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JOURNAL ARTICLE

The Economics of Private Equity Funds

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Abstract

This article analyzes the economics of the private equity industry using a novel model and dataset. We obtain data from a large investor in private equity funds, with detailed records on 238 funds raised between 1993 and 2006. We build a model to estimate the expected revenue to managers as a function of their investor contracts, and we test how this estimated revenue varies across the characteristics of our sample funds. Among our sample funds, about two-thirds of expected revenue comes from fixed-revenue components that are not sensitive to performance. We find sharp differences between venture capital (VC) and buyout (BO) funds. BO managers build on their prior experience by increasing the size of their funds faster than VC managers do. This leads to significantly higher revenue per partner and per professional in later BO funds. The results suggest that the BO business is more scalable than the VC business and that past success has a differential impact on the terms of their future funds.

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