

COMPENSATION OF PRIVATE EQUITY PROFESSIONALS IN BRAZIL

Research 2021

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Private Equity funds play an important role in the economic development of countries. Besides providing capital to nascent and mature companies that need restructuring, they help to improve governance, professionalization and operational processes, making them more efficient, competitive and able to grow in a sustainable way. The Brazilian Private Equity industry has been growing and already has a significant number of experienced professionals, who collect a number of successful investment cases. According to the Spectra-Inspere database, there were



200 GPs

of **Private Equity** and **Venture Capital** in 2019

which held together a committed capital (invested in companies and available for new investments) of R\$198.1 billion, which represents more than 3 times the 2011 committed capital of R\$63.5 billion.



THE PRIVATE EQUITY PROFESSIONAL HAS A VERY DYNAMIC ACTIVITY.

It needs to raise capital for the funds, develop investment theses, seek and select companies to invest in, negotiate the acquisition price and the terms that will regulate the relationship after the investment, monitor through the board of directors and informal meetings with the executives, help the companies implement the value creation thesis, and after a while (usually 3 to 5 years after the acquisition), sell the stake in the invested company to return the capital to the fund's shareholders.



TEAMS ARE TRADITIONALLY LEAN, AND CAREER ADVANCEMENT INTERNALLY IS MOST COMMON:

analyst/associate promoted to principal and then to partner. Team members who are not promoted most often stay in the industry, migrating to other firms, or opening their own management company.



THE QUALITY OF A MANAGER'S TEAM:

Individual skills and good interaction among team members are critical success factors. Because the funds have a life of about 10 years, there is a concern to keep staff motivated, with long-term financial incentives, so that turnover is as low as possible.



THIS REPORT DESCRIBES THE FIXED AND VARIABLE COMPENSATION PER JOB POSITION

in 25 Brazilian asset managers, as well as carry (performance fee) and long-term incentive schemes. It aims to portray and discuss current compensation schemes, to create benchmarks for managers operating in Brazil, and to provide potential compensation parameters for those pursuing or wishing to migrate to a career in private equity. The study focuses on private equity firms, i.e., those that invest in companies in more mature stages. Venture capital firms were not included. The data was collected between the years 2018-20.

¹ 25 managers answered the questionnaire regarding fixed remuneration and bonus, and 23 answered the one regarding carry.

MAIN FINDINGS



The average remuneration of Private Equity professionals in Brazil

Is compatible with U.S. managers with AUM less than \$500,000, but there is a large dispersion of compensation between large and small managers. The larger the manager, the higher the fixed remuneration and bonuses tend to be.



The bonus percentage of total compensation without regard to carry is more aggressive than what is seen in the US.



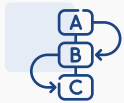
Carry distribution by position:

of 15 managers that answered the question about performance fee distribution, 53% stated that they establish the carry points to which each position is entitled, and the rest distribute them without a pre-established rule. The vesting of carry however is more common and has an average of 5.5 years.



The percentage of women in the PE industry is still low:

only 13% of the total. It appears that there is an effort to hire more female professionals, which reflects higher percentages in the more junior ranks. The percentage of women partners in Private Equity is even lower than the average: only 10% of the few women investigated are partners.



I. METHODOLOGY AND RESPONDENT MANAGERS' PROFILES

Between 2018 and 2020, face-to-face interviews were conducted with 25 Private Equity managers. The managers were asked about their organizational structures, pay regime, how much were fixed salaries and bonuses per job category, as well as what was the pay structure and carry (performance fee) eligibility.

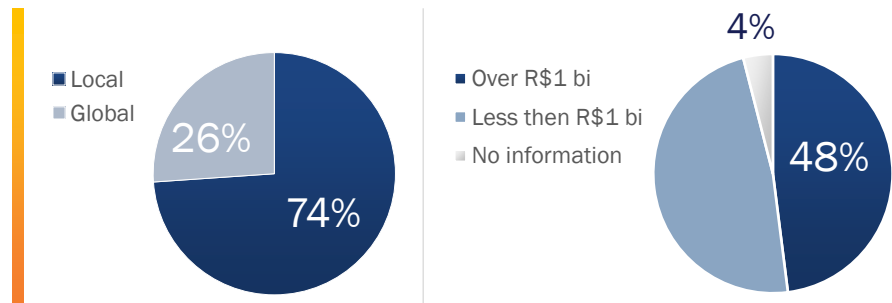
We observed a heterogeneity of formal hierarchical structures and positions among the interviewed managers. To make them comparable, we adopted the hierarchical structure of jobs and seniority levels summarized in **Table 1** to frame the job structures of each institution.

Table 1
STANDARD HIERARCHICAL STRUCTURE

POSITION	SENIORITY	SAMPLE NUMBER
Intern	-	4
Analyst	1	24
Analyst	2	13
Analyst	3	5
Associate	Full	14
Associate	Senior	21
Principal	-	13
Director	1	16
Director	2	9
Managing Director	-	13
Partner	-	20

Among the 25 managers participating in this study, 74% are of local origin and 26% are global, but with local offices and staff. The sample is well balanced between large and mid-sized managers (with assets under management (AUM) lower or higher than R\$1 billion), and this balance is maintained in both local and global managers (**Exhibit 1**).

Exhibit 1
SAMPLE PROFILE:
ORIGIN AND SIZE
(AUM)



II. FIXED COMPENSATION AND BONUSES

Of the managers interviewed, 26% stated they remunerated in dollars and 74% in reais. To analyze the fixed and total remuneration of the sample, we converted the remuneration in dollars to reais using the exchange rate of 12/31/2019: R\$ 4,03

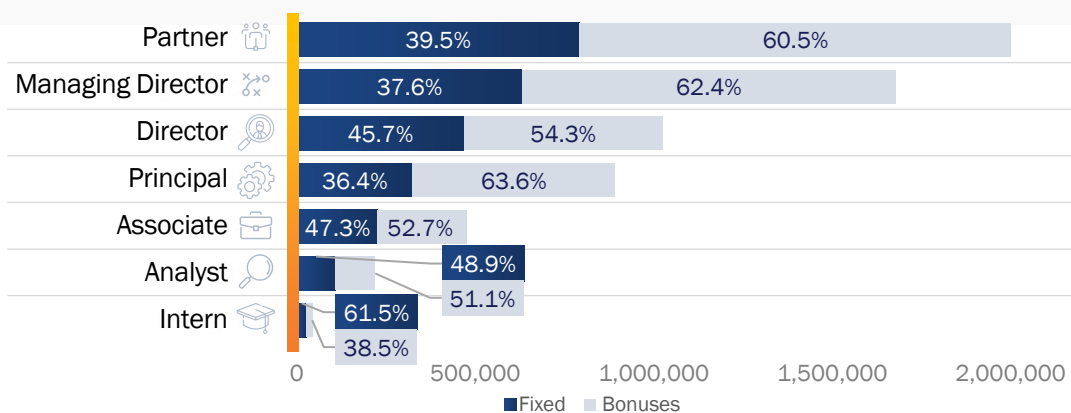
Exhibit 2 shows the average total compensation, broken down into fixed and bonus per position. It can be seen that for the most senior positions: principal through partner, about 60% of total compensation is variable. This proportion falls to 50% for the more junior categories - Associate and Analyst, while still remaining relevant. It is interesting to note that some managers include variable compensation even for trainees. This demonstrates the incentive culture within the industry, where a relevant part of the team's compensation is tied to performance. The percentage of the bonus in relation to total remuneration not including performance fee in Brazil is higher than the average in the United

States for all categories. According to a 2019 study by Heidrick & Struggles, for management companies with AUM less than \$500,000 the bonus corresponds to 20% of total compensation for partners, 27% for directors, about 45% for principal, and 30% for associates.

The average Brazilian remuneration for partners, managing directors and directors is equivalent to the average of American managers with AUM less than US\$500 thousand, when considering an average dollar of R\$4.03, but the remuneration for principals and associates is lower.

The growth in total compensation with career advancement also draws attention: the average partner's compensation is four times the average compensation of associates (R\$2 million per year versus R\$500 thousand per year), which creates an additional incentive to stay with the company and follows the trend of what happens in the USA.

Exhibit 2
AVERAGE TOTAL ANNUAL COMPENSATION IN BRL



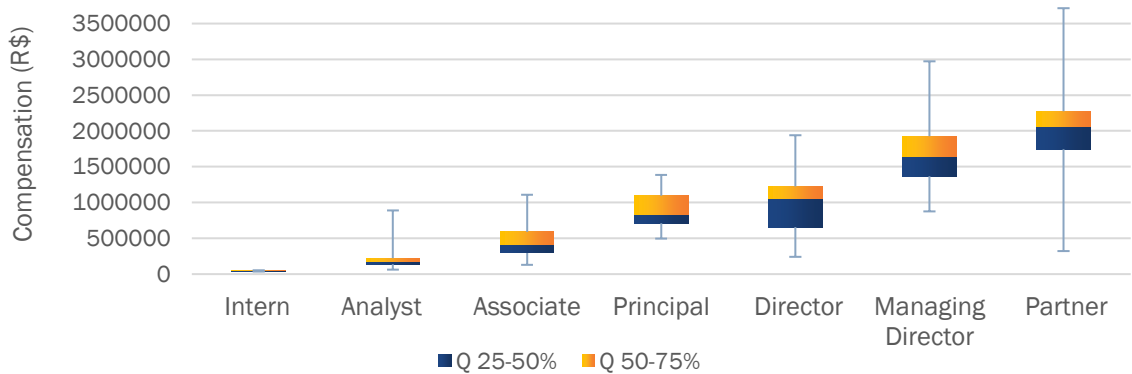
Compensation in US\$ was converted to R\$ by the exchange rate of 12/31/2019

Exhibit 3 shows the dispersion of total compensation by job title. Of note is the wide dispersion of total compensation for the top ranks - director to partner, and for partners. The fourth quartile of partners (the lowest paid 25%) receive less per year than the first quartile of principals, and the equivalent with the second quartile of associates (highest paid 50%). This dispersion is largely explained by AUM (Assets under Management of the Managers). Of the managers ranked in the first quartile - 25% of the highest compensated - approximately 65% have AUM greater than R\$1bn, while of the managers ranked in the fourth quartile - 25% of the lowest

compensated - 57% have AUM less than R\$1bn. This is in line with what is observed in the US and with the economics of private equity, as salaries and bonuses are financed by the management fee, which is about 2% a year of the committed capital. As smaller managers raise less money through management fees, they have lower fixed remuneration and bonuses, and carry is more important than for large managers, increasing the pressure for performance over the long term.

Exhibit 3

DISPERSION OF TOTAL COMPENSATION - BRL



Compensation in US\$ was converted to R\$ by the exchange rate of 12/31/2019

Given the high volatility of the Brazilian real, we re-did the analyses using a conversion rate of \$5.3 and \$3.0 (Appendix I). The growth in compensation according to job advancement and the percentage of variable compensation relative to total were similar to the results with a conversion rate of \$4.03. The partners' total compensation varied more: an average of R\$2.3 million for the FX of R\$5.30 and R\$1.7 million for the FX of R\$3.00.

Local managers remunerate their professionals in Brazilian reais (BRL). Global managers, except for one interviewee, remunerate their teams in dollars (USD), exposing them to exchange rate risk, in a manner analogous to their quota holders, who have capital called up in dollars, converted into reais when the investment is made, divested in reais and converted back into dollars when the quota is amortized. However,

while international investors have been penalized by the devaluation of the real that has occurred since 2016, Brazilian professionals from 26% of the managers interviewed (Exhibit 4) have benefited from the currency devaluation, as they have cost of living in reais, and their fixed remuneration in reais has appreciated considerably compared to local managers.

Exhibit 4 compares the monthly fixed compensation of Private Equity in Brazil with other careers in the financial market. Panel A compares the second quartile of remuneration (Q. 50%) of Private Equity with the second quartile of M&A and Trader, and panel B the first quartile (Q. 75%). The vertical axis represents the percentage of growth in fixed salary job by job, indicated by the orange ball - for example, in the second quartile of compensation, a Private Equity analyst

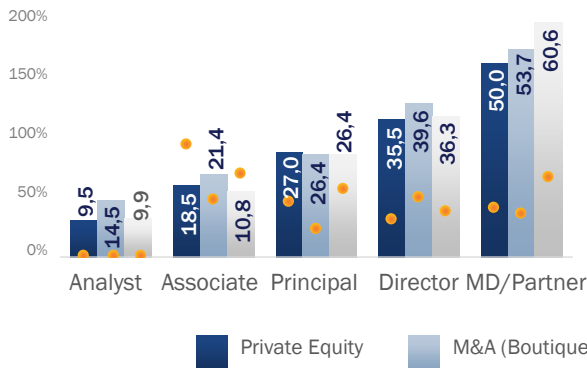
³ Source: Robert Half Salary Guide 2021

promoted to associate had a 100% increase in fixed remuneration, and an M&A analyst promoted to associate had a 50% increase. The bars, represent what is the value of the monthly fixed salary in BRL 000'. In general, the second quartile is in line with the M&A and Trader professions. The M&A professional starts his career with a relevantly higher fixed, but there is

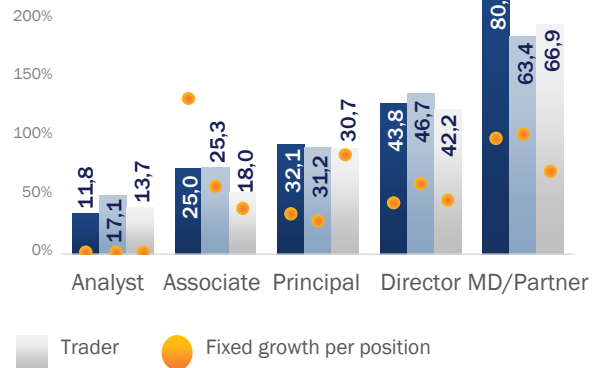
a tendency to converge with increasing seniority. When we look at the 1st quartile, there is a marked discrepancy in compensation for the partner position, indicating that the outliers of monthly fixed compensation in the private equity industry are consistently higher than the others analyzed.

Exhibit 4
COMPARISON OF PRIVATE EQUITY COMPENSATION WITH OTHER FINANCIAL MARKET CAREERS

PANEL A | 2nd Quartile

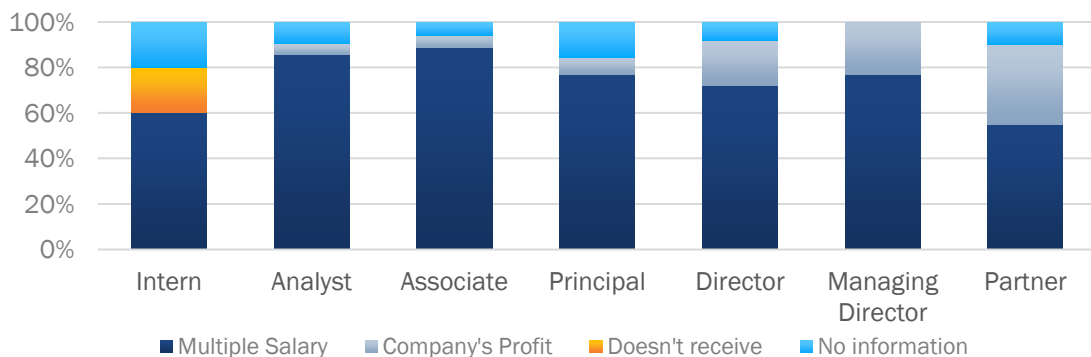


PANEL B | 1st Quartile



Two forms of annual bonus payment were observed: as a multiple of salary and company profit sharing. Up to the principal level, the bonus is mostly distributed as a multiple of salary, which gives junior and mid-level employees clearer and short-term visibility of their upside for performance. The percentage of cases with bonuses distributed as a percentage of profit becomes more relevant for director, MD, and partner positions, reaching almost 50% of the cases of bonus distribution for partners (Exhibit 5), a mechanism that aligns in a more solid and long-term way the senior professional's interest with the success of the firm as a whole.

Exhibit 5
ANNUAL BONUS PAYMENT METHOD





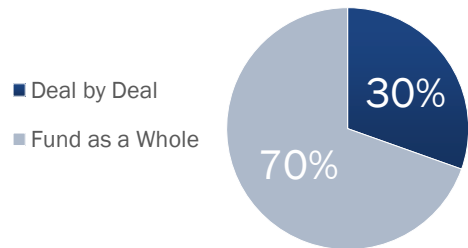
III. CARRY (PERFORMANCE FEE)

Carry is one of the main alignment tools between investors and fund managers. The PE manager is only eligible to receive carry if it has a return higher than a rate established in the fund's regulations, the hurdle rate. For funds that raise with local investors, this hurdle rate is usually accompanied by an indexer (inflation, CDI and other market indexes). Within the sample, of the managers that raise funds with local investors, all use inflation as an indexer, and the average and median of the hurdle rate is 6%, with maximum and minimum values of 9.5% and 0.0% respectively. As for the cases of funding from foreign investors, there is generally no indexer, with the exception of one manager who declared he included the US CPI in the calculation of the performance fee. Regarding the hurdle, the average and median are 8%, with maximum and minimum values of 8% and 5% respectively. The timing of the carry payment is also determined in the fund's regulations, and can be either deal by deal, in which the managers receive the carry after the sale of the participation in the invested companies, if they obtain a return higher than the hurdle rate, or fund as a whole, in which they only start receiving carry after the fund has returned to the shareholders the committed capital adjusted by the hurdle rate.

If carry is paid deal by deal, there is the risk that the fund will overpay carry to the manager. Therefore, to mitigate this risk, a claw back clause is usually established in the regulation, obliging the return of the undue carry, if applicable. Additionally, managers that receive deal by deal may direct the focus of analysts to specific deals to the detriment of focusing their work on the manager as a whole.

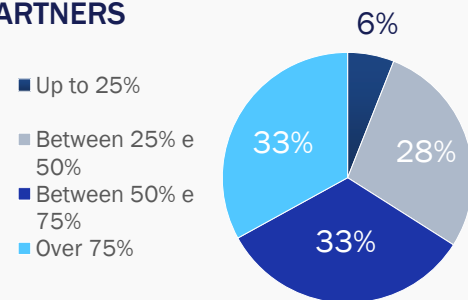
In 70% of the managers interviewed, carry is paid on a fund as a whole basis (Exhibit 6). Although this scheme represents greater security for investors, it implies a longer period for the team to start receiving carry. Of the managers that receive deal by deal, 3 declared that they have claw back clauses defined in the regulations.

Exhibit 6
TIMING OF CARRY PAYMENT



When the manager receives carry for having generated returns above the hurdle, part of this revenue is distributed directly to the partners of the firm and the rest to the investment team. Since the investment team usually includes at least one partner, it is not unusual for partners to accumulate carry shares for both positions. In general, investment managers have a predefined policy for sharing this carry among the parties. Among the 18 firms that answered the question about the apportionment policy, approximately 2/3 declare that they withhold more than 50% for the partners (Exhibit 7).

Exhibit 7
CARRY RETENTION FOR PARTNERS




Two points of attention regarding the financial incentive for the professionals in a management company are the way the carry is divided among the team and the vesting period.

 **Of the female managers in the sample, 15 informed us about the division of carry per position.**

Of these, 53% declared that they pre-establish percentage points of carry distribution per position, which increases the team's motivation. Although the other managers distribute carry to the team, there is no defined rule about how much each position will receive.

 **Another point of attention is whether there is a vesting period for the carry.**

This means how long the professional needs to remain with the manager after being hired to be entitled to 100% of the carry points of his or her category. More than half of the managers interviewed (57%) stated that they have a vesting period for carry payments, the average being 5.5 years, with a maximum of 10 and a minimum of 3 years. Only 1 manager declared no vesting period. Finally, it is worth noting that management companies, in general, have Bad Leaver clauses in their employment contracts, which deals with the exit of a partner, along with sanction mechanisms. These mechanisms can be applied to situations such as exits due to fraud, non-compliance with duties agreed upon in the employment contract, among others. An exit characterized by Bad Leaver cancels the carry already "dressed" by the former member of the manager, thus taking his right to receive to zero.

 **Vesting is proportional to the length of time the professional has worked for the management company. For example,**

after **one year** of employment, will be entitled to

20% OF THE CARRY PERCENTAGE

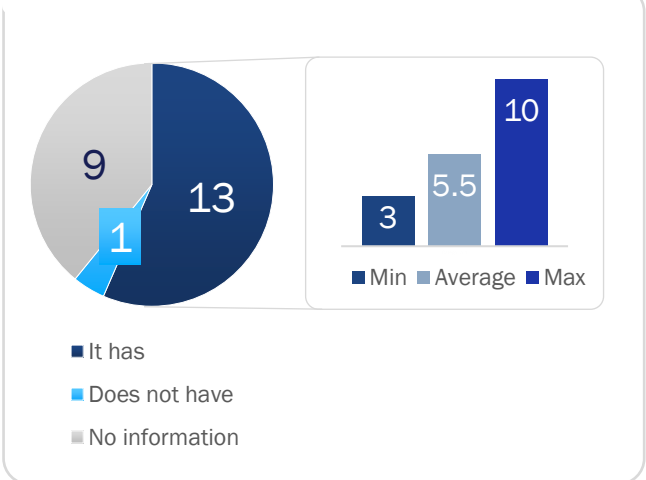
If **two years** to

40%

After **five years**

100%

Exhibit 8
VESTING





IV. GENDER DIVERSITY IN TEAMS

The LinkedIn profiles of the professionals of 13 of the female managers interviewed were collected to analyze the gender diversity in Private Equity teams.

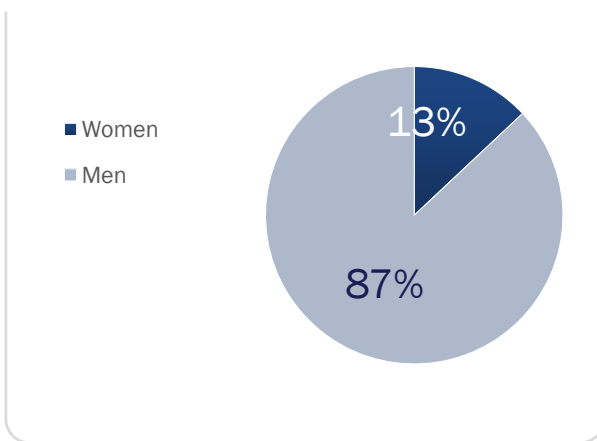
As shown in **Exhibit 9**, the percentage of women in Private Equity is still low. Of the 164 professionals investigated, only 13% are women, and 15% of the female managers have no women on the team. Only 8% of the female managers

have more than 20% women on their team.

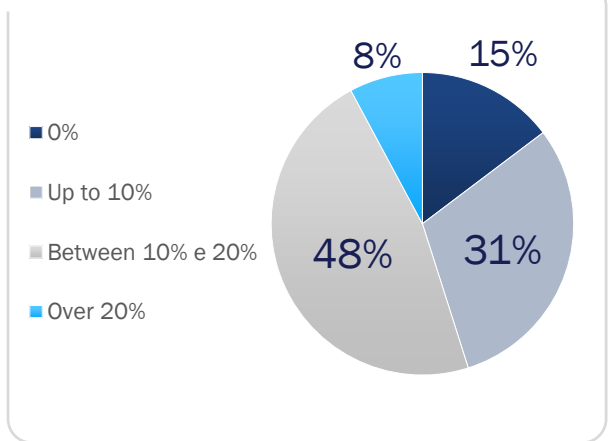
When looking at the percentage of women per position, it is higher for lower levels, and only 10% of the female professionals who had their profile raised on LinkedIn are partners. This is in line with the more recent effort by managers to increase the hiring of female professionals but indicates that this effort still has a long way to go.

Exhibit 9

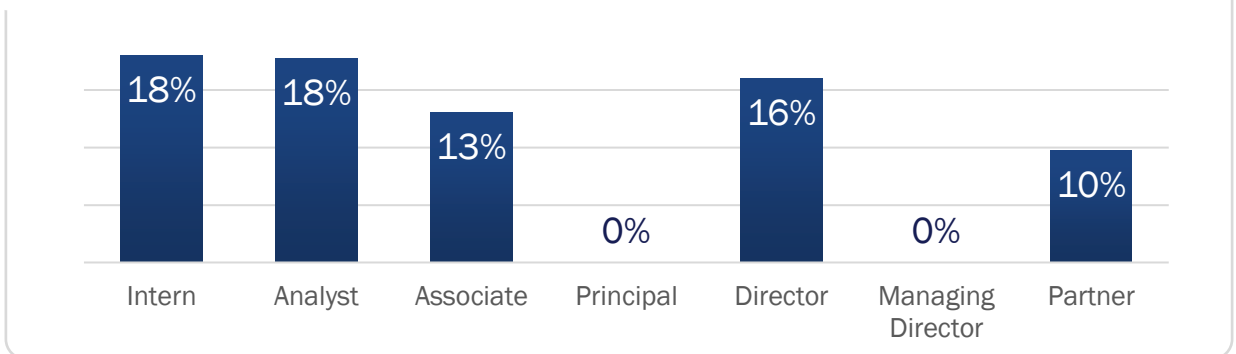
WOMEN IN PE



% WOMEN IN TEAMS



% WOMEN BY POSITION





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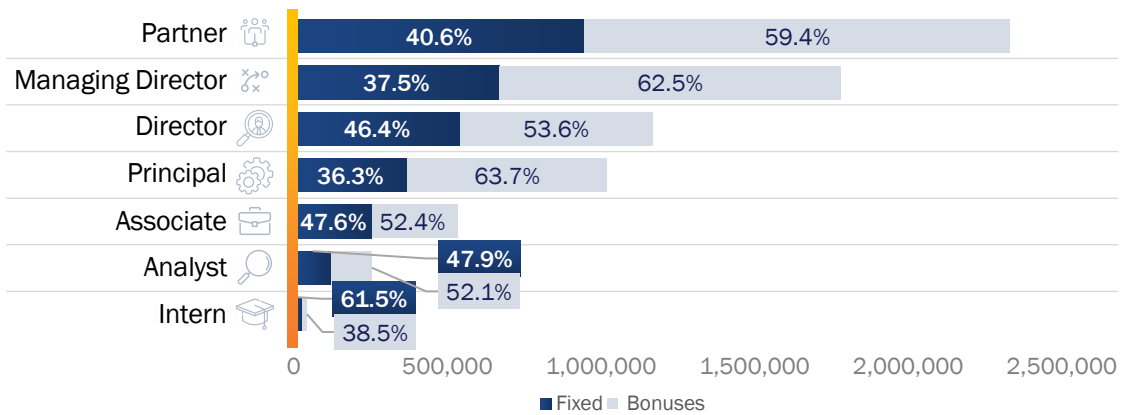
Heidrick & Struggles

APPENDIX I

APPENDIX I

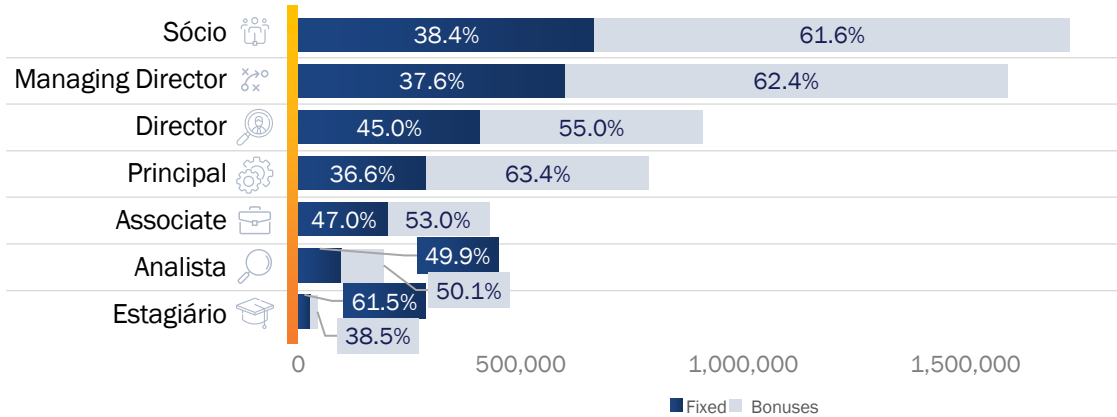
Compensation FX R\$5,30

AVERAGE COMPENSATION - BRL



Compensation FX R\$3,00

AVERAGE COMPENSATION - BRL





HEIDRICK & STRUGGLES

Insper