Week3B Private Equity Compensation

1. While profit has a similar meaning among private equity and hedge funds, income from underlying investments, the way that hedge funds and private equity funds measure profit differ from each other. In the case of hedge funds, **profits usually come from the buying and selling of individual assets**, or the **positive price appreciation of a hedge fund's position**. Private Equity profits on the other hand are calculated from the **income generated from an underlying company**, and the **eventual selloff/IPO of that company**. Usually with both types of managers, there is a **hurdle rate** that specifies the **rate that managers need to earn a return over in order to collect an incentive fee** or a **high water mark** that specifies **managers collect an incentive fee only when the fund level is above a previous high**

2. Yale is able to conduct **due diligence** on its maangers and offer **favorable fee structures** to align incentives. For example, Yale structures fees so that they pay a low amount of fixed fees, but higher performance fees to incentivize its managers. Due diligence means understanding a hedge fund/private equity fund's strategy, past performance, and even visiting the managers to understand how they think. Through this process, Yale is able to increase the transparency of the investment vehicle which helps them make an informed investment decision. Yale also has a highly skilled internal team and doesn't need an army of consultants to help make investment decisions. This helps limit any conflict of interests that Yale might face with it's consultants (payment for order flow)