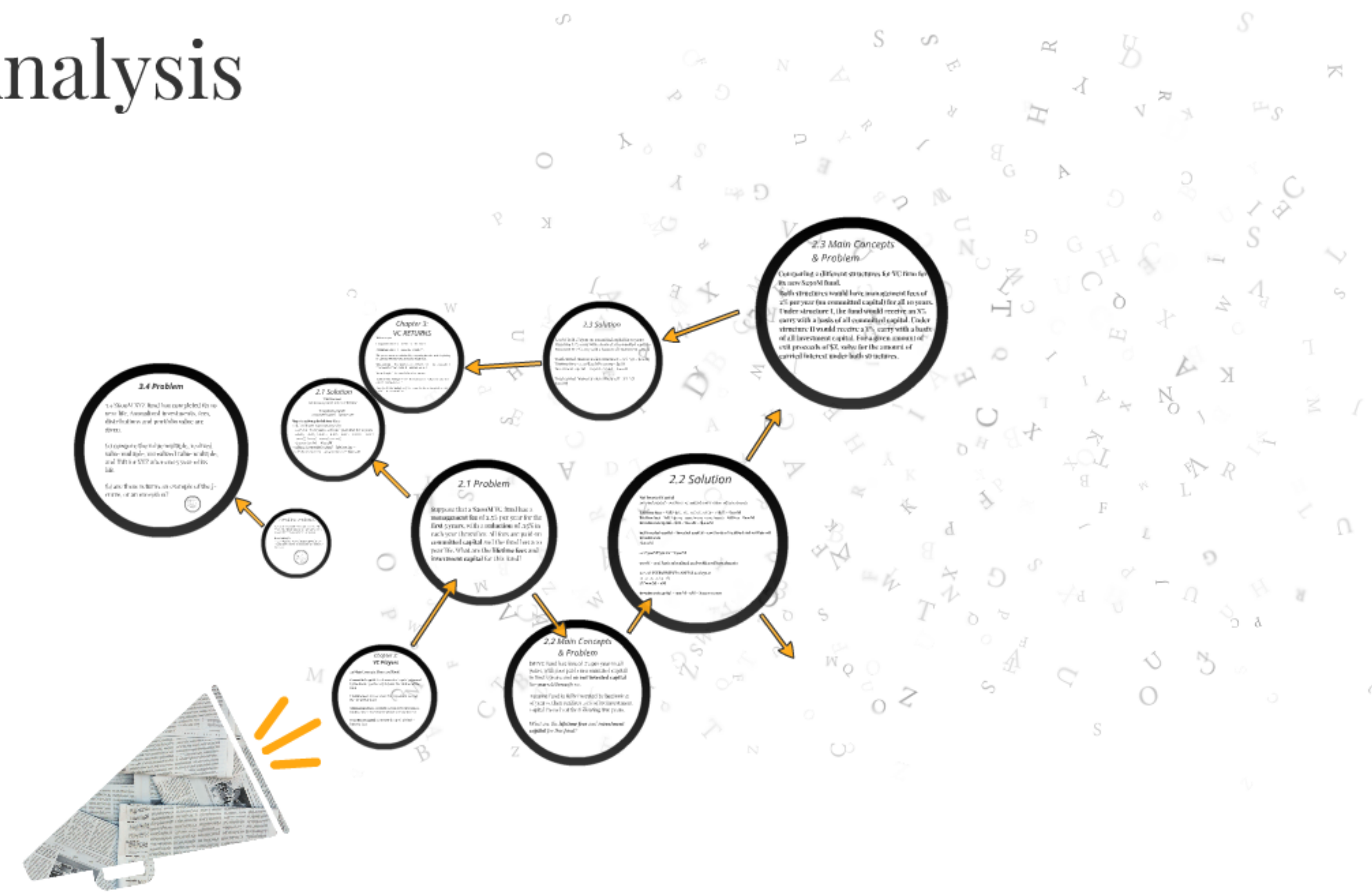
MBA Entrepreneurial Finance Harvard Case Solution & Analysis



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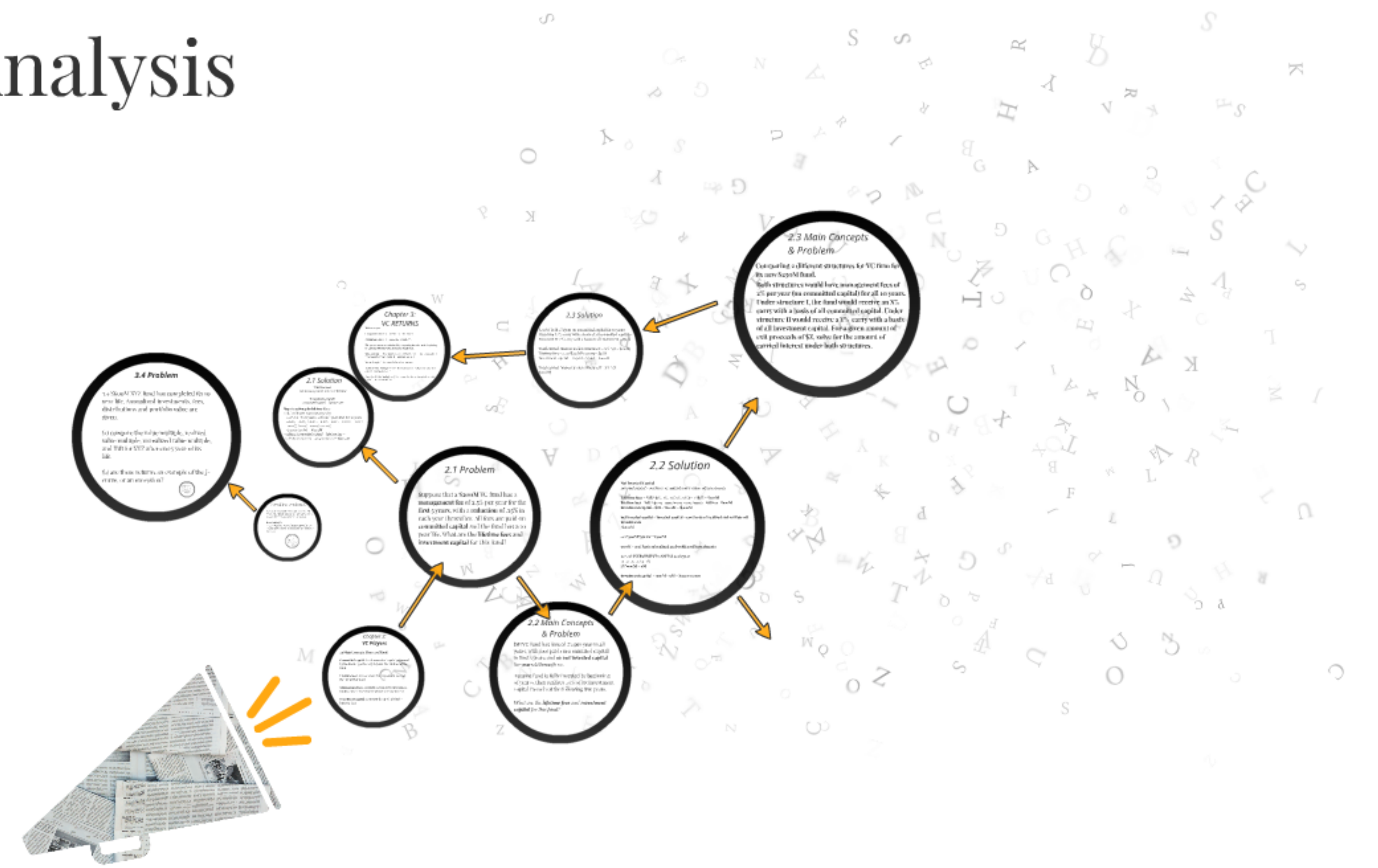

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Chapter 2:
VC Players

2.1 Main Concepts: *Firms and Funds*

Committed capital: total amount of capital promised by the limited partners (LPs) over the lifetime of the fund

Lifetime fees: sum of annual management fees for the life of that fund

Management fees: periodic payment by investment fund to fund's investment adviser for investment

Investment capital: committed capital of fund – lifetime fees

2.1 Problem

Suppose that a **$200M** VC fund has a **management fee** of **2.5%** per year for the **first 5 years**, with a **reduction of .25%** in each year thereafter. All fees are paid on **committed capital** and the fund has a 10 year life. What are the **lifetime fees** and **investment capital** for this fund?

2.1 Solution

Lifetime fees =
total management fees over lifetime

Investment capital =
committed capital – lifetime fees

Steps to solving for lifetime fees:

- add each year's *management fees*:
  - 2.5% for first 5 years, .25% each year after for 10 years
  - 0.025 + 0.025 + 0.025 + 0.025 + 0.025 + 0.0225 + 0.02 + 0.0175 + 0.015 + 0.0125 = 0.2125
  - (0.2125*200M) = **$42.5 M**
- subtract *committed capital – lifetime fees* =
  - *$200,000,000.00 – 42,500,000.00 =* ***$157,5M***

Realized Value Multiple = (T
capital + management fees)

Unrealized Value Multiple =
Capital + management fees)

2.2 Main Concepts & Problem

$1B VC fund has fees of 2% per year in all years, with fees paid on committed capital in first 5 years and on **net invested capital** for years 6 through 10.

Assume fund is fully invested by beginning of year 6, then realizes 20% of its investment capital in each of the following five years.

*What are the **lifetime fees** and **investment capital** for this fund?*

2.2 Solution

Net Invested Capital =
invested capital - cost basis of realized and written-off investments.

Lifetime fees = $1B * (2%+2%+2%+2%+2%) = .1*$1B = $100M
lifetime fees= $1B * (0.02+0.02+0.02+0.02+0.02)= $1B*0.1=$100M
investment capital= $1B - $100M = $900M

net invested capital= invested capital – cost basis of realized and written-off investments
$900M

0.2*900M*5years= $900M

900M - cost basis of realized and written off investments

20% of INVESTMENT CAPITAL each year
.2+.2+.2+.2+.2=1%
1%*900M = 9M

investment capital = 900M - 9M = 891,000,000

2.3 Main Concepts & Problem

Comparing 2 different structures for VC firm for its new $250M fund.

Both structures would have management fees of 2% per year (on committed capital) for all 10 years. Under structure I, the fund would receive an X% carry with a basis of all committed capital. Under structure II would receive a Y% carry with a basis of all investment capital. For a given amount of exit proceeds of $Z, solve for the amount of carried interest under both structures.