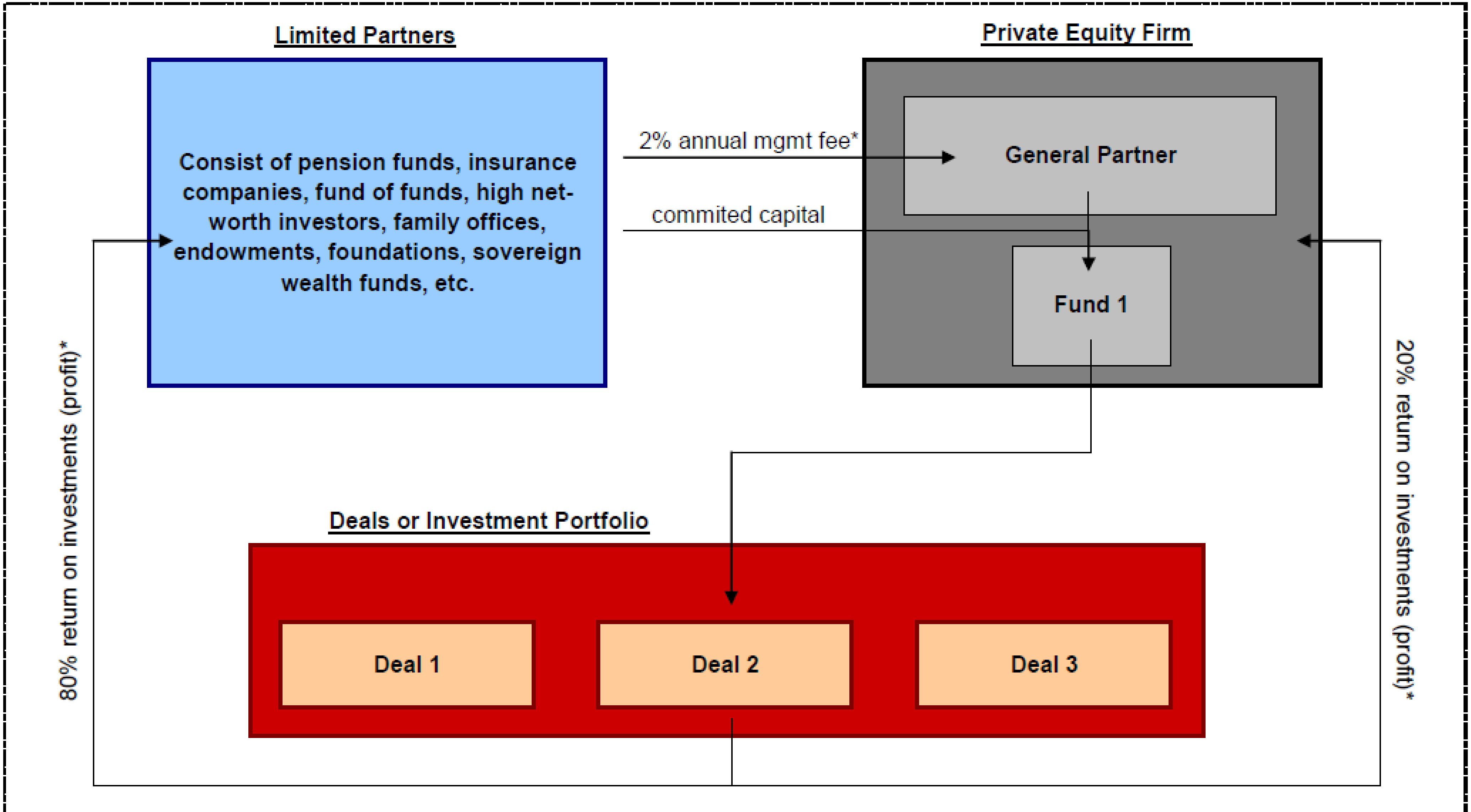
PRIVATE EQUITY FUND STRUCTURE

A private equity fund, also known as a general partner, consists of an investment team that raises committed capital from outside passive investors known as limited partners. Limited partners typically are made up of endowments, pensions, high net worth individuals, and institutional capital. The general partner invests the capital in public and private companies, manages the portfolio of investments, and seeks to exit the investments in the future for sizeable returns. A typical fund for a private equity firm has a total lifespan of approximately 10 years. The PE firm is required to invest each respective fund's capital within a period of about 5-7 years and then usually has another 5-7 years to sell (exit) the investments. PE firms typically use about 90% of the balance of their funds for new investments, and reserve about 10% for capital to be used by their portfolio companies (bolt-on acquisitions, additional available capital, etc.). Funds can span different sectors, risk appetites, investment horizons, or any other investment style, but firms often specialize in one area (or a couple of related areas) and focus on growing their expertise and returns there.

A PE firm sustains itself through a continuous cycle of raising capital. As PE firms grow their capital base from funds, they are able to grow the firms, as a result of the increased fees received for managing the investments in the various funds they are managing. Conversely, if a PE firm does not have a strong investment track record, it may be forced to unwind its operations if it is unable to raise additional capital by raising new investment funds.

Here's an example: a private equity firm may raise its first fund, which it could call Fund 1. Fund 1's committed capital is being invested over time, and being returned to the limited partners as the portfolio companies in that fund are being exited/sold. Therefore, as a PE firm nears the end of Fund 1, it will need to raise a new fund from new and existing limited partners to sustain its operations.

Once 50% of Fund 1 has been invested to acquire companies, the PE firm will most likely need to make preparations to start fundraising for Fund 2. If the PE firm is able to show an impressive track record of returns from Fund 1, it should be able to raise larger sequential funds (starting with Fund 2). But if Fund 1 is not doing very well, it may struggle to raise capital for Fund 2, which will possibly jeopardize the firm's ability to continue operations



**Average fees on private equity funds is 2% annual management fee and 20% performance fee on committed capital and profit, respectively.*