

Winter 2013/14

In pursuit of prosperity: How Europe can climb the growth curve



EVCA BRIEFING

EUROPEAN COMPETITIVENESS



Entrepreneurs like David Marcus prove how much business talent Europe has to offer.

Born in France, Marcus became a serial tech entrepreneur. His last start-up – Zong – is now a core part of PayPal's offering and he is President of this 13,000-employee online payment company.

Marcus made this incredible journey with the help of venture capital (VC) backing. VC is part of the larger private equity industry, which has guided many other companies, at different development stages, to similar

success. Alliance Boots, Moleskine and Applus+ are three other businesses we profile in this issue of the *EVCA Briefing*.

These companies share a core set of characteristics – innovation, productivity and competitiveness – recognised and nurtured under private equity ownership. Europe 2020, the European Union's plan for sustainable economic growth, lists these areas as priorities. At the 25 October 2013 meeting of the European Council, EU heads of states and government agreed that "investment in research and innovation fuels productivity and growth and is key for job creation".

Earlier this year, the EVCA commissioned research on the impact of private equity on economic growth in Europe. Drawn from 60 recent academic and professional studies, the findings form the basis of this *Briefing*.

They reveal that companies under private equity ownership often display the characteristics required for long-term growth. A contributing factor to this is the mix of strategies private equity brings to the table: helping companies operate more efficiently, launching products and services and expanding overseas.

Encouraging though the findings are, they just scratch the surface. Further research is needed to improve our understanding of private equity's impact on growth.

But we believe the report is a good start to the discussion about how private equity can contribute to the goals of Europe 2020 and beyond.

Dörte Höppner,
Secretary-General

INSUMMARY

- Productivity, innovation and competitiveness are central to the EU's plan for long-term economic growth; innovation and the digital agenda are European Council priorities
- Private equity backing improves the operating performance of firms by up to 8.5% in the first three years of investment
- In the private sector, private equity-backed firms employ less than 6% of workers yet account for up to 12% of innovation
- Private equity-backed companies are more focused on expanding overseas, making them more competitive
- Private equity is a major provider of risk capital – one indicator of an economy's competitiveness – contributing to the creation of up to 5,600 new businesses each year

Innovating for growth



A new independent report, commissioned by the EVCA, underlines private equity's contribution towards making Europe more innovative, productive and competitive

The private equity industry is playing a key role in supporting Europe 2020, the European Commission's ten-year strategy to drive growth in the EU and create a more 'smart, sustainable and inclusive' economy. That's one of the main conclusions of a new report, *Exploring the impact of private equity on economic growth in Europe*.

Europe 2020 sets five headline targets for the EU to achieve by the end of this decade, covering employment, research & development (R&D), climate change and energy sustainability, education and fighting poverty and social exclusion.

The report, produced by Frontier Economics, demonstrates how private equity can help in achieving these goals (for the main findings, see page 6).

Innovation impetus

The research highlights private equity's contribution towards Europe 2020's R&D target, which requires 3% of the EU's GDP to be invested in R&D by 2020. It demonstrates

that private equity-backed firms invest more in innovation and achieve better results than their peers, securing patents worth up to an estimated €350bn in the five years to 2011.

This is an important example of private equity's role in the European economy, says Syed Kamall, MEP for London and a member of the European Parliament's Economic and Monetary Affairs and International Trade committees.

'Private equity needs to tell more and more of those sorts of stories, particularly where they concern new technology companies or job creation,' he says. 'How has it invested in or grown the R&D function in a company where it had been neglected, for example?'

Kamall believes private equity's ability to take a dispassionate view of firms and turn them around is important for Europe's growth sectors. 'In the EU we are constantly talking about how we want to create a digital, modern economy in an information society.'

Supporting innovation and the digital agenda are priorities for the European Council. But Kamall says: 'We need to make sure the players in that sector perform to the best of their ability – or our competitors will out-compete us.'



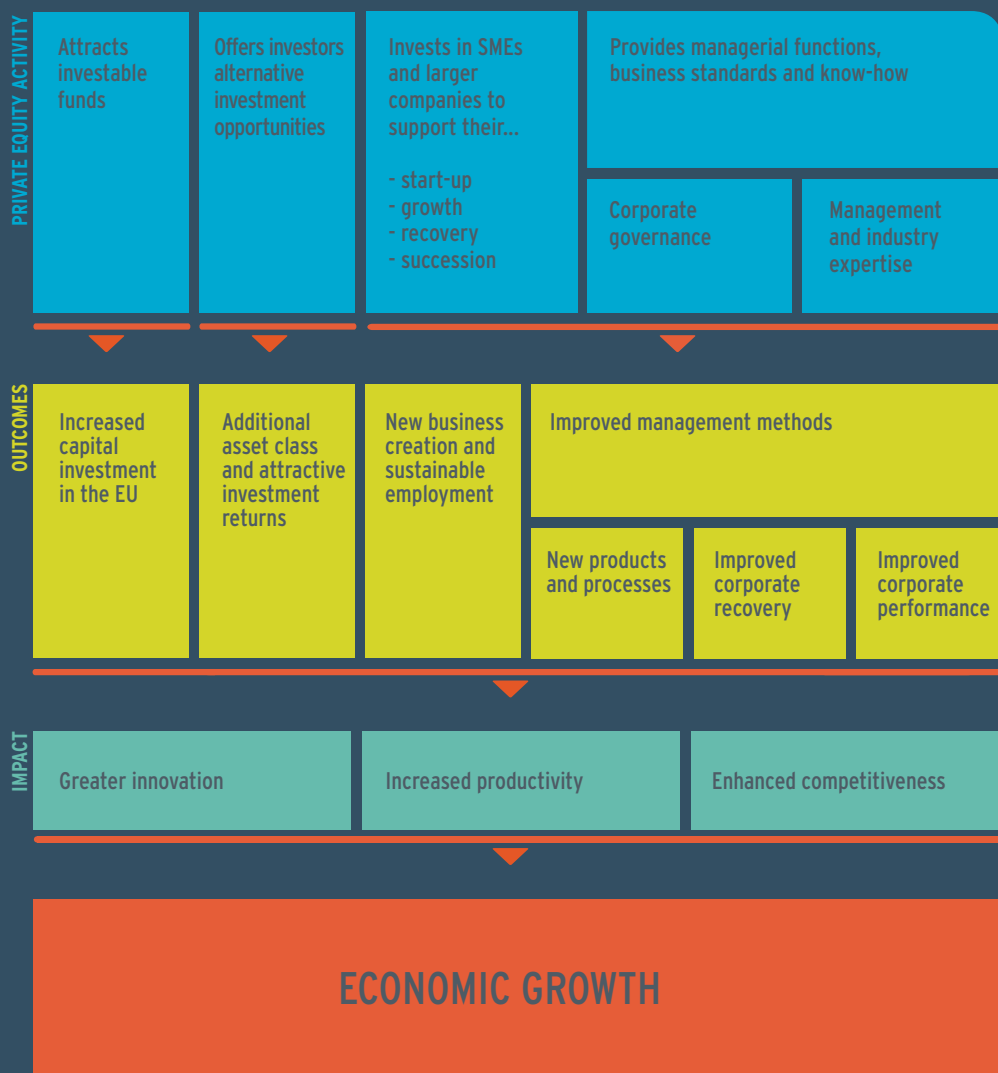
We need to make sure the players [in Europe's digital, modern economy] perform to the best of their ability - or our competitors will out-compete us

Syed Kamall,
MEP for London



Cause and effect

Employing methodology traditionally used to assess economic policy, it is possible to trace the path linking private equity activity to economic growth



A productive relationship

The Carlyle Group contributed to improved performance at Barcelona-based Applus+ by helping it to run more efficiently

When The Carlyle Group bought Applus+ in November 2007, it spied the potential for impressive growth. Since then, staff numbers have jumped by nearly 10,000 and income at the global company, which tests, inspects and certifies industrial equipment and vehicles, has increased from around €650m to €1.5bn in 2012.

To achieve this, Carlyle helped the Barcelona-based business improve managers' performance and focus its efforts on three areas where it could be world leader: inspections for industrial clients in the energy industry; vehicle inspections required by law; and testing vehicles for major automotive makers. A series of takeovers, particularly in the energy division, has helped it to expand into countries across the globe and pursue that world-leader status.

Improving the productivity and financial performance of a number of under-performing business units formed a significant part of the growth plan. The company's loss-making laboratories business was restructured to focus on a reduced number of core activities. Its financial



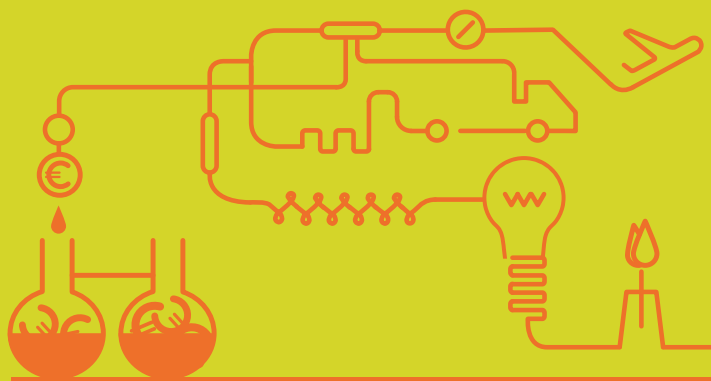
Improving the productivity and financial performance of a number of under-performing business units formed a significant part of the growth plan



performance has improved and it is expanding internationally. 'It's now one of the top two players in Europe for the inspection of aerospace composites for Airbus,' says Alex Wagenberg, a Managing Director at Carlyle and a member of the Applus+ board.

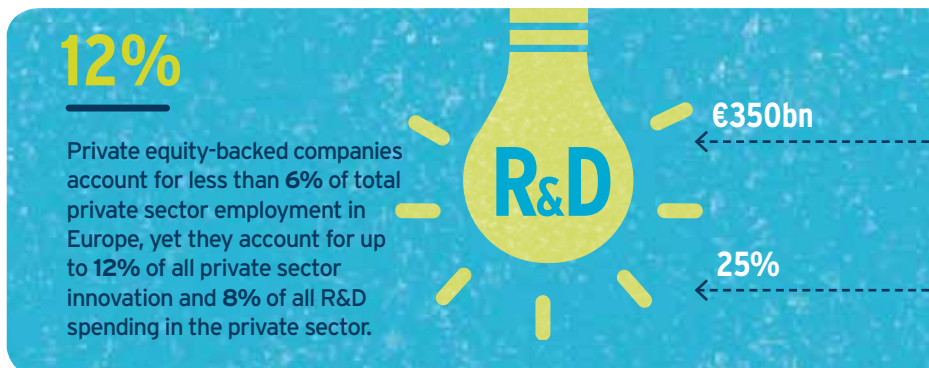
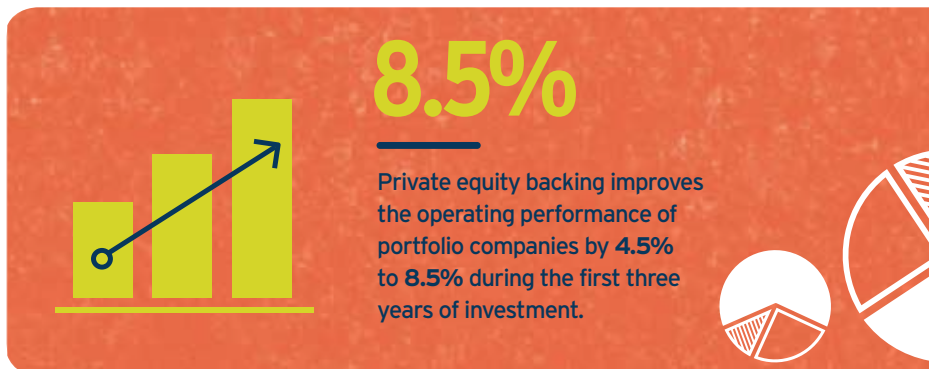
The group's statutory vehicle inspection business also saw improvements in efficiency and customer service. 'Clients in Catalonia used to wait five or six days for an appointment, which they had to book by phone,' says Wagenberg. 'Now the waiting times are less than a day and about 30% of bookings are done on the internet.'

Today, Applus+ employs more than 18,000 people and is a global company, operating in 65 countries. It boasts Shell and Mercedes among its clients. Wagenberg believes there's further scope for productivity improvements as the company's scale grows. 'That's already happening business by business - but there's more to come,' he says.



Winning numbers

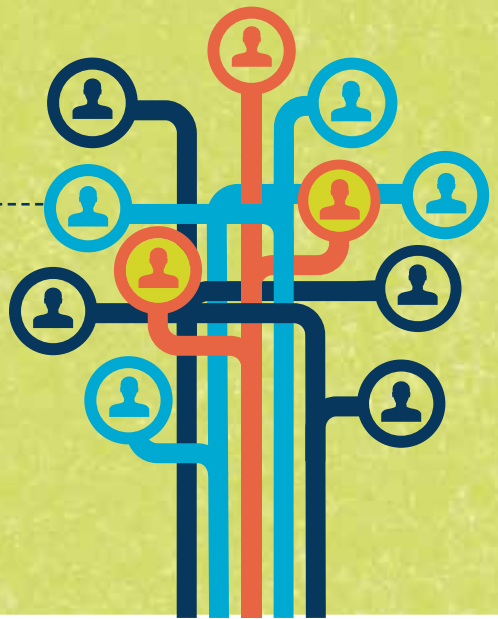
Did you know that private equity contributes to the creation of 5,600 businesses in Europe every year? Or that private equity-backed firms are up to 50% less likely to fail than similar companies under alternative ownership? The main findings of Frontier Economics' new report show private equity can be a key ally in Europe's quest for competitiveness and growth





5,600

Private equity contributes to the creation of up to **5,600** new businesses in Europe annually, either through direct investment or via a 'spillover' effect, caused by knowledge sharing, networking and inspiring role models.



6 years

6.9%

In large companies, private equity backing leads to improved productivity (measured by EBITDA per employee) of **6.9%** over a six-year period.

Patents granted to private equity-backed businesses from **2006-2011** are likely to be worth up to **€350bn**.

Private equity participation increases the number of patent citations (a measure of a patent's technological significance and market value) by **25%**.

50%



Private equity-backed companies are up to **50%** less likely to fail than non-private-equity-backed companies with similar characteristics.



From Nottingham to Nanjing

In partnership with private equity, Alliance Boots has used innovation and internationalisation to become one of the world's biggest players in health and beauty

When John Boot opened a small herbalist shop in Nottingham in 1849, little did he know that more than 160 years later the business that bears his name would employ over 108,000 people in more than 25 countries worldwide.

Still based in Nottingham, Boots UK is now a key business within the Alliance Boots Group. In 2007 it became the first FTSE 100 company to be taken private when Kohlberg Kravis Roberts (KKR) acquired it in partnership with Alliance Boots' then Deputy Executive Chairman Stefano Pessina.

Patchwork of entities

'Back in 2007, Alliance Boots was a patchwork of entities,' says Yves Romestan, the company's Director of Group Communications. 'But our focus and strong executive management team has unified the company. For example, Alliance Healthcare has been transformed from trading under 21 names into one strong healthcare brand, Alliance Healthcare.'

Pessina, now Executive Chairman, agrees the deal was transformational. 'I have often said that KKR could not have been a better partner for me and for Alliance Boots.'



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Stefano Pessina,
Alliance Boots



They share my vision for the group, and they have supported me through all the steps towards creating a global industry player. They really are the partner of choice.'

Away from the public markets, KKR and Pessina have been able to shift the focus to long-term value gain and create an ownership culture that encourages innovation and entrepreneurship.

2007

Alliance Boots becomes the first FTSE 100 company to be taken private after it is bought by a partnership between its Deputy Executive Chairman Stefano Pessina and private equity firm Kohlberg Kravis Roberts

£2bn

Alliance Boots invested in a £2bn development programme which involved revamping stores, overhauling the distribution system and updating the brand

A £2bn development programme has included smartening up stores, overhauling the distribution system and updating Alliance Boots' group of brands.

Developing new products and technologies has also been at the forefront of the business's agenda, having hit the jackpot with No7's Protect & Perfect range, which has grown into a leading UK skincare brand.

'The achievement of No7 products speaks volumes about the innovation potential within the company,' says Dominic Murphy, Member and Head of KKR's Health Care Industry team in Europe. And more recently, Boots Opticians has entered the digital age, introducing an Eye Check app.

From West to East

Since 2007 the focus has been on growing internationally with the group's presence increasing across Europe, the US, Russia, the Middle East and Asia. 'Alliance Boots has used its position as the largest integrated wholesaler in the market as the platform for international expansion,' says Murphy. 'We see this as a very natural value creation driver for the business.'

Alliance Boots has also focused on China, where it has been since 2008. The group has bought a minority stake in Nanjing Pharmaceutical, China's fifth-largest pharmaceutical wholesaler, and worked with Guangzhou Pharmaceuticals, its third-largest drug company. In addition, management is reported to be considering expansion into South America.

Alliance Boots' international ambitions were boosted in 2012 when US chemist Walgreens bought a 45% stake in the business, with an option to acquire the rest in 2015. 'Together with Alliance Boots and Walgreens, we have created the world's biggest buyer of prescription drugs and the world's largest pharmacy-led health and wellbeing enterprise,' says Murphy.

John Boot would no doubt have been proud to lend his name to such success.



Together with Alliance Boots and Walgreens, we have created the world's biggest buyer of prescription drugs and the world's largest pharmacy-led health and wellbeing enterprise

Dominic Murphy,
Kohlberg Kravis Roberts



Moleskine: adapting through innovation

Can traditional notebook makers survive the rise of personal electronic devices? Luxury Italian brand Moleskine has - through innovation and expansion.

With the backing of private equity firm Syntegra Capital, Moleskine partnered with notetaking software and service provider Evernote to create an app that digitalises ideas and sketches onto a computer, phone or tablet so that they can be saved, searched and shared.

It also diversified from its Ernest Hemingway-inspired black notebooks to offer pads in numerous sizes and colours across 90 countries. Some notebooks have themes such as style, music and pets.

In April 2013 the company debuted on the Milan Stock Exchange and is now expanding. Six store openings are planned by the end of the year - two in China, two in the US and two in Europe.

A global success story



Advent Venture Partners helped Zong become a credible international competitor. Now the start-up is a jewel in eBay's crown

In 2004, venture capital investor Frédéric Court met entrepreneur David Marcus in Geneva. Marcus was pitching for financing to grow his brainchild Echovox – a company that helped media firms interact with consumers via mobile technology.

Today, Marcus is President of PayPal, one of the world's biggest online businesses. His incredible journey, made with the support of Court's Advent Venture Partners, shows how private equity can help transform European companies into global success stories.

US springboard

Advent backed Echovox in 2007. It morphed into Zong, which allowed people to pay for online services with just their mobile phone number and a secure PIN code.

'Very quickly, we focused on supporting Zong's expansion in Europe but also tried to get a foothold in the US, a very large mobile market but less mature

than Europe at the time,' says Court. 'To increase the chances of success, David moved to Silicon Valley within the first year of our investment.'

'We aimed at winning over the US market, an ambitious strategy that Frédéric and Advent supported,' says Marcus. 'It was like having a great partner on board.'

Soon, Zong was signing up prestigious customers such as Facebook. To cope with this growth, Advent helped Zong raise finance from US venture capital firm Matrix Partners. Within just 18 months, eBay subsidiary PayPal bought Zong for \$240m. Marcus has advanced quickly there, with mobile one of the main reasons behind PayPal's growth.

Could Zong have enjoyed similar success if Marcus had stayed in Europe? 'We have a lot of talent for innovation in Europe but we need to be more aggressive in terms of taking that innovation to market,' says



We aimed at winning over the US market, an ambitious strategy that Advent supported. It was like having a great partner on board

David Marcus, PayPal
(formerly of Zong)



Court. In particular, European corporates could be less risk averse about investing in innovative start-ups.

Championing innovation in the wider economy is one way to tackle that risk aversion. Venture capital is well placed to do this, helping Europe's economy to grow at the same time, but the industry needs support from policymakers to help it make a difference.

In conversation with Vincenzo Morelli

Private equity's 'unique advantages' make it a more effective form of governance for delivering company and industry growth, says the former chairman of the EVCA

What's the most important conclusion of Frontier Economics' recent report?

That the private equity industry contributes disproportionately to company and industry growth in Europe by helping to develop innovation, productivity and competitiveness to a greater degree than other forms of ownership. Many individual academic studies have pointed in the same direction but were all quite fragmented. Frontier Economics' report uses a robust OECD methodology to join the dots.

Why is private equity doing this more effectively than other forms of governance?

Because it has unique advantages. We start with a clear strategy: we buy a company only after extensive due diligence and based on an explicit investment case. Second, the incentives are aligned: management is involved in developing strategy and shares the rewards of ownership. Third, the partners or advisers of private equity firms typically have a significant degree of specialisation or experience. Lastly, we eventually have to sell the

company - and that brings great discipline.

An FT report argued that the Frontier Economics research reviewed a thin body of literature and didn't deliver strong enough proof of private equity's contribution. What's your response to that?

I think that's a bizarre contention. The report looked at more than 60 studies. If you go back to 2009, another secondary report, by the Swedish academic Per Strömberg, summarised the conclusions of almost 90 studies. That's tens of thousands of data points over long periods of time. Few things have been studied to that degree.

How could private equity make an even greater contribution towards European growth and the Europe 2020 agenda?

I think there will be even more successful results if we work constructively with the European Commission and national governments to orient our investments towards higher-growth areas of the economy. For example, the Commission is currently looking into a programme to

match private sector funds and co-invest in the riskier part of venture capital investment. That would be an interesting catalyst for investment in start-ups and higher-growth opportunities.



The private equity industry contributes disproportionately to growth in Europe by helping to develop innovation, productivity and competitiveness to a greater degree than other forms of ownership

Vincenzo Morelli,
Former Chairman of the EVCA



The EVCA is the voice of European private equity.

Our membership covers the full range of private equity activity, from early-stage venture capital to the largest private equity firms, investors such as pension funds, insurance companies, fund-of-funds and family offices and associate members from related professions. We represent 700 member firms and 500 affiliated members.

The EVCA shapes the future direction of the industry, while promoting it to stakeholders such as entrepreneurs, business owners and employee representatives.

We explain private equity to the public and help shape public policy, so that our members can conduct their business effectively.

The EVCA is responsible for the industry's professional standards, demanding accountability, good governance and transparency from our members and spreading best practice through our training courses.

We have the facts when it comes to European private equity, thanks to our trusted and authoritative research and analysis.

The EVCA has 25 dedicated staff working in Brussels to make sure that our industry is heard.

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EVCA BRIEFING

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