Essential work 2014-2019

Private equity's contribution to building European businesses

EVCA

Long-term investments play an important part in building our future

Europe faces a clear challenge over the next five years: to return to sustainable growth and durable employment. With unemployment still above 11% and growth at around 1%, this can appear a daunting task, which is made more so by the structural challenges that Europe faced even before the crisis: its ageing population; the increasing competition posed by emerging markets – in Asia and Latin America in particular; and the need to invest in infrastructure on which long-term growth depends.

The good news, however, is that Europe is blessed with world-class businesses, from innovative start-ups to established global brands. These can, with the right public policy support from Member States and at EU level, grow and develop further.

The private equity and infrastructure industries are already playing their role in helping those businesses to expand and grow. Private equity backs over 25,000 companies in Europe, 83% of which are SMEs, in sectors as diverse as life sciences, retail and energy. And it invests for the long-term, channelling capital from pension funds and insurance companies that need to grow their funds to pay the pensions and meet the claims of European citizens. The EVCA provides a voice to those investors and to the businesses and infrastructure they are building.

The policy framework provided by the EU is vital to this work. Institutional investors need to be prudentially sound and encouraged to commit to long-term financing; the single market needs to function so that companies and infrastructure assets in one Member State can receive investment from another and can then use the world's largest integrated market as a springboard to exploit international opportunities; and the EU needs to be a champion of global trade, open to new markets and investors across the world.

This paper seeks to explain how private equity makes its contribution to Europe's economy and also to outline some of the key policy challenges that will need to be met during this mandate.

The last mandate rightly focused on restoring trust in financial markets and delivering stability in the sovereign debt markets. The new European Parliament and European Commission have the potential to build on the stable foundations that the last mandate worked so hard to construct to ensure that investment, growth and, ultimately, jobs are the key achievements of the next five years. Private equity can play an important role in that future.

Challenge: Growth & employment

Opportunity: Companies & infrastructure needing investment

Our contribution: Providing capital and know-how

What is private equity?

What do start-ups and well-established companies have in common? They both need investment to help them grow. Growing might mean building factories, hiring more staff, creating innovative products or helping save a company from closing down. The investment might be borrowed money from a bank or the company could sell shares and raise money from a stock exchange. But some companies are looking for something more. They are looking for investment from someone who will guide them in building their business. This is especially true in the current economic climate, where many businesses need to transform the way they operate and achieve a step change in performance.

Private equity is just one form of investment, but it has particular characteristics that make it a little different from the others.

Active engagement: A private equity investor becomes part of the company they back, generally taking a board position, with the long-term goal of nurturing the business, helping to foster growth and creating additional value.

Patience: A private equity investor provides capital to companies with growth potential, investing for an average of five years.

Who the EVCA represents

- Private equity fund managers – including venture capital, mid-market and large buyout investors – who back companies at different stages in their development, from start-ups to multinationals.
- Infrastructure investment managers who invest in operating assets in energy or telecoms, for example.
- Professional investors such as the pension funds, insurers and other institutions that invest in private equity.

Private equity fund managers invest money from pension funds, banks or insurers. They also invest their own money, meaning that they have a direct stake in the company's success.

When the company has reached its target, the investors sell their equity. The value created is then shared out between all the people who provided the original investment, helping to provide pensions and returns to savers.

And while there are of course exceptions, most companies backed by private equity become stronger and more valuable, which is why private equity matters: it helps to build better businesses. And that's good for employees, pensioners, investors and the European economy.

Look out for:

Policy action points
How EU policy can support private equity

Find out more
Sources of further information

Backing Europe's businesses

Access to finance
In 2013 alone, more than 5,000 European companies received private equity backing. These represent a wide range of sectors: from communications technology to retail; from life sciences to industrial products.

Not all companies will be right for the particular benefits that private equity brings. Private equity managers work hard to find the right company to invest in at the right time in its development – companies in which they can make a real difference and with whom they can build productive, long-term relationships.

Across Europe, private equity investors are backing entrepreneurs and established businesses of all sizes, from the newest start-ups to the biggest household names. In every case they are providing hands-on management and an injection of new finance, whether through equity or debt. At a time when other sources of finance are difficult for many of our companies to access, for example as a result of bank deleveraging, private equity investment has an important role to play.

Private equity is particularly good at attracting investment from outside Europe. In 2013, over 50% of the money that was invested into European private equity came from outside Europe. Private equity helps businesses in Europe to access the finance that global investors want to put to work, and it helps global investors to feel more comfortable about investing in Europe by giving them access to experienced managers who know the market and understand where to find great businesses in which to invest.

Helping transform businesses
No form of ownership can guarantee that an individual company will prosper, but there is strong evidence that private equity investment makes a positive contribution to the European economy. The EU's Europe 2020 strategy identified innovation, productivity and competitiveness as key priorities for the European economy, and research shows that private equity-backed companies outperform against all three.

Competitiveness: Private equity is prepared to back companies with new ideas which are prepared to take risks in launching new products or services. The investment that private equity offers, coupled with the expertise it brings, can help not only an individual company but also the wider economy to become more competitive.

Innovation: Over the five years to 2011, the value of patents granted to private equity-backed companies in Europe was about €350bn, and private equity-backed companies account for 12% of the continent's industrial innovation – far more than their proportionate share.

Productivity: Private equity backing makes firms more resilient, less likely to fail and more productive. The improvements to strategic and operational performance by private equity owners make a key contribution to this productivity.

Find out more
Frontier Economics, *Exploring the impact of private equity on economic growth in Europe*, www.evca.eu/research/economic-impact-data/

Policy action points

Alternative Investment Fund Managers Directive (AIFMD)
Background: The AIFMD creates a harmonised regulatory framework for the management and marketing of private equity, infrastructure and other alternative investment funds in the EEA.

To do: The AIFMD's implementation and its 2017 review should ensure a genuine single market for private equity and infrastructure fund investment across Europe, with rules that are tailored to these industries' characteristics. It should guarantee that European professional investors retain access to global investment opportunities, with a workable passport regime.

EU Venture Capital Regulation (EuVECA)
Background: EuVECA provides European venture capital firms with a passport, enabling them to seek investment across Europe while applying standards that are appropriate to the size and characteristics of venture capital.

To do: In 2015, EuVECA should be made available to venture capital funds located outside the EU to provide European professional investors with full access to global investment opportunities. The review in 2017 should ensure that the regime remains voluntary and has requirements that are appropriate to the sector's characteristics.

A harmonised fund structure
Background: Member States' differing tax treatments of investment funds causes uncertainty over tax liabilities and risks double taxation of investors. This acts as a disincentive for global investors wanting to invest in Europe.

To do: A common EU approach to the tax treatment of investment funds should be developed, either through legislation or non-binding standards. EU and international action to protect the tax base must not act as a disincentive for professional investors to pool their resources via a fund structure.

Public-private partnership
Background: The Horizon 2020 and COSME spending programmes provide funds that could be used to attract international investors to invest in innovative new European companies.

To do: Horizon 2020 and COSME funding should be used to develop a public-private 'fund of funds' structure that would attract international investors to commit to European venture capital.

Promoting global investment in Europe
Background: Although European businesses benefit from access to the world's largest single market, they also need to be able to compete on the global stage. A lack of convergence on regulatory standards can be a huge barrier to this.

To do: Differences between European and third-country regulatory and supervisory regimes should be minimised. The EU institutions and the European supervisory authorities should engage actively with their counterparts in other jurisdictions during the EU rulemaking processes, and with international standard-setting bodies.

Find out more:
Policy information on the EVCA website: www.evca.eu/policy/key-topics/

IN NUMBERS

How private equity contributes to Europe's economy

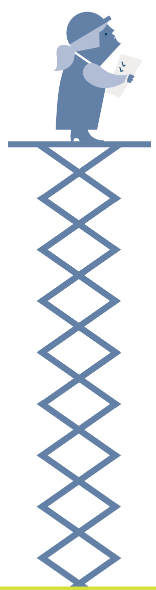
INVESTMENT

€307bn

invested by private equity in European companies from 2007 to 2013 in the 12 largest private equity markets in Europe.

25,000

companies backed by private equity in Europe...



83%

...of which are SMEs.

>50%

of the total invested into European private equity in 2013 came from outside Europe.

Source: EVCA PEREP Analytics

COMPETITIVENESS

5,600

new businesses created every year in Europe, either through direct investment or via a 'spillover' effect, caused by knowledge sharing, networking and inspiring role models.

INNOVATION

€350bn

is the economic value of patents granted to private equity-backed companies in Europe between 2006 and 2011.

12%

of all industrial innovation in Europe is attributable to private equity-backed companies.

Source: Frontier Economics

PRODUCTIVITY

4.5-8.5%

The percentage by which private equity backing improves the operating performance of portfolio companies during the first three years of investment.

Up to

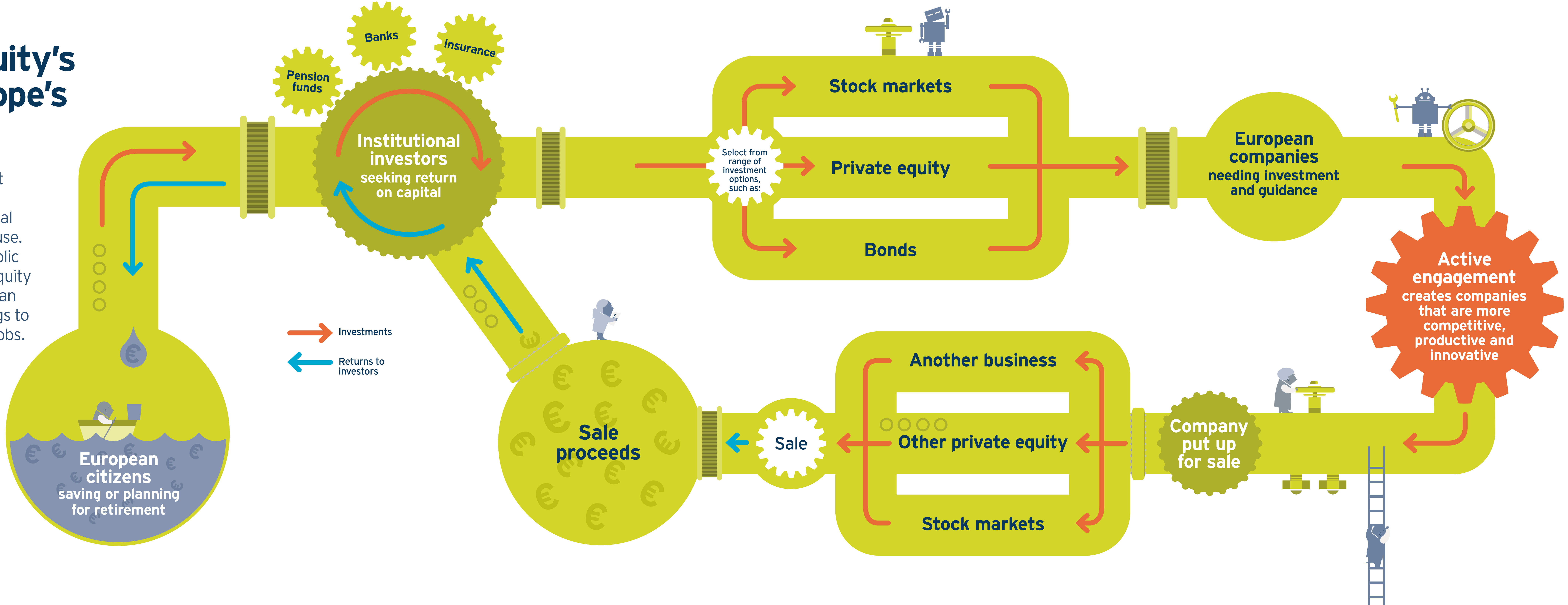
50%

The percentage by which private equity-backed companies are less likely to fail than non-private-equity-backed companies with similar characteristics.

Source: Frontier Economics

Private equity's role in Europe's economy

There are many different ways in which funding is channelled from individual citizens into productive use. Alongside banks and public stock markets, private equity is one of these ways. It can help pensions and savings to grow and create stable jobs.



Private equity activity in your region

Find out how private equity is contributing to your national and regional economy.

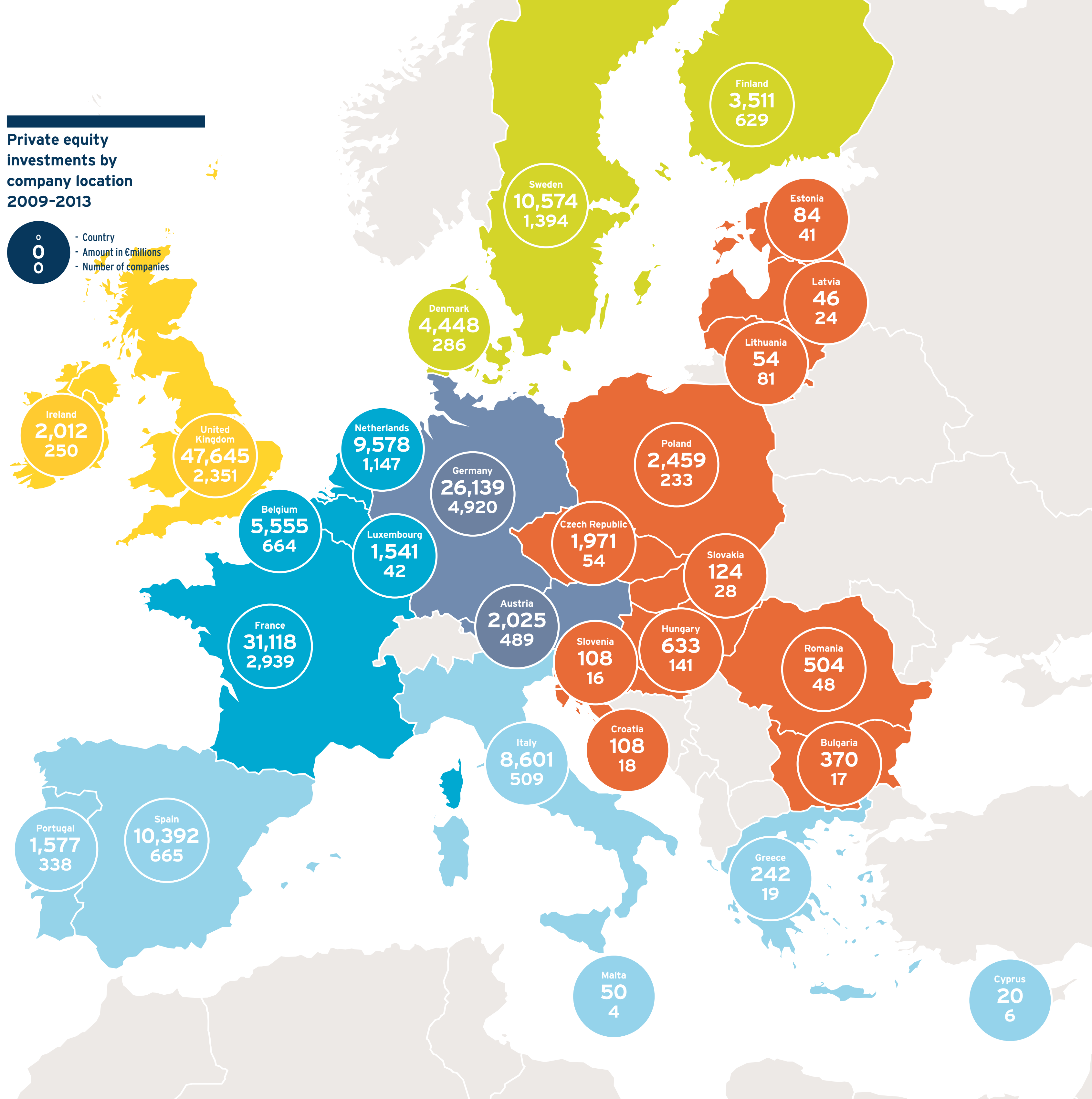
€555bn
Total capital under management

€307bn
has been invested since 2007 in

25,000
companies, which employ

7-8
million people

Visit the EVCA website to find examples of private equity-backed companies in your region: www.evca.eu/about-private-equity/private-equity-in-action/case-studies/



	Private equity investments by company location 2009-2013 (number of companies)	Private equity investments by company location 2009-2013 (amount in €millions)
CEE	701	6,460
DACH German-speaking region	5,409	28,165
France & Benelux	4,792	47,793
Nordics	2,308	18,533
Southern Europe	1,541	20,882
UK & Ireland	2,601	49,657
TOTAL	17,352	171,490

The total sums are smaller than when summing up country figures individually because some companies changed geography within the five-year period. The total sum therefore corrects any double-counting.

Selection of European private equity-backed companies

arena, Ducati, Moleskine, Mont Blanc, Kiala, Magotteaux, Post, Poundland, Tommy Hilfiger, Boss Hugo Boss, Materne, Permasteelisa Group, Teufel, Fon, Permobil, Rovio, Shazam, Skype, Skyscanner, Spotify

Investing responsibly for the long-term

Some companies will be able to reach their full potential very quickly, finding an immediate market for their new product or making a seamless transition from their home market to an export market.

But that will not be the case for all companies, and the private equity approach to ownership and to investment has much to offer those businesses that need patient investment and a committed partner, eager to work with the management and employees to build a business that will thrive over the long-term.

Professional investors such as pension funds and insurers start with a long-term perspective. They commit their capital for around 10 years, and this in turn gives the private equity manager the time and space not only to pick the right companies in which to invest, but also to engage patiently and actively with those companies.

The private equity approach is predicated on taking a long-term view of how a company can develop, and playing a hands-on role in making that happen. By getting involved directly with the management of the company, the private equity backer can bring its expertise to bear. Many private equity managers come with a strong background in a particular industry or sector, and their knowledge and contacts are key advantages that private equity brings.

In addition, because private equity backers are freed from the pressure to deliver short-term results, they can patiently build the business in which they are investing, maximising the likelihood that it will be sustainable over the long-term and beyond the period of private equity ownership. This long-term approach and active involvement make private equity particularly well-suited to being a responsible investor as well. Because private equity investors take such a hands-on approach to the companies they are backing, they are in a very strong position to ensure that environmental, social and governance issues are addressed.

The average length of time investors will commit their capital to a private equity fund is

10 years

Private equity has developed a robust set of professional and ethical standards – enshrined in the ***EVCA Handbook of Professional Standards*** – which guide the standards of EVCA members. Many private equity practitioners have also signed the UN Principles for Responsible Investment.

These standards are, of course, backed up by a vigorous regulatory and supervisory framework at EU level. The AIFMD sets out the requirements that European private equity must meet, and these are overseen by the European Commission and the European Securities and Markets Authority (ESMA). With the AIFMD set to be reviewed during this mandate, and with decisions also due to be taken on the powers of ESMA, the European private equity industry looks forward to ensuring that we can preserve a robust regime that protects individual investors, delivers financial stability and facilitates ongoing investment in European businesses.

Find out more
EVCA Handbook of Professional Standards, www.evca.eu/about-evca/professional-standards/

Policy action points

European Long-Term Investment Funds (ELTIF)

Background: The ELTIF regime, currently in development, will create a new product framework to encourage investors to commit capital for the long-term.

To do: The ELTIF regime needs to ensure that different types of investor, both retail and professional, receive the level of protection that is appropriate to their needs. Fund managers should be given sufficient flexibility to manage the long-term assets in which they are investing in a way that does not impose unnecessary costs and reduce returns to investors.

Valuing long-term assets

Background: There are good reasons for regulators to want investors to use market prices to assess how risky their portfolio of assets might be. However, it is difficult to value long-term assets in this way as they are traded infrequently. A market price is hard to determine and can make such assets appear riskier than they are. This approach risks discouraging investors from committing to long-term assets such as private equity or infrastructure.

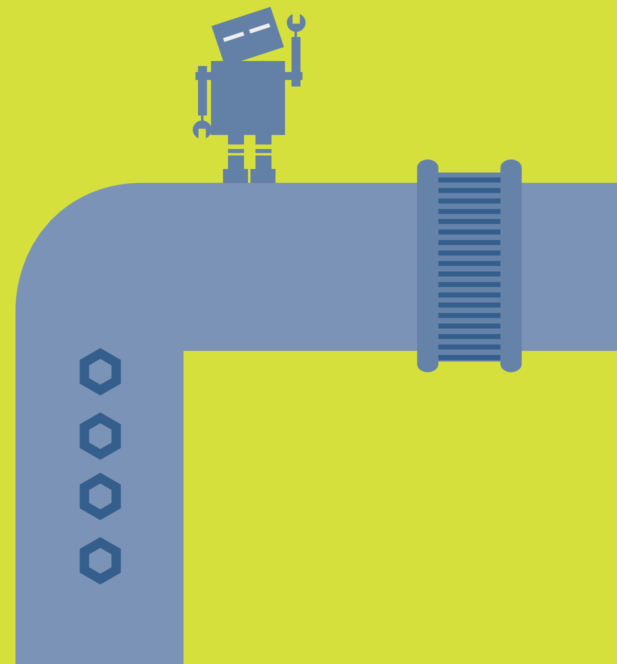
To do: Industry and regulators need to cooperate to find an appropriate and more accurate approach to valuing long-term assets for the purpose of determining investors' prudential capital requirements.

Financial supervision

Background: The three European supervisory authorities (ESMA, EBA, EIOPA) play a vital role in the European financial market, developing binding standards and helping to interpret EU law.

To do: When their roles and responsibilities are formally reviewed, open and regular engagement with stakeholders must be guaranteed. The development of an integrated EU and a global market must be a driving principle for all three authorities.

Find out more
Policy information on the EVCA website: www.evca.eu/policy/key-topics/



Keeping investment flowing

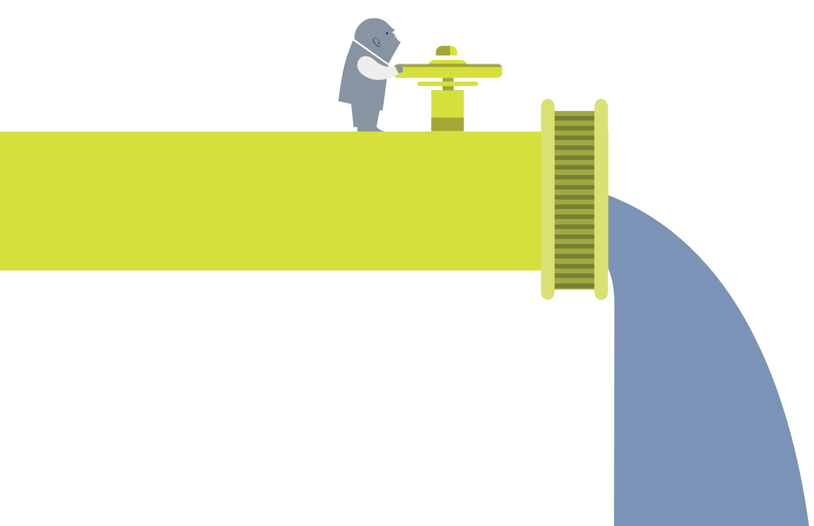
Although investment into private equity and infrastructure usually comes from large institutional investors such as pension funds or insurance companies, they are really only investing on behalf of individuals: ordinary citizens who want to ensure that they have a comfortable pension for their retirement, or insurance policyholders who want to know that their insurer can meet their claims.

To meet the needs of these clients, institutional investors need to invest in a wide range of different assets, and for many of them private equity or infrastructure will be a small, but important, part of their overall portfolio. They have the advantage of being long-term asset classes, which help institutional investors to match their long-term liabilities. They also have a good track record of delivering a competitive rate of return.

With interest rates likely to remain at the current, very low levels, assets such as government bonds are increasingly unable to deliver the above-inflation returns that institutional investors need to meet the commitments they have made to pensioners and insurance policyholders.

Private equity and infrastructure investing offers a 'win-win-win': European companies and infrastructure get access to patient, private sector funding and experienced management know-how; institutional investors are given an opportunity to diversify their portfolios and achieve the rates of return they need; and, ultimately, holders of pensions or insurance products see their savings grow and their claims met.

Private equity delivers a virtuous cycle of funding. As a private equity-backed company is sold on to its next owner, this process of 'exit' generates resources for the next round of investment, and the cycle can begin again. The next innovative entrepreneur with a bright idea can be supported; the next SME gets the chance to grow; and the next large company is developed and re-energised.



Policy action points

Insurance companies

Background: Solvency II is a fundamental review of prudential regulation for the European insurance industry. It provides a risk-based framework for defining capital requirements for investments in different assets, including private equity and infrastructure.

To do: Negotiations on Solvency II have now concluded. It is important that the remaining Level 2 measures and national implementation of the Directive encourage investment in long-term asset classes such as private equity and infrastructure.

Pension funds

Background: The European Commission has presented a proposal to reform the Institutions for Occupational Retirement Provision (IORP) Directive.

To do: Any new IORP Directive must ensure that European pension funds are encouraged to invest in long-term assets such as private equity and infrastructure.

Third-country passport

Background: European professional investors need to be able to pursue investment opportunities around the world to manage their risks effectively and to ensure that they can achieve the returns that are essential to meet their pension or other liabilities to EU citizens.

To do: The marketing passport envisaged in the AIFMD for non-EU funds and managers needs to be delivered quickly and in a form that will facilitate global investment.

Banks

Background: The EU has a comprehensive package of measures to strengthen banks. New capital requirements are being put in place and the European Commission has published a proposal that will require the structural separation of European banks and prohibit certain activities.

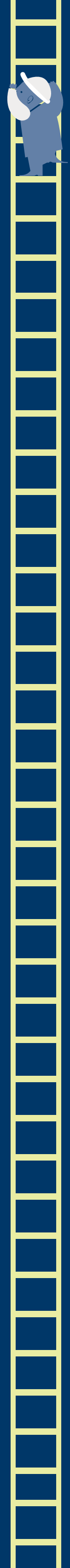
To do: The proposal on bank separation must not jeopardise the vital role that banks can play in financing the real economy, including by investing directly into private equity or infrastructure funds and lending to the companies and assets they back. New capital requirements for European banks must ensure that banks are not disincentivised from supporting long-term investment.

Promoting initial public offerings (IPOs)

Background: Listing shares on a stock market via an IPO is one route by which a private equity-backed company or an infrastructure company might proceed to the next stage of its development. To promote a vibrant IPO market in Europe, the EVCA has teamed up with European Issuers and the Federation of European Securities Exchanges to deliver recommendations to improve this market.

To do: EU policymakers should engage with the task force and its recommendations.

Find out more
Policy information on the EVCA website:
www.evca.eu/policy/key-topics/



The EVCA's role

The European Private Equity and Venture Capital Association provides a voice to private equity investors and to the businesses and infrastructure they are building. We aim to be a constructive partner for the European institutions, helping policymakers to understand the positive contribution that private equity can make to Europe's economy, and how EU policy might impact on its ability to do so. With a track record of constructive engagement at EU level for more than 30 years, we are keen to play our part in helping Europe to deliver jobs and growth, now and in the future.

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To learn more about the EVCA and its members, visit www.evca.eu

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