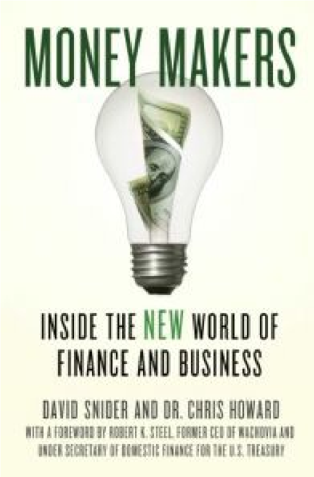

Book Money Makers

Inside the New World of Finance and Business

David Snider and Chris Howard
Palgrave Macmillan, 2010
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Recommendation

If you've ever wondered what drives major segments of the financial industry – investment banking, venture capital, private equity, hedge funds, management consulting and corporate management – David Snider and Chris Howard provide some solid answers in this introductory overview of these sectors. Their survey includes interviews with industry leaders and a summary of the traits employees need to succeed in these fields. *BooksInShort* finds this jargon-free, informative book useful for business students and others interested in finding careers in this challenging industry.

Take-Aways

- Six pivotal sectors of the financial industry offer significant career opportunities:
- Investment banking provides advisory services, sales and trading, asset management, and research to institutions.
- Venture capitalists finance start-up firms, and hire self-motivated, disciplined people.
- Private equity funds support going concerns. To succeed, you need to be a critical thinker, a good risk manager and a capable judge of a business's potential.
- Hedge funds make money by arbitraging markets; a hedge fund employee should feel at home in a trading room.
- Management consultants need strong analytical skills to work as logical problem solvers.
- Corporate senior managers must focus on their products, customers and innovation.
- Most of these sectors demand extensive training, great ambition and long hours.
- Employees who do well in these areas are usually disciplined, self-motivated and driven.
- Compensation in these sectors is often a mix of salary, bonuses and stock options.

Summary

Out of the Shadows

The 2008 financial crisis made people aware of the unknown, often-mysterious inner workings of the financial industry. Considering the trillions of dollars of lost investments, the demise of venerable firms and the resulting downturn affecting households, small businesses and major corporations, the financial industry clearly plays an outsized role, for good or bad, in world commerce. Six "money makers" in particular will continue to grease the wheels of an interconnected, global economy: investment banks, venture capital firms, private equity funds, hedge funds, management consultants and the top level of *Fortune* 500 companies.

Investment Banking

Investment banking in the US began before the Civil War, when brokers sold government bonds to private investors. Through the 19th and 20th centuries, investment banks provided advisory, sales and investment services that promoted burgeoning industries. As a US middle class emerged, stock trading and initial public offerings (IPOs) fed its growing appetite for equity investments. Changes in federal legislation beginning in the 1980s allowed investment banks to purchase and repackage mortgage loans; inventive investment bankers developed high-yield, or junk, bonds that gave companies with low credit ratings access to public capital markets. More recently, investment banks became active in securitizing and reselling consumer debt to investors.

> "Although the elite fields of business and finance play large and dynamic roles in the global economy, how they work remains a mystery to most outsiders."

"The 2008 crisis highlighted the shortcomings of financial innovation and the profit it brings." Globalization of the financial industry allowed what was a relatively contained US real estate crunch to affect investors worldwide. Bankers' overreliance on statistical models blinded them to the actual risks they were running. The financial crisis brought about a consolidation within the sector, as relatively stronger firms picked up weaker rivals. Fewer firms mean fewer jobs for would-be investment bankers in the United States, but employment will grow internationally, particularly in developing markets. In the future, investment banks will likely work with less leverage and face greater regulator scrutiny, but their activities in advisory services, sales and trading, asset management, and research will continue.

> "The face of business and finance has been changed irrefutably, but the key industries and the functions they serve will persist."

If you still want a job in this field, be aware of the all-consuming "organizational culture and lifestyle." Workweeks easily can run from 80 to 100 hours, and being on call to work weekends and holidays is standard. As you rise in the ranks, travel and client meetings further unbalance your work-life pendulum. Yet the rewards can be enticing: In flush times, first-year investment bankers earn from $125,000 to $150,000 annually; bonuses comprise the lion's share of compensation. Good bankers are client-driven, quantitatively inclined and team-oriented.

Venture Capital

Venture capitalists (VCs) work with entrepreneurs to finance nascent businesses, help them grow and assist in their eventual sale. While entrepreneurs account for many small businesses in the US, few possess the four qualities VCs seek: 1) "Is the entrepreneur solving a real problem?" 2) Does the solution represent a large market potential? 3) Does the proposed business possess a unique aspect that will ensure its growth? 4) Can the VC work well with the entrepreneur's management team?

> "The issue facing the banks today is whether they can return to the levels of money making that existed before the recession, without excessive leverage or posing risks to themselves and the broader financial system."

The idea of lending to entrepreneurs dates back to ancient times, but venture capital blossomed in the US in the post-World War II period, when new technological innovations needed to reach commercial markets. Venture capital firms expanded significantly in the 1970s, as advances in technology took hold. The industry took off in 1995 with the Netscape IPO, and peaked in 2000 along with the high-tech bubble. While the amount of available investment money today has dropped substantially, the US remains the "most active venture market in the world."

> "Banking is a business with lavish perks, but they often come at a lifestyle cost."

Venture capital funds raise money from institutions and wealthy individuals and lock in their investors for between five and ten years. A successful VC firm develops a network of proven or budding entrepreneurs from which it sources deals. Once it conducts thorough due diligence on an up-and-coming business, the VC maximizes its control over the company and its returns. While VC funds charge their investors roughly 2% as a fee, most of a VC's profits come at the "exit," when the VC and entrepreneur sell the firm; then, the VC takes 20% of the profit.

> "The economics of venture capital are such that one can succeed with a few big hits or with a more consistent approach."

Culturally, VC firms tend to employ disciplined people who are self-motivated and self-learners. Successful employees are adept at identifying trends, researching opportunities, building trust, evaluating people and assessing investments. VC professionals' financial rewards take time to amass, given the multiyear structure of their deals. Starting associates with a graduate business degree can expect to earn from $150,000 to $250,000 annually.

Private Equity

The private equity sector spun off from the venture capital field, but with some crucial differences. Private equity firms borrow heavily to invest in going concerns. Using a leveraged buyout (LBO), a private equity firm seeks to extract greater returns from a company than its sellers can realize. They uncover this hidden value in their target companies by divesting unproductive assets and divisions, combining operations and generally streamlining performance. The expected higher cash flow from the corporate makeover goes toward paying off the massive debt the firm's purchase incurs.

> "Venture capitalists continue to take pride in the fact that their investments are major drivers of innovation for the US economy."

Kohlberg, Kravis, Roberts & Co. (KKR) is a pioneer in this field; it began making "bootstrap" investments in the 1960s. In 1979, KKR set a precedent when it became the first private equity firm to take over a publicly traded company. By the 1980s, new competitors like Blackstone Group, Bain Capital and the Carlyle Group joined the field. In 1988, KKR brought the low-key business of private equity unexpected notoriety when it purchased RJR Nabisco for $31 billion, a jaw-dropping deal described in the book and film *Barbarians at the Gate*.

> "Despite compensation of hundreds of millions of dollars, Blackstone CEO Steve Schwarzman had most of his earnings taxed at a lower rate than that of people who earned less than a million."

Fueled by low interest rates and high investor demand, the LBO market scored a record $228 billion in investment capital in 2007. This allowed private equity firms to handle larger and larger transactions. In an ironic twist, the Blackstone Group was the first private equity firm to go public. In June 2007, its owners reaped a $2.5 billion payoff, as well as considerable infamy, when the public learned that the government would tax Blackstone's windfall at a relatively low capital gains rate. The

2008 recession and resulting credit freeze has hurt many private equity firms, but only the eventual sale of their investments will crystallize their losses.

> "With an estimated $1 trillion in capital to invest (as of 2009), private equity firms will continue to play a prominent role in the world economy."

To succeed in the private equity world, you should be a "self-starter," a critical thinker, a good risk manager and a hard-nosed negotiator. You need solid analytical judgment to evaluate uncertain business situations. You can earn a starting salary of $100,000 a year, with bonuses in multiples of that figure, but most private equity bankers tie their wealth up in their deals.

Hedge Funds

Most people consider hedge funds a modern-day phenomenon, but Alfred Winslow Jones started the first hedge fund in 1949. He sought to mitigate the impact of market directions using a strategy of buying stocks long and selling them short; this allowed his fund to make money even in down markets. Jones's concept proved valid, but the sector didn't grow until the 1980s, when Julian Robertson started Tiger Management and George Soros began trading his Quantum Fund. By then, different arbitrage models propelled the sector, attracting young fund managers looking to reap quick profits from minute price changes.

> "The nature of the fast transaction cycle [in hedge funds] allowed people far younger than traditional investing professionals to build track records, raise large funds and become fabulously wealthy."

Hedge funds burst into the news when Soros's fund shorted the pound sterling in 1992, causing the British government to devalue the currency. Then, in 1998, Long-Term Capital Management (LTCM), a hedge fund run by industry veterans and Nobel Prize-winning economists such as Myron Scholes and Robert C. Merton failed spectacularly. The fund's extensive leverage embroiled all the major investment banks, forcing them to mount a rescue package for their embattled borrower.

> "The consulting industry generally moves in boom-and-bust cycles, in line with the economy."

The hedge fund sector, which generally functions outside regulatory constraints and provides very little information even to investors, took a major hit in the 2008 financial crisis. As lending shrank and arbitrage opportunities diminished – previously uncorrelated asset classes were moving downward, together – the field dropped 18% in 2008. But the culling of weaker competitors allows surviving firms to profit from opportunities in beaten-down markets. Hedge funds tend to operate in a trading-room atmosphere, where market activity and analytics rule the environment. Expertise in particular asset classes is a plus. New hires at hedge funds often begin as analysts who develop trading ideas. Salaries begin at $100,000, plus bonuses.

Management Consulting

Management consultants privately advise top firms. The industry began in 1926 when accounting professor James McKinsey began counseling clients on budgeting and finance. The business grew into McKinsey & Co. when Marvin Bower joined the firm in 1933 and added an emphasis on professionalism, client services and employee training. In 1963, the Boston Consulting Group launched its specialization in analyzing business growth. The firm made its reputation on the "growth-share matrix," which segmented product life cycles and popularized the term "cash cow." In 1973, Bill Bain, who was "one of the most insightful consultants at BCG," left to start Bain and Company. He set out to work with executives who wanted to make dramatic changes at their companies. To maintain confidentiality, Bain worked with only one company in an industry.

> "Rarely are a business's challenges truly unique; on some level, good consultants simply have great pattern recognition."

Consulting firms help clients become more profitable by improving their strategies and execution. Consultants analyze clients' business functions, customers, costs, processes and organizational structures. Many also do primary research, such as customer surveys. Management consulting firms often are subject to the peaks and valleys of the business cycle: In hard times, corporations and governments reduce their consulting budgets. Still, this sector is growing rapidly, both by entering new regions (notably in China, India and Africa) and by serving new areas, such as hedge funds and private equity firms.

> "The art of corporate leadership is knowing enough to lead people who perform highly technical and varied task while not becoming buried in the details."

Successful management consultants travel a lot, and often the line between work and socializing tends to blur. The best consultants have strong analytical skills; they are logical problem solvers, good communicators and quick learners. They must be adept at building relationships, particularly at company headquarters. After a few years, consultants can lead their own teams, train others and determine client communication strategies. Base salaries are similar to those in other financial fields, but bonuses play less of a role in total compensation.

Managing *Fortune* 500 Corporations

Technological advances during the Civil War and World War I drove the growth of large US industrial corporations. But by the latter part of the 20th century, US firms suffered from "high labor costs, little innovation and a lack of effective forward thinking," making them vulnerable to foreign competition. Recessions exacerbated these problems and shut down many businesses that might have survived in healthier economies.

> "Historically, the periods following recessions are times of immense opportunity."

Today, senior managers, particularly in *Fortune* 500 companies, face three tasks: They must manage their products and customer relationships, oversee legal affairs and governance, and lead new business development. These tasks involve everything from regulatory compliance to change management, as well as encouraging employees' top performance, creativity and ethical behavior.

If you aspire to a career as a senior corporate officer, follow General Electric's employee performance system, "the 4Es": 1) Show "personal energy" in your work; 2) "energize" your co-workers and customers; 3) have an "edge," or the ability to make tough decisions; and 4) "execute" on your commitments and deliver results. Achieving work-life balance tends to be easier at a major corporation than at most financial firms, but international travel and foreign assignments are common in a globalized economy. At most *Fortune* 500 companies, compensation is a combination of salary, bonuses and stock options. If you dream of being a tycoon, you also might be glad to know that CEOs of large US corporations average $13 million in annual compensation.

About the Authors

David Snider works at Bain Capital, a private equity group. **Chris Howard** is president of Hampden-Sydney College and is the chairman of the Impact Young Lives Foundation.