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The European dream comes of age

Jeremy Rifkin, *Fellow, Wharton School's Executive Education Program at the University of Pennsylvania and President, The Foundation on Economic Trends, Washington DC*

The American Dream of unfettered capitalism made sense in a frontier economy. But times have changed and Adam Smith's ideal of individuals in pursuit of their own self-interest has no place in an inter-connected, global economy. These are tumultuous times. With much of the world growing dark, the European Dream stands as a beacon of light, beckoning us to a new age of inclusivity, diversity, quality of life, sustainability, universal human rights, the rights of nature and peace on earth.

The gold-standard for the last 200 years, the American Dream basically said that America is a tough country – but it's a land of opportunity for anyone prepared to get a good education and work hard. Until the 1960s this was true. Immigrants came to the USA and many of them made successes of their lives. Since then, however, the dream has dramatically unravelled. Today the USA ranks at number 24 among industrial nations in income disparity (the gap between the very rich at the top and the working poor at the bottom). Only Mexico and Russia rank lower in income distribution. Small wonder then that just 51% of Americans still believe in the American Dream – and one in three Americans don't believe in it at all.

But as the American Dream has been crumbling, a new dream has slowly been developing in Europe. And just as the American Dream was always highly individualistic, founded on autonomy and mobility, so the emerging European Dream is much more communal. To have an enjoyable quality of life – the guiding principle in Europe – the whole community has to tax itself and make sure that no-one falls too far behind. And certainly, as far as the most advanced 15 European Union countries are concerned, Europe is significantly outperforming the USA in this respect.

The collective mindset in Europe stems from an entrenched tradition founded in the paternalism of the Catholic church, the communalism of fortressed cities, dense populations and the hierarchy of feudal aristocracies. By the 20th century, and after the end of the second World War, Europeans were exploring the idea of a social economy, a balance between the market place and individualism and a social solidarity underpinned by the redistribution of wealth and the concept of working to live (not living to work, in the American-style).

61 of the world's largest 140 companies are European and just 50 of them are American.

Looking ahead, an acid test for Europe will be just how successfully it opens its doors to immigration, thereby maintaining the multi-cultural diversity that is one of its core strengths. For the moment, there is still a lot of hypocrisy around this issue in the European Dream. For the moment, America continues to be better at absorbing new immigrants. There's a real belief there that new blood is the heartbeat of America.

Europe talks about multiculturalism, but there's a lingering fear about opening the gates to immigrants, especially Muslim minorities. Until this fear dissipates, the European Dream will lack global resonance. The issue of when (or if) Turkey is admitted to the European Union will be a real bellwether.

On top of this, Europe needs to embrace two other foundation stones of the American Dream. One is personal accountability: you cannot have a strong global dream if you won't take responsibility for it. Americans are taught that they are responsible for their own lives – whereas many Europeans, raised in a climate of paternalism, prefer to blame someone else for their circumstances.

The other is the culture of optimism and risk-taking that has always been central to the American Dream. Dreams require optimism – you simply cannot be a Euro-sceptic, a defeatist or a pessimist and expect your dream to fly.

Assuming the European Dream is prepared to learn from the American Dream, cherry picking its main strengths along the way, it is ideally positioned to become the new gold standard. It is all too easily forgotten, but Europe is already a persuasive economic rival. Its GDP exceeded America's in 2003; it has the world's largest internal market; it is the world's largest exporter; 61 of the world's largest 140 companies are European and just 50 of them are American; and its industries lead the field in banking, insurance, chemicals, engineering and aerospace, amongst others.

There is much to take pride in – and much to build upon. My big concern is that Euro-sclerosis is setting in. Too many pessimists are saying that the European Dream is unsupportable, pointing to the American model as a preferable alternative. To throw away what has been built up in Europe over the last 60 years would be a dreadful waste – and to embrace America's defunct gold standard instead would be lunatic. America today stands as a monument to its own dream's inherent weaknesses. Riddled with debt, plagued by bankruptcies and labouring under a spiralling trade deficit, it has lost credibility.

Europe has a golden goose – but, for the moment, it is being starved. The time has come to feed it. Integrated commerce, capital markets and transport links would be a good start. A commitment to multiculturalism, individual accountability and risk-taking would be even better.

On an upward trend

Herman Daems, *Chairman, GIMV NV and EVCA Chairman 2004-2005*

Each EVCA Symposium provides the European venture capital and private equity industry with a chance to take stock of recent developments while looking ahead to future opportunities. The cautious optimism that characterised last year's Berlin Symposium has proved justified and this year's event takes place against a vastly improved business backdrop for our industry. The investment trend has risen steadily over the last 12 months and, with the dotcom boom/bust well and truly behind us, we are now seeing activity substantially ahead of early/mid-1990 levels, especially in the later-stage segments.

The last year has seen significant steps being taken towards boosting professional standards in the industry. Building on EVCA's pioneering work, international valuation guidelines have been set in cooperation with the French and British associations and are expected to be adopted by many more trade bodies.

Attention has also been focused on Corporate Governance and EVCA will be launching its new guidelines at this event. Certainly, the industry as a whole has been under mounting pressure to improve transparency.

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Throughout its 22 year history, EVCA has developed and promoted a range of guidelines for the professional conduct of private equity and venture capital fund managers, both in respect of the management of their activities as well as in their relationships with investors and portfolio companies. EVCA has not only issued Governing Principles for the management of funds, it has also published Reporting Guidelines to ensure best practice in investor relations and high degrees of transparency towards investors.

Entitled 'Building Bridges', this year's event is all about fostering links between the various core groups of participants making up this industry. This means that a variety of stakeholders are expected to take part, including investors, entrepreneurs, academics and regulators. Their collective expertise is a unique resource, having grown in stature with a European industry that is now a substantial financial and socio-economic force in its own right.

At a time when other investors, including hedge funds, are increasingly targeting private equity and venture capital investment opportunities, this Symposium underlines the fact that our business requires specialist skills. Successful investing is about much more than simply putting money into target companies. Results are dependent on actually doing something with those companies.

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Naturally, EVCA's commitment to raising policy issues on a public level has been ongoing – nationally and in European Union policymaking. However, as the industry has grown in stature, so EVCA's role has expanded some way beyond that of a typical trade and industry association. Its diverse membership and in-depth resources equip EVCA to function as a powerful commercial networking hub for all those connected with European private equity and venture capital – and nowhere is this more in evidence than at the Symposium.

Taking place as it does in a centre of industry professionalism, this year's event highlights the extent to which private equity can make a very positive contribution to the wider economy. And looking ahead, the UK example is one which EVCA wants to see replicated across Europe. Our medium-term target is to raise venture capital to 0.2% of European GDP and private equity to 0.4%. There is no reason why Europe should continue to under-perform the USA in this respect and EVCA expects to play a crucial role in mobilising unified financial muscle in pursuit of this objective.

What's new at the EVCA Symposium?

Cyril Mazeau, *Conference Officer, EVCA*

Organising a conference such as the EVCA Symposium is not an easy task: You all had fully-booked agendas, deals to close, business trips and fundraising to conduct (especially in 2005!). To gather everybody in the European private equity community is looking more like an impossible mission than a walk in the park!

Why are you at the EVCA Symposium? For the mysterious keynote speakers, for the networking opportunities or for the gala dinner? These are some of the questions the EVCA Conference & Member Services Committee and the EVCA Secretariat have asked themselves. We tried to understand your needs and to provide you with a reshaped annual gathering of the industry.

"So what's new then?" First, a professional chairman and moderator: Huw Edwards. A renowned broadcaster and journalist, he has set out to challenge the panellists, the keynote speakers and the audience to make the debate more interactive. Dealing on a day-to-day basis with politicians, he is used to asking the truly essential questions and getting the outspoken responses usually given only in private discussions. So, do not be afraid to help him, to join the debate, to give your views and to test the speakers!

Second, we have set up 20 Interactive Workshop Discussions to touch upon those aspects which impact your business. These debates will, of course, deal with fundraising in 2005, the issues and challenges for CEOs, companies' management and advisory boards as well as the recipe to build a billion euro company – yes, it is possible in Europe! – and many other items on your daily agenda.

We would like to stress that these workshops are the place to start long-term debates, on topics such as corporate governance, valuation, legal fund structures across Europe or IFRS. Here, you will be able to grasp the often little known parts of this industries' day-to-day business, which are so essential for your company's future success. We look forward to receiving your expert feedback on many complex issues, on which EVCA has been working for many years.

New, too, is the return of life sciences as a topic to EVCA conferences and the Symposium in particular. Thanks to an active task force, we have been able to setup a remarkably thorough programme on this sector.

Finally, but most important, this year's Symposium is about building bridges between the private equity and venture capital industry, investors, entrepreneurs, lawyers, advisors, policy makers and leading thinkers.

We sincerely hope that this year's Symposium will help the private equity industry in general – and your business in particular – to achieve long term growth and lasting success.

Enjoy the conference!

Is continental Europe's middle market an Eldorado for investors?

Dominique Nouvellet, *President and Director General, Siparex*

Like all sectors of finance, our industry has its fashions. Yesterday, it was big leveraged buyouts. Before that it was venture capital and high-tech. Today it is the middle market.

Fashions in finance have generally been based on actual market tendencies, which the most astute investors have been quick to spot, but which generally revert to fads once they stimulate excess offers with respect to supply.

Could the middle market – now fashionable in continental Europe – be an Eldorado for years to come?

There are three basic reasons why I believe this to be so:

- First, continental Europe is steadily transforming itself from a group of mutually closed domestic markets with mid-sized companies into a true single market. Critical sizes are changing and restructurings are creating numerous opportunities for financing operations, with a short turnaround time in many cases.
  This is a truly historic opportunity that Europe is offering investors, and this exceptional situation should last for several years to come. Despite the benefits of the single currency, it will take time for the markets to become unified due to the inertia caused by cultural considerations and the lack of harmonised regulations.
- Second, with the implementation of the Basel II agreements, the banks that are largely financing the growth of continental Europe's middle market companies will have to curtail their lending and increase their profits from this segment. Private equity funds backed by the banking sector will steadily disappear or become independent, leaving room for independent professionals in the sector, freeing up companies from banking constraints, and prompting them to become our customers.
- Third, as the financial markets tighten their restrictions on listed companies, they are clearing the way for private equity. Many CEOs of listed companies are looking to private equity as a means of going private, while others are looking for solutions to their issues that sidestep the stock market, hence the unprecedented growth in owner buyouts, in which private equity provides liquidity to a company's shareholders without recourse to the financial markets. Through regulations and penalties, the stock market authorities are stunting the growth of markets they are intended to protect. So much the better for our industry, because this tendency, which is not limited to Europe, may last for some time.

While these three factors are encouraging the expansion of private equity operations in Europe's middle market, the situation varies greatly from one country to the next.

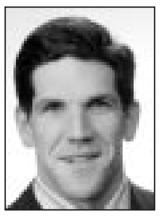
- In Germany, where the Mittelstand comprises companies that are larger than in other countries, the entrepreneurial culture is still largely hostile to outside investors. Though it will take time to bridge this cultural gap, difficulties of the German banking sector should accelerate this process.
- Italy and Spain both have a middle market, but the predominance of the banking sector, as in Germany, is inhibiting the expansion of private equity. By contrast, entrepreneurial culture is developing much faster than in Germany, and private equity deals should surge in the years ahead.
- It is in France that the middle market is showing the strongest growth, even though the companies concerned are smaller than elsewhere in Europe. This situation has led to the emergence of two markets. The primary market comprises players with strong local roots. These players have access to proprietary deal flow with a low degree of intermediation and lower valuations than elsewhere. The secondary market is made up of larger players with no proprietary deal flow because they operate out of a single office in Paris. These players ultimately buy out the investments made several years earlier by primary market specialists.

This is an interesting example of a very mature private equity market, where secondary operations are not synonymous with a speculative bubble, but rather, correspond to a variety of strategies depending on the different players' size and organisation, and to the presence of investment banks and intermediaries that have thrived in this specialised market over the past several years.

There is reason to hope that this model will ultimately prevail throughout continental Europe. It is particularly attractive for investors provided that they choose the best specialists and understand their niche strategy.

BEING SUCCESSFUL IN ICT

Leveraging European success in the world markets



Scott C Collins,
Managing Director,
Summit Partners

In 2003, Jamba!, a leading provider of digital content and one of Europe's fastest-growing technology companies, sought $40 million in recapitalisation funding from a private equity firm based in the USA and London. Jamba!'s founders, brothers Alexander, Marc, and Oliver Samwer, had already proven themselves as entrepreneurs, having founded a German Internet-based auction company earlier that was eventually sold to e-Bay. They were well known in their native Berlin and would have had no trouble raising money from local investors, yet they went outside their geographic market for funding.

A look at the reasons why Jamba!'s founders made this decision to take private equity may shed some light on why, even though the European venture capital community is growing in size and sophistication, the most effective infrastructure for European companies' growth could well exist outside their home markets.

One major issue for European companies is liquidity – a significant lack of exit opportunities for venture-backed companies in the UK and continental Europe. The European venture capital community has made great strides in recent years, at last count raising €30.6 billion in 2004, up from €29.1 billion in 2003 according to the 2004 Annual EVCA Survey of Pan-European Private Equity and Venture Capital Activity. However, it still lags the US market in capital raised and invested and, most significantly, in the ability to realise value through IPOs or strategic sales.

There were 34 European venture-backed IPOs in 2004 with a value of €712 million, up significantly from 2003's nine IPOs and €129 million, according to VentureOne. By contrast, according to the National Venture Capital Association, the USA had 93 venture-backed IPOs in 2004, raising a total of $11 billion, and up from 29 transactions totaling $2 billion in 2003. Merger opportunities are also more limited in Europe, particularly in sectors like technology where many of the major multinational players are headquartered in the USA.

One major issue for European companies is liquidity – a significant lack of exit opportunities for venture-backed companies in the UK and continental Europe.

In the case of Jamba!, the company's management team had grown their company rapidly with the ultimate goal of realising liquidity through an IPO or strategic sale. They knew that their prospects for a liquidity event within Germany - or even continental Europe - were limited. The Samwer brothers recognised that global connections could prove extremely useful in accessing the vast, liquid market for technology companies that exists in the USA.

Yet the Samwer's decision to seek a global financing partner was driven by more than their end goal of liquidity. They also felt that global connections could help them grow their business. In particular, they were eager to enter the US market, where demand for Jamba!'s product – entertainment based content for mobile phones - was just picking up momentum.

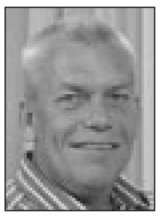
Jamba!'s management had developed an innovative subscription model for selling digital content. Instead of buying ringtones one by one, for instance, its customers would pay a monthly fee. This subscription model turned out to be immensely successful, expanding Jamba!'s reach from Germany throughout Europe, and increasing its customer base from a few hundred thousand to several million over a period of months. This strategy, supported by Jamba!'s private equity partner, proved critical in maximising the firm's value and setting the stage for an exit strategy.

In early 2004, Jamba!s management team began working with its private equity partner to introduce the company to both US and German investment banks, as well as strategic buyers worldwide. The company conducted a dual-track process that culminated in an M&A transaction. In May 2004, VeriSign, Inc. (Nasdaq: VRSN), a California-based technology company, purchased Jamba! for $273 million in one of the largest technology transactions in Europe that year. The Jamba! acquisition enabled VeriSign to expand its existing capabilities and strengthen its presence in the European markets. Jamba! conversely extended its reach into the USA. Today, Jamba!'s founders continue to grow their digital content business in both the US and European markets.

Jamba!'s founders recognised that, for their company to reach its full potential, they would have to reach outside their home market, for customers, strategic partners and, ultimately, a buyer. Taking on a global private equity partner was an important step in that process.

Today many European companies, particularly those in the technology sector, are finding that their local markets simply cannot support their long-term strategies for global growth, their need for experienced strategic partners with expertise in their industry or their long-term needs for liquidity. For these companies, the most effective infrastructure for growth could well exist outside the home market.

Supporting Europe's entrepreneurs



Professor Roel Pieper,
Managing Director
and Chairman,
Favonius Ventures

Although it is less of an issue in the UK and Ireland, Europe's entrepreneurs face an uphill battle. And nowhere is this truer than in the information and communication technologies sector (ICT). The stigma surrounding failure (and, indeed, success) is pervasive and acts as a real dampener on entrepreneurship.

If we compare the environment facing ICT entrepreneurs on either side of the Atlantic, some key differences stand out. Amongst the most significant is the enduring separation between the worlds of academia and business – and the problems this poses for effective technology transfer. In the USA, the 1980 Bayh-Dole Act has been credited with playing a pivotal role in the development of the national economy, ensuring that inventions move smoothly from university laboratories into the commercial world. With no equivalent legislation at European Union or national level, Europe is at a disadvantage.

European entrepreneurs are also held back by the dearth of visible role models in terms of successful companies, and successful individuals. On top of that, Europe is conspicuously lacking in social economic networks – the innovation ecosystems, where knowledge exchange, financial and professional capabilities and commercial partners cluster together to make things happen.

The net result is that young entrepreneurs find it hard to get started in Europe. Of course, there is no shortage of innovation in Europe. Indeed, the reverse is true – there is a wealth of world-class talent. The challenge is turning this into companies that can move forward, prosper and, in time, become role models in their own right.

Europe needs a multilayered response to fostering the establishment of social economic networks.

The Lisbon Agenda was always wildly optimistic, and the closer we get to 2010, the more far-fetched it appears. With no-one responsible for meeting its objectives and no quid pro quo, it stood no chance of success. If Europe wants to make amends and redress the balance, a key first step will be to push through greater awareness of the mechanics and potential of technology transfer – amongst academics, students, companies and financiers. Following from that, Europe needs a multilayered response to fostering the establishment of social economic networks. For this to happen, attitudes will have to change at every level.

People point to a supposed rise in risk aversion as a stumbling block for European ICT entrepreneurship. Whether or not this is the case is open to debate. Venture capitalists will always invest in a good deal if they see one – there's nothing subjective about their selection processes. They are not in the business to act as sponsors – they are there to make money.

With more successful ICT companies and better tech transfer mechanisms, venture capital firms would adjust to accommodate the increased flow of commercialised inventions in Europe. In support, of course, we need to see viable stock exchanges with the liquidity needed to absorb IPOs coming from ICT further down the line – and until these are in place, the centre of gravity, in investment terms, will continue to favour the USA.

Governments have a role to play in fostering innovation, introducing new legislation and plugging the seed-stage gap. But, on a more general level, they should stay out of this process. The mindset change we need will have to happen at a more grassroots level if it is to take root. It is time that we started celebrating success – instead of treating it with scepticism.

NEW WAYS IN LIFE SCIENCES

Therapeutic medical devices – an investment opportunity

Frank Kenny,
Managing Partner,
Delta Partners

When people talk about venture capital investment in life sciences, they are typically referring to drug development and biotech opportunities, rather than therapeutic medical devices. As the market develops, however, the latter represent an increasingly attractive alternative to the mainstream.

Venture opportunities in drug development and biotech have become increasingly challenging. The substantial costs involved in Phase 3 clinical trials mean that drug development companies will need to have gone public – or been acquired – well in advance of that stage. And, with the public markets notoriously fickle when it comes to drug development/biotech IPOs, exit windows are few and far between.

In this environment, therapeutic medical device companies have a number of points in their favour. First of all, they are plugged into a large and growing market. Demographic trends mean rising demand for 'spare parts' and smart devices (knees, hearing devices, drug eluting stents, laparoscopic equipment etc) amongst ageing baby-boomers. And, with health services facing mounting financial/sourcing pressures, anything that reduces inpatient time must be an attractive proposition.

Therapeutic medical devices' accelerated time to market is also in their favour. For a drug development company, a 15-year gap between concept and market is far from unusual. Strict observance of in vitro testing, lab testing, animal testing and clinical trials is a fact of life. However, as engineered products, straightforward therapeutic medical devices can expect to get a CE mark in 12 months (enabling it to be sold in Europe), and a 510k in 18 to 36 months (enabling it to be sold in the USA under FDA regulations).

In this environment, therapeutic medical device companies have a number of points in their favour.

Of course, for more complex devices, market distribution rights are harder to obtain – but, at a certain level, therapeutic medical devices can obtain early, if limited, market distribution. And unlike drugs, which must be adopted by (understandably) conservative physicians before they can be marketed, they are used by surgeons, natural experimenters, who are much less constrained in terms of what they can and cannot test on patients.

Comparatively fast time to market notwithstanding, therapeutic medical devices generally find it hard to attract true market development partners. Unlike drug development companies, which will have already linked with one of the majors to get through Phase 3 trials, therapeutic medical devices companies are much less likely to have attracted the attention of the majors by the time they are ready to go to market. Any interest they receive at that stage is therefore likely to be limited to distribution-only deals, rather than onward product and company development.

Over the last 15 to 20 years, the big therapeutic medical devices players have ensured that intellectual property protection is a significant bar to entry for newcomers. While this limits development at one end of the market, it does mean that there are some very potent opportunities for creating new intellectual property in other, emerging areas (such as bio-materials, therapeutics and nanotechnology). Innovative technologies in all these 'new' areas are regularly discovered by surgeons and academics – but they need engineering to turn them into reality. And that's where venture capital backing comes in.

Europe has an excellent supply of talent in engineering and surgical innovation. But it lags behind the USA when it comes to moving these technologies from laboratory to marketplace. Venture capitalists have a vital role to play in making this happen, leveraging their business and financial expertise to build robust companies. If these synergies can be created in clusters (such as Galway and Medicon Valley), then so much the better.

Finally, exit strategies present venture capitalists with persuasive pitch material. For therapeutic medical devices companies, the most likely exit route will be via acquisition – particularly in the current climate, where there are such limited opportunities for IPOs. Attracting the attention of a potential acquirer means having a top-ranked product, with solid intellectual property and equally robust business fundamentals and, without venture capital backing, many will find it hard to get to that stage.

Opportunity knocks

Dr Helmut Schühsler,
Managing Partner,
Techno Venture Management and
Member of the EVCA Board of Directors

From TVM's point of view, things are looking up for European venture capitalists. The turbulence of the past three years has given way to the perception of a healthy and cleansing cycle with an upturn visible on the horizon. When times were good in the late 1990s, it was easy to forget the normal economic ups and downs that characterise financial markets. That made it all the more distressing when the pendulum swung back in the early part of this decade, making it tougher for companies to raise capital on the public or the private equity markets.

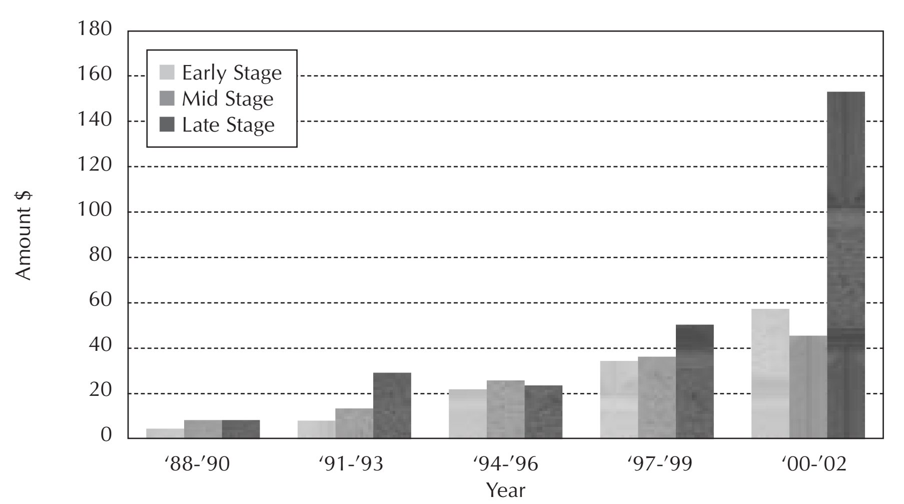
This year, however, especially in Germany but also in the rest of continental Europe and in Great Britain, biotech companies will be reaching their break points, and so will some of their investors. These parallel waves of consolidation will lead to a smaller but, in the long run, stronger European life sciences market.

We have observed several trends that convince us of the powerful changes that are transforming European life sciences companies and laying the groundwork for a stronger, more sustainable industry. These include:

- A more realistic set of expectations on the part of venture capital investors, both in their evaluation and in their execution of new projects.
- A higher level of experience on the part of analysts at investment banks.
- Many more biotech companies with clinical products and development programmes, especially compared to the market peak of 2000. Examples include Actelion and Basilea in Switzerland; Intercell in Austria; and Morphosys, Jerini, Medigene, Paion and GPC Biotech in Germany. According to Ernst & Young and BioCentury, the size of the product pipeline among European public companies alone includes 53 products in Phase III clinical testing and 456 products in the pre-clinical and clinical pipelines.
- A larger pool of qualified managers, who do not only build companies, but also show calm and good judgment in times of crisis.
- A consolidation of specific companies, creating more powerful combinations. Recent examples include Medigene taking over MBT, GPC taking over Axxima and Curacyte acquiring IBFB Pharma.
- A pharmaceutical industry much hungrier for acquisitions now that its own development pipelines are running dry, combined with venture capitalists for whom an acquisition exit at the right price is just as welcome as an IPO. An example of an acquisition of a biotech firm by a pharmaceutical company is the sale of Celltech to UCB in 2004. In 2005, many sales of private biotech companies to pharmaceutical companies have already happened in the USA.
- Pharmaceutical companies paying more at every stage of partnering deals with biotech companies. For example, the average milestone payment in a late-stage therapeutic alliance more than doubled between 1997 and 2002, according to Recombinant Capital (see Graph).

The venture capital market is also responding to these challenging times. European venture capital investors are creating stronger syndicates beginning with Series A financings, allowing companies to make more progress towards financeable milestones without raising outside capital. These syndicates are in a better position to make strategic changes, when necessary, in their companies in a more timely and thorough manner.

Average total milestone payments in therapeutic alliances



The increase in demand has translated into an increased willingness to pay across all stages
Source: Recombinant Capital

The cautious trend towards accessibility of the capital markets that we have observed in Europe in the last 12 months continues. The increased access to capital through an IPO is providing particular incentives to build critical mass via consolidation. The result of this bulking up of the best companies will be a larger number of truly financeable firms that will be in a position to raise money with confidence on public markets and prevail against international competition.

How to cope with CEOs and Advisory Boards

A symbiotic relationship

Hugh Elwes,
Managing Director,
Financial Services Group,
Hawkpoint Partners

The balance of power between general partners and chief executive officers (CEOs) is a crucial consideration, but it would be wrong to suggest that this dynamic is all important. Investors look first and foremost at the quality of the whole management team – the emphasis is on broad-based commercial management skills, alongside leadership and innovation.

CEOs play an important role in entrances and exits – but they are far from becoming kings. At both ends of the deal, successful negotiations are built on a level of give and take between management and investors. Without broad-based agreement on reasonable incentives and exit timetables, deals do not tend to get signed. If he has control the business owner will generally have the upper hand in the exit process, but it will be rare for an asset to be sold without the co-operation of management.

It is dangerous to go into a deal without having a strong CEO already in place. If a replacement CEO is needed, that should be dealt with as part of the deal itself – not left until later. When it comes to attracting suitable candidates, the economics of private equity deals are still attractive to CEOs – naturally it depends on the business, but there are still more competent candidates than there are positions in highly-leveraged buyouts.

In our discussions with management and private equity firms, it is clear that both sides need each other. Both have a range in mind for their overall slice of the equity, and what they end up with depends on the balance of power between them, the type of asset, the size of the deal and the CEO's relevance i.e. client and supplier relationships. The usual range of 5% to 30% still applies for the venture stake in any small-to-midsize buyout. Management will have to reinvest in the newly-leveraged structure; if they are coming into the business via management buyin, they will be expected to put enough cash on the table to keep their attention focused on the business.

Where financing is concerned, the terms and leverage will generally be handled by the private equity firm – this is one of their core skills and the balance of power is in their favour. At the moment, with the debt markets so hot, highly-competitive financing – up to nine-times EBITDA – is available. However, some deals are so highly leveraged that they will inevitably result in restructurings further down the line – a small chill wind in the economy will be enough to have dramatic consequences. In light of this, perhaps CEOs should be more sceptical of some of the highly leveraged structures suggested by venture capitalists.

General partners and CEOs need each other. Theirs is a symbiotic relationship where CEOs (and their management teams) need to make a good impression, just as venture capital firms need to do something to make themselves stand out. With too much money chasing too few deals, differentiation is essential.

In general, the larger the deal, the less the potential relevance of the incumbent CEO. There tends to be more financial engineering and private equity houses feel that they can hire the best talent from outside the company.

Non-executive directors – roles and responsibilities

Rémy Sautter, *Chairman,*
Channel 5 Broadcasting Ltd;
Chairman, RTL France Radio;
and non-executive Director,
Taylor Nelson Sofres plc

An important opening point to make about non-executive directors is that they are there to provide management with high-level opinions on strategy, rather than advising them on more granular issues. Their opinions should be based around a medium-term vision, say three to five years, while management is responsible for exercising a more immediate strategic focus.

Within this medium-term outlook, one core function is to concentrate attention on the selection and appointment of new management. The non-executive directors should be aware of rising talent in the business, taking steps to ensure that the next generation is reviewed, identified and groomed at regular intervals throughout the year.

Another important role played by non-executive directors is to review competition, constantly challenging management to think about what else is going on in the market – and what this might mean for the company's medium-term strategic objectives. The tendency will otherwise be for management to get too engrossed in its own goals and priorities, without looking further ahead.

Altogether, non-executive directors should be playing an important role in terms of management, competition and strategic thinking, the essence of their role being to manage along a three to five year timescale.

In terms of value-added, and on top of the above factors, non-executive directors play a valuable role by helping management to avoid loneliness. Management must often make tough decisions, placing bets based on incomplete intelligence, and in those circumstances a tried and trusted confidant can be extremely reassuring. Because non-executive directors can give impartial advice, without self-interest getting in the way, they can fulfil an important role in the company. For instance, in a situation where the chief executive officer is wondering whether to promote his chief financial officer, by giving him responsibility for a subsidiary, or whether to keep him in his current job, an open dialogue (with a non-interested party) around this issue can prove invaluable. Non-executive directors can provide a helpful warning light, based on their past experience, which saves management from taking a potentially damaging course of action.

The fact that management is running the show should never be in doubt. This is why the UK's Combined Code strongly suggests that, under normal circumstance, a company's former chief executive should not become its chairman (removing the potential for a former executive to peer over his successor's shoulder). With an effectively-functioning board, non-executive directors are there to ask incisive questions, founded in down-to-earth commonsense. They do not always need to be overwhelmingly bright – indeed, sometimes, those that have a tendency to ask too many questions, instead of keeping management focused on what really matters.

A properly-built board will be comprised of balanced sector and management expertise. The latter must include an effective finance function; indeed, in view of the inevitable trend towards a European equivalent of Sarbanes-Oxley, the role of the audit committee chairman is set to become increasingly crucial. Excellent human resources management expertise is another important component – although all too often lacking.

The board's relationship with any incumbent general partners raises delicate questions of balance. Representing important (if not majority) shareholders, the general partner has an influential role to play – one which may, on occasion, give him access to certain privileged information which the non-executive directors themselves do not have access to. He will, for example, be well acquainted with the company's debt structure, and consequently, be likely to receive reporting memos in greater depth, and with greater frequency, than other board members. This is less of an issue when the company is unlisted, but with a listed company, it can causes difficulties if this information is not being shared with the other board members. In an unlisted company, governing the general partner really comes down to making sure that he is not taking on a management role, especially in terms of influencing short-term thinking in favour of his firm's investment position and exit timeline.

If one looks at the many regulators and monitoring authorities in the UK, I am not aware of any that are professionally qualified to monitor the role of the general partner as board member. In view of the influence that their position can have, this is surprising. Maybe the Combined Code, along with the various institutions responsible for monitoring corporate governance, should issue special recommendations to take account of this lacuna?

The year after CEE accession

Post-accession opportunities

Joanna James,
Managing Director,
Central and Eastern Europe,
Advent International plc

One year on from European Union (EU) accession, and it is fair to say that the private equity industry has benefited. But the arrival of these benefits has not been an overnight development. Accession has been ongoing for the last 10 years, and many of its anticipated benefits have long been factored into the market. From our perspective, the most immediate impact has been in terms of an improved fundraising environment. Greater awareness of the region, in Western Europe and the USA, has been a notable feature. The performance of our third regional fund underlines the emergence of this phenomenon: closing earlier this year, it raised more than twice as much as its predecessor.

For the purposes of this discussion, we are really talking about Poland, Hungary, the Czech and Slovak Republics, and the Baltic states. Certainly the experience of the last 12 months or so has been of direct benefit to these countries, as well as positively influencing investment attitudes towards the next round of accession countries. Pre-accession, and in its immediate aftermath, the fear amongst countries in this region was that their markets would be flooded with goods and services when the tariff barriers came down (especially in the agricultural sector). In fact, the opposite has proved true – each of these accession countries has been able significantly to step up its exports into Western Europe.

Increased bureaucracy has proved to be one unavoidable by-product of accession.

Meanwhile, Western companies have continued to relocate their manufacturing facilities to Central and Eastern Europe, as they seek to take advantage of its low labour costs. Where trade in goods is concerned, the region's real competitive advantage currently lies in its low wage rates, but the countries should not rely on this advantage being sustainable long term. It is therefore important that governments and companies use the current benefits to develop value-added industries and their own intellectual property.

Of course, EU enlargement has had the positive effect, where institutional investors are concerned, of focusing global attention on the region, but more profound changes to the macro-economic landscape will be more gradual. Whereas in Spain, Portugal and Greece, for example, EU accession was the launch pad for very substantial inputs of funding into those countries, in Central and Eastern Europe the infrastructure is limited in its ability to process the onslaught of paperwork and bureaucracy involved. It is, however, unlikely that this will adversely affect levels of entrepreneurship in the region – entrepreneurs always find a way of making things happen (and, in any event, as former state-controlled economies, these countries are no strangers to red tape).

Increased bureaucracy has proved to be one unavoidable by-product of accession. However, even if local judiciaries take years to assimilate the mountains of new legislation and regulation, the silver lining for the private equity industry has been the creation of a more predictable legal framework. EU compatibility means that we can invest in these countries with a degree of confidence that the laws we need to protect us are actually there.

The fact of EU accession did not in itself lead to an explosion of interest from the private equity industry. Really, as outlined above, deregulation and liberalisation had already been going on for years, and this has long been an interesting marketplace for the smaller, more specialised firms geared up to handle €50 million deals. These deal sizes mean, however, that the large, pan-European firms will remain on the sidelines for some time yet to come.

"Further, Faster." Lower risk and higher returns

Robert Conn, *Managing Partner,*
Innova Capital

Over the last two years, we have seen a number of successful exits from deals put together since 2000. These exhibit very different qualities, by and large, to the 1990s deals that were profiled in EVCA's 2004 publication "Central and Eastern European Success Stories".

The 1990s deals typically were either start-ups, early-stage or privatisations. Deal sizes have grown significantly since then and positive EBITDA is the norm. Innova's average enterprise value (EV) now falls somewhere between €25 million and €100 million compared with less than €5 million when we began investing our first fund.

The 1990s deals were, in the main, expansion capital, with no leverage and the private equity fund often took minority stakes. That has all changed. Now the focus is very much on buyouts (six of the seven deals in our last fund were buyouts, and five of them used leverage), with investors taking controlling stakes. As companies mature, so they are increasingly capable of generating the levels of cashflow needed to support leverage. And at the same time, changes of ownership (including corporate restructurings and entrepreneur succession) are creating more and more buyout opportunities.

The biggest buyout to date has been Mobiltel, a €1.2 billion deal structured with €650m debt. Other recent deals include EBCC, a buyout by Innova, subsequently recapped with €20m in debt, and DGS, a €100 million buyout structured by Enterprise Investors including 40% debt. A sure sign of the maturing of the market is the presence of a number of senior lenders (including PeKaO, BPH and Erste Bank), and mezzanine lenders (including Mezzanine Management and Darby) that have committed themselves to developing a buyout practice.

Exit routes were, until quite recently, unclear and remote in time. Now multiple exit routes are on offer. Trade sales continue, buoyed by heightened FDI post-Europena Union accession (examples include the sale of Orange Romania to Orange by a consortium including Innova, Enterprise Investors and AIG-CET and the sale of Mobifon/Oscar to Vodaphone by Advent – both transactions for at least four-times money). A new development, however, has been the emergence of the Warsaw Stock Exchange as an attractive exit route, via IPOs and secondary placements (examples include Comp Rzeszow, and later this year, Opoczno, anticipated to be a €450 million offering). Also, in a welcome new development, we are seeing greater activity from local strategic investors buying into deals (for example, a consortium including Innova recently sold our stake in STK Cable to Vectra). Last of all, secondary purchases are starting to come through as viable exit routes in some cases, the purchase of Fibernet by Warburg Pincus and of Aster City by Hicks Muse are both good examples of this trend. Looking ahead, trade sales and the Warsaw Stock Exchange will continue to be the most fruitful exit routes. Increasingly, though, Western European mid-market buyout shops will be buying from local players, as deals edge into their size range.

As exit routes have opened, so holding periods have come down dramatically. Average holding periods for our 1998 fund were over five years. For our latest fund, the average has dropped to three years, with two deals likely to clock in at 12 months (at the same time generating over 2.5-times returns). This trend is graphically illustrated by the fact that this year alone, Innova expects to generate exits in an amount equal to our entire invested basis in our last two funds.

Back in the 1990s, there was a limited local chief executive officers (CEO) pool. Now, with 15 years since transition, there is a sufficient supply of high-quality, experienced Central European CEOs. Instead of everyone – investors and CEOs – being on a tight learning curve from day to day, it is now all about selecting the best talent from a number of competent candidates. Indeed, there are now a number of Polish CEOs heading up significant European companies (including, for example, major divisions of Danone and Wrigleys).

When we first got involved in this region in the mid-1990s, the market was highly fragmented, with around 65 fund managers active in Poland, Hungary and the Czech Republic. Our common denominator was a lack of experience. Now, with 10 years and 25-plus deals under their belts, the leading players present a very different profile. As a result, deal making capabilities have grown increasingly skilful and, inevitably, the market has consolidated quite dramatically, to the extent that the 65 pioneers have been whittled down to eight players commanding between 80% to 90% of the uninvested capital. Competition and entry valuations are, therefore, now very rational.

'Further, Faster' really does sum up the way this market is heading. Whatever we saw coming out of the 1990s can only be improved upon from now on. With lower risk and higher returns achievable in less time, the future for mid-cap private equity in Central and Eastern Europe will be exciting.

Central and Eastern Europe in the spotlight

Charles Jonscher, *President, Central Europe Trust Co Ltd (CET)*

The last few years have proved very successful for private equity houses in Central and Eastern Europe. To cite our own experience, the $320 million New Europe Fund, managed by AIG-CET Capital Management, has just exited from a mobile telecommunications company in Romania, selling its stake to France Telecom for $167 million, a return of more than four times the amount invested. Among the fund's other completed exits is United Bulgaria Bank, which also achieved a multiple of more than four times. In fact, before the fund's investment period ended in 2004 it had already realised, including dividends and partial exits, more than the total amount invested.

Deal flow in the region is improving and, most significantly, bigger deals are becoming available. The largest private equity deal led by the New Europe Fund was a $170 million investment in a mobile phone network in Slovakia. Now there is an increasing range of deals in the several hundred million euro price bracket. Sectors with exciting potential include retail (we are currently preparing the IPO of a large Polish retail chain), food and beverages, real estate construction and development, technology/telecoms and media.

A good example of this new breed of deal is the recent sale of Cesky Telecom, the Czech Republic's leading fixed and mobile telecom services operator. Three private equity funds – Blackstone, Providence and CVC – put forward a bid, supplemented with only a minority participation from France Telecom acting as the trade buyer, to buy this €2.5 billion asset. Until a year or so ago, most of the private equity money in Central and Eastern Europe was managed by regionally-focused fund managers (examples, in addition to our own involvement, being Advent International and Enterprise Investors). Now the interest in the region by major European and US funds is emphatically on the up, as the markets mature and larger deal opportunities continue to emerge.

Finding the right deals remains hard work, of course, but where doesn't it?

With the exception of Russia and, more generally, the former Soviet Union (apart from the Baltic States), most of Central and Eastern Europe now stands on a par with Western Europe in terms of the confidence with which one can conduct the investment process. Legal systems and laws of contract are, in the main, well developed and the on-the-ground professional expertise needed for due diligence and enforcement is in place. Even in Russia, there are signs of significant funds once again taking a major interest, memories of the 1998 crash having receded. But the going is still tough there; Carlyle made a high profile entry in 2004 with the opening of a Moscow office and the announcement of a £300 million fund, before abandoning the project last month over doubts of satisfactory investment conditions.

Last year's accession to the European Union of eight Central and Eastern European countries has certainly helped boost interest in the region. This process has been played out in two stages. The first kicked off three to four years ago, when investors realised that asset prices would go up in the 2004 accession countries. That same phenomenon is now being seen in Bulgaria, Romania and, to a lesser extent, in Croatia.

The second wave of interest has been powered by strategic investors looking to shift their production to the region post-accession, taking advantage of low costs. Until a few years ago, Western companies were, almost exclusively, targeting market share. Now they are also seeking low cost production, as well as lower customs and logistics barriers. The change in emphasis has created a whole new raft of opportunities for private equity houses, whether coming in as co-investors with strategic buyers (particularly in the manufacturing and service sectors), or investing with a view to exiting to such buyers two to three years later.

To sum up, these are exciting times for investing in Central and Eastern Europe. Over the last 12 to 18 months, not only have a number of major regionally-focused funds been launched (including Advent's €330 million fund, ACEE III, which closed this spring), but even more significantly, the major pan-European funds are now actively searching for deals in the region.

Many investment institutions will be sitting up and taking notice of Central and Eastern Europe for the first time. The message to them is that deals in the Czech Republic, Hungary, Poland, Slovenia, Slovakia and the Baltic States are available, and that the investment disciplines are extremely similar to those which apply in France, Spain and Germany. The conduct of due diligence, execution and exits are all reassuringly familiar. With regard to exits, while sales to strategic investors remain the norm, local stock exchanges provide an increasingly plausible route, while IPOs via international exchanges have been achieved by investors on several occasions. Finding the right deals remains hard work, of course, but where doesn't it?

The success story continues

Robert Manz, *Partner, Enterprise Investors and Chairman of the EVCA Central and Eastern Europe Task Force*

In October 2004, EVCA's Central and Eastern Europe Task Force published *Central and Eastern Europe Success Stories*, setting out details of 25 successful private equity and venture capital deals drawn from across the region. The publication was extremely well-received, particularly among institutional investors, and has contributed to a rapidly growing interest in private equity across the Central and Eastern Europe (CEE). The publication turned a spotlight on what had previously been a well-kept secret regarding the level of activity in these markets and the quality of investments and exits.

This EVCA Symposium provides an excellent opportunity to discuss how quickly the CEE private equity market has developed in recent months and what the future holds. The deals highlighted in Central and Eastern Europe Success Stories were, for the most part, put together in the mid to late 1990s and the market has transformed significantly even in the short time since those transactions were exited. The level and pace of change has surprised even many of the market participants and the dynamism of the regional marketplace shows no real signs of letting up

Private equity fund managers are putting to good use the lessons learned from investing in the 1990s while at the same time the market has transitioned from an environment of "firsts" where fund managers were pioneers, to a more developed and sophisticated private equity market. These last two years have been particularly exciting, with deal sizes, structures and complexities evolving across the entire region. Buyouts have taken over as the dominant type of transaction, with leveraged deals becoming commonplace. Some of the largest deals done to date have occurred in the last two years. Larger deals in CEE are seen not only in the bigger European Union member countries Poland and Hungary, but also in Bulgaria and Romania.

The exit environment has seen a dramatic improvement over these past two years, with trade buyers becoming more active and the domestic stock exchanges proving to be valuable exit routes.

Investment opportunities are evolving as well, with an increasing number of private sector enterprises reaching critical mass. More and more of these companies are becoming ripe for transactions as entrepreneurs from the early 1990s seek an exit. An ever increasing pool of professional management talent in the CEE markets allows for a growing number of management buyins. Whereas such opportunities were not attractive some five to seven years ago, today they are an important source of deal flow.

The exit environment has seen a dramatic improvement over these past two years, with trade buyers becoming more active and the domestic stock exchanges proving to be valuable exit routes. Trade buyers have returned to the CEE market alongside European Union accession, as was anticipated by local market participants. However, the real success story in exiting has been some of the regional stock exchanges. The Warsaw Stock Exchange was Europe's second most active IPO market (in number of companies) in 2004. This market has become a key weapon in an increasing number of fund managers' arsenals, particularly as the market has become accepting of full exit at IPO. The Prague Stock Exchange also saw a major private equity backed IPO in the past year, a first for that market. With the first true secondary transactions also having been consummated, the CEE exit environment has never been more robust and is paying off for private equity investors in unprecedented ways.

That these trends have coincided with the run-up to, and immediate aftermath of, European Union accession is certainly no coincidence. We always knew that this would be a defining moment for the region, with sustainable increased investment and exit activity an inevitable consequence.

The consequence is that the bottom line is expected to continue to improve in this new and dynamic environment. The returns on deals reported in Central and Eastern Europe Success Stories were generated on unleveraged deals in a much less liquid exit environment. With reasonable leverage, much improved exit capability and more experienced fund managers, it seems obvious that returns are destined to show an upward trend. When speaking with institutional investors, they are also optimistic about the region's potential.

Overall, the Central and Eastern Europe private equity market is developing quickly and fund managers are well equipped to take advantage of the opportunities in a post-European Union accession world. New chapters of the Success Stories publication are being written in the market place each quarter and this is just the beginning of an expected long-term trend of the development of private equity in this exciting part of the world.

PROGRAMME

Wednesday 15 June 2005

17.00 **Registration at the Hilton London Metropole**

19.30 **Welcome Reception at the Science Museum**
Hosted by: **BVCA (British Venture Capital Association)**
Transport tot the welcome reception venue leaves from the Symposium hotel at 19.00.

Thursday 16 June 2005

09.00 **The Private Equity Landscape - Looking Forward**
Herman Daems, *EVCA Chairman 2004-2005, GIMV NV*

2004 Headline Figures
Provided by Thomson Venture Economics and PricewaterhouseCoopers

Huw Edwards, *broadcaster and journalist*, will steer keynote speakers, moderators and panelists through the 2005 Symposium programme with the aim to stimulating the debate.

09.45 **Keynote Address**

10.15 **Networking and Refreshment Break** Sponsored by: **Ogier**

11.00 **Panel Discussion: Where is Private Equity on your Radar Screen? Help or Nuisance?**
Moderator: Huw Edwards
Panel Members: Peter Gale, *Gartmore Investment Management PLC*
Daniel Sachs, *Proventus AB*

11.45 **Huw Edwards will introduce the four afternoon parallel tracks by interviewing the four moderators of the sessions: Scott Collins (ICT), Jonathan MacQuitty (Life Sciences), Walter Butler (Buyout) and Neil Milne (Central and Eastern Europe).**

12.00 **Lunch** Sponsored by: **Aon Mergers & Acquisitions Group**

13.30 **Parallel Tracks:**

- **Venture Parallel Track: ICT - Fast Forward Europe's Entrepreneur's Big Challenge?**
  Moderator: Scott Collins, *Summit Partners Ltd*
  Panel Members: Rebecca Harding, *Deloitte and UK Global Entrepreneurship Monitor*
  Bruce Huber, *Broadview International*
  Marten Mickos, *MySQL AB*
  Roel Pieper, *Favonius Ventures*
  Danny Rimer, *Index Ventures*

- **Venture Parallel Track: Life Sciences - Relationship Building**
  Moderator: Jonathan MacQuitty, *Abingworth*
  Panel Members: Frank Kenny, *Delta Partners*
  Jan Lundahl, *CapMan AB*
  Helmut Schühsler, *Techno Venture Management (TVM)*

- **Buyout Parallel Track: GP/CEO Relations The Forming of a New Deal**
  Moderator: Walter Butler, *Butler Capital Partners*
  Panel Members: Hugh Elwes, *Hawkpoint Partners Ltd*
  Ken Landsberg, *ECI Partners LLP*
  Christopher Masek, *Industri Kapital Ltd*
  Frédéric Sanchez, *Compagnie de Fives-Lille*

- **Central and Eastern Europe Parallel Track: One Year after EU Accession - Are Growth Expectations Met?**
  Moderator: Neil Milne, *Copernicus Capital Partners LP*
  Panel Members: Martin Frank, *Bank Austria Creditanstalt*
  Joanna James, *Advent International PLC*
  Charles Jonscher, *Central Europe Trust Co Ltd*
  Roberto Pilotto, *PPM Ventures*
  Henry Potter, *EBRD*
  Jacek Siwicki, *Enterprise Investors*

14.30 **Networking and Refreshment Break** Sponsored by: **Ogier**

15.15 **Interactive Workshop Discussions**

- **Corporate governance principles Do it in private, share it in public**
  Moderators: Tina Baker, *Brown Rudnick*
  Vincent Neate, *KPMG LLP*
  Hervé Claquin, *ABN AMRO Capital France*

- **International private equity and venture capital valuation guidelines**
  Moderator: Anthony Cecil, *KPMG LLP*

- **EVCA's activity and performance figures Vital statistics, a look behind the scenes**
  Moderators: Keith Arundale, *PricewaterhouseCoopers Global Technology Industry Group*
  Glenn Bedwin, *Thomson Venture Economics*

- **Which European countries give entrepreneurs the best chance?**
  Moderators: Jonathan Blake, *SJ Berwin*
  Ulf Söderholm, *Andulf*
  Daniela Weber-Rey, *Clifford Chance*

- **ICT (1) - Can you build a winner on a budget?**
  Moderators: Scott Collins, *Summit Partners Ltd*
  Jim Martin, *Add Partners*

- **Life sciences (1) - Make your life easier: simplify the agreements!**
  Moderators: Robert James, *Prelude Ventures Ltd*
  Perry Yam, *SJ Berwin*

- **Central and Eastern Europe - Success stories and beyond**
  Moderators: Robert Conn, *Innova Capital*
  Robert Manz, *Enterprise Investors*

- **Management packages - Slicing and dicing the cake**
  Moderators: Philippe du Mesnil, *CEVA Santé Animale*
  Hugh Elwes, *Hawkpoint Partners Ltd*
  Christopher Masek, *Industri Kapital Ltd*

- **Fundraising (1) - Travel agents or essential partners?**
  Moderators: Bruce Barclay, *Advent International PLC*
  Antoine Dréan, *Triago*

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16.15 **Change of Rooms**

16.30 **Interactive Workshop Discussions**

- **Directors' responsibilities and duties across Europe**
  Moderators: Simon Witney, *SJ Berwin*
  Patrick Dunne, *3i Group PLC*
- **Private equity and generational change - Passing on the torch**
  Moderators: Roger Abravanel, *McKinsey*
  Fabio Sattin, *Private Equity Partners SGR S.p.A.*
- **International financial reporting standards**
  The crash course
  Moderator: Angela Crawford-Ingle, *PricewaterhouseCoopers*
- **ICT (2) - Company establishment:**
  location, location, location...
  Moderators: Bruce Huber, *Broadview International*
  Nigel Grierson, *Doughty Hanson & Co Ltd*
- **Life sciences (2) - Medical devices: a small but vital part!**
  Moderators: Jan Lundahl, *CapMan AB*
  Rafaële Tordjman, *Sofinnova Partners*
- **Repeating the accession countries' success**
  New CEE frontiers?
  Moderators: Robert M Luke, *GED Capital Development*
  David Mathewson, *Bedminster Capital Management*
- **Operating partner - Whose side are you on?**
  Moderators: Frédéric Sanchez, *Compagnie de Fives-Lille*
  Richard Stephenson, *Duke Street Capital*
- **Financing - You take the high yield, I take the low yield**
  Moderators: Tom Attwood, *Intermediate Capital Group PLC*
  Nick Coates, *Royal Bank of Scotland*
- **EVCA's activity and performance figures**
  Vital statistics, a look behind the scenes
  Moderators: Keith Arundale, *PricewaterhouseCoopers Global Technology Industry Group*
  Glenn Bedwin, *Thomson Venture Economics*
- **Fundraising (2) - A never ending story**
  Moderators: Mounir Guen, *Mvision Private Equity Advisers Limited*
  Jamie Weir, *Duke Street Capital*
- **Building relationships between limited and general partners**
  What really counts?
  Moderators: Réal Desrochers, *California State Teachers Retirement System*
  Emmeran von Braun, *Von Braun & Schreiber Private Equity Partners GmbH*

17.45 **General Assembly**

20.00 **Gala Dinner at the Guildhall** Hosted by: **Apax Partners**
Transport to the gala dinner venue leaves from the Symposium hotel at 19.30.

Friday 17 June 2005

09.00 **Welcome by Huw Edwards, Conference Moderator**

09.15 **Panel Discussion: Relationship Building (1) - LPs and GPs: Is it a Real Partnership?**
Moderator: Huw Edwards
Panel Members: George Anson, *HarbourVest Partners (UK) Ltd*
Réal Desrochers, *CalSTRS*
André Jaeggi, *Adveq Management AG*
Rhonda Ryan, *Insight Investment*

10.00 **Panel Discussion: High Growth Market**
Europe Unites to Meet the Challenge
Moderator: Stephen Schweich, *Mooreland Partners LLC*
Panel Members: Jerry Benjamin, *Advent Venture Partners LLP*
Michael Elias, *Kennet Venture Partners Ltd*
Markus Boser, *Deutsche Bank Corporate Investments*
Martin Graham, *AIM*
Martine Charbonnier, *Euronext*

10.45 **Networking & Refreshment Break** Sponsored by: **Ogier**

11.30 **Panel Discussion: Relationship Building (2)**
Advisory Boards, Operating Partners and Corporate Governance
Moderator: Huw Edwards
Panel Members: Mathew Judd, *Clifford Chance LLP*
Bernd Lattemann, *Finatem II*
Rémy Sautter, *RTL France Radio*
Richard Stephenson, *Duke Street Capital*

12.15 **Keynote Address by Jeremy Rifkin**
Jeremy Rifkin, *president of the Foundation of Economic Trends and author of 'The European Dream'*

13.15 **Closing Remarks**
Sir David Cooksey, *EVCA Chairman 2005-2006, Advent Venture Partners*

13.30 **Lunch**

15.00 **Guided Sightseeing Tour and Dinner**
Visit to two of the major London theatres.
Friday evening dinner to be held at Lincoln's Inn.

evca
European Private Equity & Venture Capital Association

Relationship building for LPs and GPs

What do LPs really want?

Rhonda Ryan,
Head of Alternative Investments, Insight Investment

First and foremost, as investors in private equity, our job is to provide our clients with returns that are superior to those that can be achieved in the public markets. This is our primary goal. Fancy dinners and annual general meetings in exotic locations would probably be easier for general partners to provide. However, it is top quarter returns that we want. This prompts the questions: is this all that limited partners want and are general partners aligned to reach this aim?

Firstly, return expectations. Our internal clients have been investing in private equity funds for more than twenty years and we aim to deliver returns 3% to 5% above long-term public equity returns. Unsurprisingly, this is the aim of our due diligence process: to identify funds, that regardless of past history, will make their next fund (and preferably many funds after that) top quartile. Every general partner that meets us or provides us with marketing information states that they are top quarter. Statistically that is not possible, and it is up to us to decide which groups it is true for and, more importantly, will it be true for this new fund?

Are investors satisfied with just good returns? Well it is a good start and without them it is unlikely that you even need to consider what else limited partners might like. However, there are a few other things that will enable you to develop a good long-term relationship with them. Firstly there is open and honest communication. The relationship between limited and general partners is a bit like a marriage, without honest, prompt communication it is likely to wane. Even if the news is bad, limited partners like to know and know early. It is not a good start to the day if you read in the newspaper that one of your portfolio companies is going bankrupt or being sued – and that is all you know because the general partner has not called you.

Fancy dinners and annual general meetings in exotic locations would probably be easier for GPs to provide.

Secondly, limited partners like regular transparent reporting. Reports serve many purposes. They provide information that enables us to understand how the fund is performing and they also give us information that we need to provide to our clients whether they are our trustees or investment committees. Over the years we have noticed a strong correlation between funds that provide good quality reports and those that provide good returns. The inverse is even more true - badly performing funds often communicate poorly and slowly. Overall, private equity is a long-term investment and therefore the limited and general partners relationship ideally should be long-term - a relationship based on trust and openness.

So investors ultimately want good returns and are then focussed on open timely communication. Is this what general partners want too? I am not a general partner and would not presume to speak on their behalf. However, from an limited partner perspective, if you are a general partner with a fund that receives a management fee that hopefully the investors have insisted only covers your overheads, you should be focussed on returns. It is carry, not management fees that should make the general partner wealthy. Carry should align limited and general partners' interests so that if a fund makes good returns, the general partner also benefits. In fact, they should not get rich and have a comfortable retirement unless they provide the retirees and future retirees that I invest on behalf of with excellent long term returns that will enable them to have a good quality retirement income.

Limited partners should not begrudge general partners their carry as it incentivises them to generate top quarter returns.

Secondly, unless you are lucky enough to run an evergreen fund, the fundraising cycle every few years should focus general partners on achieving a top quarter return. Top quartile returns should enable general partners to raise funds relatively quickly and get management focussed back on what they prefer doing, which is deals rather than flying around the world marketing to investors.

The long-term nature of private equity investing should mean that it is a true partnership with both partners focussed on the goal of maximising returns. Carry goes a long way in aligning these interests as both parties benefit if the general partner does well. The limited and general partners relationship should also be one where there is open transparent communication both verbal and written. Dinners and exotic locations may be easier for a general partner to provide an investor with but these are irrelevant in our quest to provide our clients with a good retirement income – returns are the ultimate goal.

Relationship building

George Anson,
Managing Director, HarbourVest Partners

Personal, professional and institutional issues converge in any general and limited partner relationship. And, like any marriage, the challenge is always to align interests so as to put in place the foundation for a stable, long-term relationship.

And, like any marriage, the challenge is always to align interests so as to put in place the foundation for a stable, long-term relationship.

At a personal level, this business is all about interacting with individuals. There has to be an underlying element of trust for the relationship to work out. And that's why, whenever possible, we all prefer to do business with people we know and like.

On top of this, there needs to be a genuine alignment of interests. And this is where problems arise. Put bluntly, we are forever trying to reconcile the irreconcilable. It is impossible to legislate effectively for the myriad developments that will crop up in the course of a long-term relationship – institutional time-frames will always be in conflict with the exigencies of personal lives.

One effective way of meeting this problem head-on would be for limited partners to ask their general partners to make material and meaningful personal financial contributions to the deal. General partners talk about performance and carried interest, but unless their own money is tied into the outcome, there is no pain for them if things go wrong. At a base level, managers should be expected to share in the pain, as well as the gain.

It is commonplace these days to point the finger at private equity firms for raking in substantial management fees on the funds they raise. So why not ask general partners to commit their own money to the deal – up to, say, 5% of the total value? As the years go by, their management fees can be used to fund their initial capital commitment.

For all the talk of transparency and disclosure, it is still impossible to find out what percentage of a general partners' gross (not net) worth has been committed to the funds they run. In my view, if it is to achieve an optimal alignment of interests, it will need to be as high as 80%. And if we are really serious about bottoming out this discussion, it is time we agreed that this is the best way forward. Certainly, the private equity and venture capital market has become increasingly global over the course of the last five or six years. And, in line with this globalisation, levels of disclosure and transparency have improved significantly. This bodes well for the sort of initiative I am suggesting.

Following on from this, it is fair to ask whether, and to what extent, it is reasonable to extend this general partner commitment to other managers? Should we be expecting the managing directors to commit to 75% of the total, with their managers making up the remaining 25%? That way, the whole firm is tied into the deal – and the whole firm has a vested interest in its success.

If this is to happen, it is crucial that these objectives are set out at the beginning. Expectations and commitments have to be clearly articulated by both sides. The quid pro quo is that, if general partners are to start making these commitments, limited partners have to avoid being too dogmatic in their demands. Flexibility is essential and each deal will need to be negotiated on its own merits. There can never be a perfect template.

Value creation in private equity

Dr André P Jaeggi,
Managing Director, Adveq

With balance sheet structuring and operational improvements now a commodity amongst private equity fund managers, it is becoming increasingly evident that they need to find new ways of generating the level of returns their investors expect. According to Adveq, there are two key elements which are important for the generation of returns in buyout and venture capital: the growth orientation of portfolio companies and fund managers' ability to exit investments.

The buyout market
Given the fairly dull economic outlook for Western Europe over the next few years, companies will only be able to generate growth by acquiring market share from competitors or through a structural change in the underlying market.

In the buyout industry, one way in which managers can make a difference to their portfolio companies is through internationalisation. Historically, only a small proportion of M&A transactions have been executed across continents. For example, in 2004 European buyers made just over 10% of their acquisitions outside Europe (both in terms of the number of deals and transaction value). This compares unfavourably with the level of cross-continental acquisition activity in 1997. Within Europe, there have been signs of a slight increase in cross-border M&A activity - up from 25% in 1997 to 37% in 2004. However, buyout managers still need to overcome the current fragmentation, not only through M&A but also through organic expansion. Buyout managers who are able to act as catalysts for their companies and accelerate their growth can create significant value for their investments.

In addition, the exit environment for buyouts is currently extremely challenging. About 500 transactions with an aggregate enterprise value of €60 billion or more are completed every year – a stark contrast with the number of deals actually exited. In 2004 (not including secondary transactions as either new transactions or as exits) there were about 450 new deals but only 100 exits, less than a quarter of the investments made. It is hard to imagine that strategic buyers will be able to make up for this deficit in the future and investors, therefore, need to carefully verify the capacity of a private equity firm to exit its investments.

Venture capital
The venture capital market is facing similar issues. The European exit markets remain virtually non-existent and the USA remains the major route for exits by European venture capital backed companies. It is clear, therefore, that successful venture managers must learn to build companies that not only exploit European technological expertise, but that also have a truly global perspective. In reality, only a few venture managers in Europe have shown a consistent ability to establish global companies and technologies or have demonstrated that they have the appropriate networks to market their portfolio companies on a worldwide basis.

An analysis of the Red Herring 100 companies in 2004 revealed that only two of the listed companies were pure European firms, whereas nearly half had both US and European operations, emphasising the importance of having a global reach, as well as the significance of a strong European presence for successful venture capital backed companies. This is underlined if you look at venture capital backed IPOs on Nasdaq in 2004. Out of the 93 venture capital backed offerings, 32 had operations in both Europe and the USA and there were none that were solely European.

What this shows is that the most promising venture capital approach in Europe is based on a global outlook and, as such, investing in European venture capital requires investors to identify venture managers who understand their role and contribution towards transforming portfolio companies into a global platform.

Exit potential in the venture capital market is also an issue. In Europe, the venture capital industry backs a significant number of new start-ups relative to the capital deployed. While this seems like a capital-efficient approach, it proves critical if you evaluate venture capital backed exits. An analysis of exits of venture capital backed companies through IPO or M&A in Europe and the USA since 2000 indicates that what Europe's venture capital market is still missing is the big hits, i.e. deals with very high multiples which drive overall venture capital performance.

Against this backdrop, it is clear that financing large numbers of companies, while spreading the risk more widely, does not work and merely adds to the increasing back-log of venture capital backed companies that are dying as they wait for an exit. Over the past few years, several venture capital firms have emerged in Europe with a clear understanding of this situation and, moreover, have demonstrated an ability to achieve globalisation within their portfolios. For financial institutions investing in venture capital internationally, it is crucial to cross-reference the capabilities of European managers with those of managers on the other side of the Atlantic.

In summary, the main challenges for the industry – in both buyout and venture capital – are clearly the same in Europe and the USA and are the result of the growth and maturing of the private equity markets globally. Fund managers need to actively address these challenges. To do so effectively, they need to commit to the growth of their underlying portfolio companies on a global basis and enable them to achieve a successful exit. Those who follow this approach will be well positioned to outperform their peers in the current environment.

2005 fundraising – a game of two halves

Mounir Guen, *CEO, MVision Private Equity Advisers*

With appetite for the asset class bouncing back, fundraising was expected to be extremely competitive in 2005, with an anticipated €60 billion being targeted by double the number of funds marketed in Europe last year.

As it turns out, we are seeing a game of two halves. Those funds that have already built stable funding bases have been dominating the market in the first half of the year, with the majority of them achieving relatively high re-up rates from satisfied investors.

The market for established players is bifurcated. Some investors prefer the consistency of returns that they know they can get from regional players with solid cash-in, cash-out dynamics. Others like to target smaller 'local heroes', niche leadership stories that, because of their smaller size, tend to become rapidly oversubscribed. Both camps have, in the main, experienced relatively quick fundraisings since the start of the year.

Meanwhile, first-time funds have been, for the most part, scheduling their fundraising for the second half of the year. They should expect to encounter a challenging environment, with backers becoming increasingly programme-driven in their approach (in terms of allocations to pre-defined market sectors, fund sizes, regions etc).

Subsequently, 2005 will be complicated for these funds, particularly start-ups with no track records to speak of. Spin-outs, which are easier to judge, should have an easier ride, but if they fall outside the mainstream they will have to demonstrate real focus if they are to succeed.

> *Abundant and abiding structural inefficiencies in Europe create real scope for value enhancement, opening the door to 3-times returns.*

European venture funds of all sorts are finding the market tough going. The asset class continues to be out of favour, with an abundance of negative press and entrenched scepticism to be overcome. Most interest continues to be concentrated in the buyout end of the market, with investors believing in Europe's capacity to outperform the USA.

As a value play, Europe has real attractions for investors (as compared with the growth play USA) and this bodes well for future fundraising efforts. Abundant and abiding structural inefficiencies in Europe create real scope for value enhancement, opening the door to 3-times returns. By contrast, only localised funds offer an equivalent rate of return in the US market – and these are hard to access and quickly over-subscribed.

Looking ahead, Asia is set to become increasingly attractive, with more money flowing into Asia-based funds in the next 12 months than they have seen for a long time. The reason being that, on a deal-by-deal basis, these funds are achieving 4-times returns, slightly above European averages.

To sum up, there is every reason to be bullish about prospects for this asset class. But there is no doubt that investors are becoming increasingly demanding – notwithstanding the fact that general partners are managing their money as responsibly as possible. Under these circumstances, placement agents have really come into their own. Bringing with them myriad investor relationships, increasing efficiency and minimizing risk in the fundraising process, they have a key role to play in facilitating limited and general partner communication.

GIVE ENTERPRENEURS A CHANCE

Benchmarking tax and legal environments the push for parity

Ulf Söderholm, *Partner, Andulf Advokat AB and Member of the EVCA Tax & Legal Committee*

This Symposium sees EVCA launching new efforts to produce an update of its publication Benchmarking European Tax and Legal Environments. Since it was updated and republished in 2004, this initiative has done much to raise awareness of the important role tax and legal environments have to play in the development of private equity and venture capital.

The main finding from that report – that restrictions on, and multiplicity of, tax and legal systems impede the development of private equity and limit the funds available for European companies – remains unchanged. On a national level, tax and legal restrictions continue to impede fundraising for private equity funds.

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However, there has been some encouraging progress – notably in Belgium and Luxembourg (enacted legislation), Denmark (advanced rulings) and Finland (pending legislation after Supreme Administrative Court case), where non-resident investors are, or are expected to be, exempt from tax on capital gains realised on local private equity investments.

One of the aims of this benchmarking exercise is to place private equity on an equal footing with public equity for tax purposes, and the examples of Denmark and Luxembourg will, it is hoped, spur similar reforms in other European jurisdictions.

If momentum builds around this issue, the net effect for European private equity and more widely for European entrepreneurship, would be extremely positive. Instead of committing substantial financial and management resources to the establishment of complex offshore investment structures, investors in private equity would be able to concentrate their resources much more effectively.

As things stand, however, investors have little choice but to push for a higher return on their private equity investments to compensate for the additional tax risk and burden. The fact that their investments in public equity are not subject to this treatment, even when involving local brokers acting for foreign investors, continues to place private equity at a disadvantage.

Private equity law in europe: recent developments and their impact on the industry

By Simon Witney, *Partner, SJ Berwin and Secretary of the EVCA Tax & Legal Committee*

The European private equity industry now has a higher profile than at any time in the past. Not only are more deals being done and more funds being raised, but the industry also benefits from stronger links with national and European authorities. As a result, it has an increasing influence on legal and tax developments. In some cases, that has allowed it to shape an agenda; in others, to head off a threat. But with higher profile comes an increased focus on the industry by policy-makers and the media – and that can also pose challenges. We have certainly seen some of those in recent months.

This article considers some recent legal and regulatory developments and their impact on those involved in European venture capital deals and buyouts.

Tax treatment of private equity and venture capital

Tax treatment of private equity and venture capital funds has not stood still in Europe in recent years. In Germany the re-introduction of tax transparent German funds should attract more non-German investors. Changes to the capital gains tax treatment of carried interest, and an acknowledgement that management fees will not always attract value added tax, will also make it easier to raise funds in Germany.

Spain's traditionally advantageous tax regime for Spanish venture capital entities has witnessed further improvements, making Spain more attractive for venture capitalists. The abolition of the thin capitalisation rules for financing from any European Union country has benefited the buyout industry in particular.

The UK's treatment of private equity and venture capital is increasingly ambivalent. On the one hand, the gradual reduction in capital gains tax rates for British entrepreneurs has been beneficial; on the other hand the unexpected introduction of a very harsh thin capitalisation rule will adversely affect UK buyouts.

In the context of such tax reforms, EVCA has been busy engaging policymakers, and digesting the impact of these changes. In March 2004, the EVCA Tax & Legal Committee published a special paper on Debt Financing Structures, which deals with thin capitalisation rules across Europe, and more recently has updated its paper on Taxation of Corporate Profits, Dividends and Capital Gains in Europe.

With an higher profile comes an increased focus on the industry by policymakers and the media.

The UK pensions industry

Recent developments in UK pension rules impact significantly on local deals. Changes in the calculation of the pension deficit arising when a company leaves a group pension scheme will make certain buy-outs harder or even uneconomic. Additionally, the new pensions regulator has powers to review completed deals and impose "financial support directions" or "contribution notices" on shareholders in certain circumstances, requiring them to contribute to under-funded pension schemes. In view of these powers, private equity houses will welcome the regulator's recent guidance on the advance clearance procedure that allows companies to seek clearance for a deal that could result in the regulator imposing financial measures.

Encouraging venture capital and private equity

A number of European initiatives aim to encourage venture capital and private equity. In September 2004 the French Finance Ministry and insurance industry representatives reached a non-binding agreement whereby French insurers commit to increasing their investments in private equity over the next three years. In particular, insurers will invest 2% of their total assets under management in small and medium-sized companies that are not listed on a regulated market. A package of tax breaks for "young innovative companies" (*jeunes enterprise innovantes*) also aims to kick start the French venture capital industry, whilst the introduction of "preferred shares" (*actions de préférence*) will be welcomed by the private equity industry generally.

The UK has developed the Enterprise Capital Funds to plug the equity gap for business seeking from £250,000 to £2 million and will use government leverage alongside private capital to drive higher returns for investors. Following state aid clearance from the European Commission in May 2005, the first round of Enterprise Capital Funds will shortly be launched on a trial basis.

Recent regulatory changes to UK securities laws will also make it easier for companies and funds to market their shares to high net worth individuals and "sophisticated" investors thanks to a self-certification system. As marketing and promoting private equity funds is a complex matter across Europe, the EVCA Tax & Legal Committee published Legal and Regulatory Aspects of Marketing and Promoting Private Equity Funds across Europe in June 2004, which offers an overview of the European regimes.

Accounting standards, valuation guidelines and freedom of information

Although the obligation on European listed companies to report under International Accounting Standards (IAS) will impact on buyouts, the new standards will probably be an inconvenience rather than a real problem. As the IAS board is already working on similar standards for smaller business, the venture capital and private equity industry could actively influence this process to ensure new standards are relevant to private equity financing.

To standardise the valuation of venture capital and private equity investments, and to take account of the IAS and developing accounting practice, EVCA and the French and British national associations published joint international valuation guidelines in 2005. This initiative is an important step forward for the private equity industry, which should lead to greater consistency on the question of valuation. The international valuation guidelines will be endorsed by a large number of national venture capital associations worldwide.

At the start of 2005, freedom of information rules came into force in the UK and imposed wide-ranging disclosure obligations on UK public bodies, including many investors in European private equity funds. However, thanks to the rules' significant exemptions and routine confidentiality restrictions in fund documents, funds should be able to protect the most sensitive data provided by investors from disclosure to the public. The precise scope of these rules is still being worked through, however, and the threat has not yet completely receded.

Private equity industry embedded in its macro-economic environment

Daniela Weber-Rey,
LL.M., Partner,
Clifford Chance and
Member of the EVCA
Tax & Legal Committee

In 2003 and 2004 EVCA prepared a benchmark study of the tax and legal environment in 15 and 21 European countries respectively. The benchmark paper included indicators such as tax rates, fiscal incentives and the entrepreneurial environment. It focused on legal and tax regulations applicable to fund structures. The study resulted in a ranking of the European countries with respect to the development of the private equity industry. The idea was to give European and national policymakers an insight into practices currently in place and to take action where necessary. The ranking is accompanied by detailed comments which also provide an overview of the different strengths and weaknesses of certain countries compared to others.

On 1 March 2005, the OECD (Organisation for Economic Co-Operation and Development) presented a new publication – Economic Policy Reforms: Going for Growth – on the benchmarking of OECD countries with a similar goal: to help policymakers to achieve stronger economic growth by enabling them to compare the strengths and weaknesses of their economies. The OECD paper is not restricted to the private equity industry. In contrast to the EVCA benchmark paper it resulted in several comparisons of a multitude of indicators in the various economies in the territory of the OECD. The paper focused on the factors influencing economic growth, labour and product markets, and resulted in a number of lists and rankings giving some background on the reasons behind growth or the lack of growth. One of the most striking results of the OECD paper was that the Gross Domestic Product (GDP) per capita in most of the European countries (e.g. France, Germany or Italy) is about 30% below the GDP of the USA and the gap is expected to increase rather than decline.

With respect to product market regulations and barriers to entrepreneurship, both papers show similar tendencies. In particular, they indicate that the UK and Ireland seem to have rather low barriers and therefore, good opportunities for entrepreneurship to develop further – and thus, the private equity industry. This may be one of the reasons which has led to the relatively good overall performance of GDP per capita of the two countries compared to other European countries. However, other factors such as educational standards, labour utilisation and investments in public infrastructure have also a significant impact on the overall economic performance of a country and the standard of living of its inhabitants. Regarding educational standards and investments in public infrastructure the OECD paper shows that the UK will also need further reforms. With respect to labour utilisation, continental Europe will have to make significant progress, particularly regarding pension reforms, unemployment insurance and working time.

The idea was to give European and national policy makers an insight into practices currently in place and to take action where necessary.

The papers are in line with other developments within the European Union. In particular, EVCA has developed a paper on its Public Policy Priorities, the goal of which is to further the ideas of the Lisbon Agenda and give concrete recommendations to strengthen entrepreneurship in Europe. The importance of these recommendations has even been emphasised by the result of the mid-term review of the Lisbon Agenda, which came to the conclusion that the ambitious goal to make the European economy the "most competitive and dynamic knowledge-based economy in the world by 2010" will have to be approached differently. Another paper by the European Commission published at the end of April 2005, the Green Paper on Financial Services Policy (may be commented on until 1 August 2005; the final programme to be finalised by November 2005), provides a similar goal to bring in line a "well-functioning risk capital market as a strategically important element of promoting new and innovative firms, entrepreneurship, raising productivity and the sustainable rate of economic growth in Europe".

This clearly illustrates that European policymakers in particular have a big challenge ahead of them and that several associations from different backgrounds have recognised the importance of identifying the priorities for any further initiatives. Furthermore, the OECD has announced it plans a benchmarking exercise every two years and a special issue at the beginning of 2006 with a focus on financial markets and innovation policies. These papers and benchmarking exercises should assist policymakers in Europe to clarify the priorities in their respective countries and to develop the right strategies. For the development of the European private equity industry this implies that, as it is part of the macro-economic environment of the country of its activity, it will have a considerable impact on the overall economic situation and is expected to contribute to economic growth. Hopefully, the governments in Europe will take this opportunity to learn from the comparisons with their competitors and thus, help to change the economic and regulatory environment for the better.

Good governance guidelines launched

Vincent Neate, *Director, KPMG LLP and Member of the EVCA Corporate Governance Working Group*

This year's Symposium sees the launch of EVCA's new Governance Guidelines for the management of privately-held companies. The result of a year's work by the EVCA Professional Standards Committee working group, the guidelines have now passed through their final consultation period and are in final form. They are, in essence, all about capturing best practice, setting out at a comparatively high-level what private equity and venture capital fund managers' roles, responsibilities and expectations should be in dealing with their investee companies.

As the wider debate continues in Europe over the respective merits of principles-based and rules-based corporate governance systems, these guidelines set out to establish a number of foundation principles for good governance in this industry. It is intended to be valuable for fund managers, as well as for the management teams of private equity backed companies, and anyone else interested in understanding how the industry operates.

The guidelines address two central areas – highlighting the management and board behaviours that private equity fund managers seek to identify in target companies and setting out what constitutes best practice in terms of managing a portfolio of investee companies.

Successful private equity investment is all about investing in a company to produce strong business performance. Building on that premise, the guidelines identify and itemise best practice, illustrating how investors can emulate this in their own management of privately-owned companies.

The guidelines establish seven core principles of good governance in private equity investment. These are: that investors act in accordance with local laws and regulations; that they act with integrity towards their investee companies and other stakeholders; that they are aware of the fact that they are investing in a partnership relationship founded on negotiated rights and responsibilities; that they are investing for the long term; that they should respect the interests of all stakeholders in the business; that they should strive for transparency in their communication with the company; and that they should never take inappropriate advantage of privileged information.

The guidelines then look at the three different roles arising in the private equity investment situation, setting out the principles of conduct attached to each of these – whether as a shareholder, a board member or a member of management. For example, the board member and management team all have different responsibilities where strategy is concerned.

Overall, the guidelines are not intended to be proscriptive. Rather, they set out to establish best practice in this crucial area – hopefully to the benefit of the European industry and to the companies in which it invests.

Investing for the long term

Daniel Sachs, *CEO, Proventus AB*

As a private investment company investing in ailing companies, our expertise lies in driving change and creating long-term value in our investments. We sit somewhere between typical corporate investors, on the one hand, and private equity firms, on the other.

Unlike corporate investors, which tend to pursue specialist strategies, we adopt a more generalist approach. And the fact that we are a privately-held company gives us real flexibility, enabling us to adopt a long-term perspective that is off-limits to exit-focused private equity firms.

The relationships we build with our investments also set us apart. In fact, having a longer term perspective on corporate development also means that we can not only focus on cost efficiency, financial structure and so on, but we work with the product at the center trying to achieve sustainable growth of the business we invest in.

Of course, in some ways we do work in similar ways to private equity firms. After all, at a basic level our core motivation is the same – to maximise the potential of our investments. For this reason we do, from time to time, look at making co-investments. We looked at one such opportunity last year, but eventually decided against taking it forward. There were too many potential pitfalls – not least of which would have been negotiation over pre-emption rights, as well as attempting to resolve respective exit expectations.

We are equally open to undertaking co-investments with industrials. Indeed, we have just completed one such deal, our 50/50 purchase with Bonnier Group of Finnish TV channel MTV3. This is, in many respects, a classic illustration of our preferred approach – because neither ourselves nor Bonnier has an exit strategy in mind, there is much less scope for conflict.

The same goes for our investment in Swedish toymaker BRIO AB, where we are the principal shareholder. Our preference there has always been to adopt a product-centric approach for driving growth. Change for BRIO will be long-term and, precisely because we are privately owned (with no fiduciary duties and no investors), we are able to concentrate on substance without getting too entangled in form.

This independence is a real strength in a competitive investment market. We can be quicker and more flexible than private equity players, whose investment strategies are necessarily defined by institutional investor asset allocations. Certain market segments are adjudged too high risk by limited partners – but the whole spectrum is open to us.

Whether or not industry/private equity collaborations will succeed is open to question. These relationships are inevitably fraught with the potential for conflict – corporate investors will almost always have longer-term expectations than private equity firms, which are much more focused (of necessity) on maximising short-term cashflows. And notwithstanding the fact that private equity firms are being forced to look at building long-term relationships (because much of the value from restructuring and refinancing has been driven out of the market), they cannot get away from the fact that they operate within limited fund life spans.

Can private equity fund managers really extract value from intuition?

Oliver Gajda, *Commissioning Editor, EVCA and Member of the EVCA Tax & Legal Committee*

At the EVCA Investors Forum 2005, the keynote speaker talked about "extracting value from intuition" – clearly, statistical measures of success where not at the forefront of his interest. Or so it seemed at first. The speaker, Professor Kahneman, was awarded the Nobel Prize in Economic Science in 2002, after he integrated insights from psychological research into economic science – especially concerning human judgement and decision-making in uncertain situations. But what can the private equity industry learn from his findings?

To begin with, intuitions are realistic expectations when anticipating future events. Intuitive decision making is something the private equity industry uses frequently as a differentiator from asset classes in which a wide range of statistical data is publicly available. They are correct to do so, to a certain degree, since both research on privately held firms and investment performance indices for private equity portfolios virtually do not exist. However, this may change and EVCA is currently working to improve both performance data and conditions for high growth companies on the stock markets.

In decision making, one should try to adopt techniques that help to avoid mistakes, rather than techniques that aim to achieve brilliance. The latter can only be accomplished in highly behavioural situations, such as when playing chess or hockey – as in both cases knowledge is perceptual. For example, if one receives immediate and plain feedback on ones actions and expectations, one has the opportunity to gather expertise and to learn skills. On the other hand, if one receives only very delayed (maybe even by years) and ambiguous feedback on ones actions and expectations, only a limited opportunity to gather expertise or to learn skills exists. Therefore, skills and expertise can only be gained with practice, but the quality of both depends on the speed and the quality of the feedback. If this takes years, as in the private equity industry, experience can only be built up very slowly. Overall, private equity is somewhere in between the two extremes of qualitative and immediate versus ambiguous and extremely delayed feedback. This means that track records are only worth so much. In addition, it is important to realise that the industry operates in a universe of irreducible uncertainty, which means that who was successful once is not necessarily likely to be successful a second time.

In order to deal with these circumstances the private equity industry has created its own language to communicate and to share its learning. As a result, there is nowadays more known about private equity than ever before. However, this is not a sufficient indication for the good forecasting of future events. Moreover, the industry wisdom seems to be based on hindsight. This is, of course, where the private equity industry's love affair with track records comes from. Since we do not know what will come next, we seek confidence in what has happened before – and assume that the experience taken from this will also help to achieve similar performance in the future.

Hindsight is, de facto, responsible for common-place ignorance of the world's uncertainty. In hindsight, so it seems, the right and the wrong decisions can be clearly determined. A survey among private equity players – in connection with the EVCA Investors Forum 2005 – which asked participants to reflect of a decision once taken that in hindsight ended in disaster, offered as the most often stated answer: "I wish I had cut off the investment/cost earlier." In general, when people are presented with a problem, it is normal to form a hypothesis on the likely outcome. If with increasing information the odds should change, decision makers are unlikely to adopt their hypothesis.

Decision makers are inclined to develop an inside-view through their close involvement with a problem – and not only in due diligence processes. As a result, they may ignore some of their knowledge and skills previously acquired the more they get involved with a problem – and increasingly they loose sight of the broader picture. A first possible solution is to work with a plan. However, this can lead to a misconstruction of the subject. Therefore, when predicting under a plan, several outlines should be produced in order to prevent any planning fallacy (or a best plan scenario), especially since its risk can be higher in complex situations. Secondly, an outside opinion should be consulted which could offer a broader view of the problem and therefore may help to develop different possibilities.

So, when asked about a disastrous decision, why did private equity players not answer most often: "I wish I had invested in xyz when I had the chance?" In private equity, a decision maker receives limited feedback on his decisions from the market and therefore, for example, only very little information on missed opportunities. This means that when track records are used as indicator for future performance, it is only based on realised chances, but leaves out all missed opportunities. Adding to this, with regard to track records, learning about a particular aspect or an individual – say a team member, during due diligence processes does not provide enough information to form a sufficient opinion on possible success in future complex situations.

Intuition is especially biased by, of course, personal experience. Nevertheless, personal experience is a vital part of due diligence, especially in human resources, as exercised by many investors and fund managers alike. To avoid such bias, it is vital to first use all available data statistically. This is a main point for private equity investors and practitioners. They should be absolutely clear about what can be known. And, just considering possibilities is already a reduction of options! Compared to the results delivered by hindsight, the average intuitive decision in a market with limited feedback will not be supportable. Findings of long running empirical studies among decision makers have shown, the average correlation of a person's single successes and overall performance is near zero. Bearing this in mind, it is surprising to see companies' limited efforts to measure their own and others performance appropriately.

This call for a different way of tracking success has a motive. People use data differently in different situations. In complex situations with high uncertainty levels, this has, of course, a significant impact on decision making based on intuition. This again has been proven empirically. Moreover, it can be said that decisions based on statistics have higher prediction rates than the average intuitive decision. This is founded in the fact that intuitive variations considerably lower peoples' success in assessing problems.

In conclusion, the private equity industry is facing uncertainty. Most mistakes are made on the grounds of optimism or the illusion of control. Life in general is not a game of skill. Therefore, decision makers should be thinking about what their competitor is doing, what the broader issues influencing their business are. Often it is outside factors nobody can foresee that change the outcome of decisions. Consequently, it should be clear that private equity has not yet reached its optimal performance and that private equity fund managers and investors alike can improve their results, just by reducing the frequency of their own mistakes.

The overheating debate

Mirela Ene,
Research Coordinator,
EVCA

There are quite a wide range of views on whether there is overheating in the private equity industry. With several ways of defining heating, or private equity industry for that matter, the situation gets complicated. Add to that the impact of leverage and the current status of the debt market, and the only consensus that remains is that there are several answers possible. EVCA's view is that there is currently no overheating at the private equity fund level.

How to convince investors to make higher allocations to private equity?

The EVCA 2004 final activity figures (prepared by Thomson Venture Economics and PricewaterhouseCoopers on behalf of EVCA) offer evidence to support this view – at a level close to the previous two years the 2004 fundraising is lagging behind the amount invested by 26%. This is the third year in a row when the lag is present. The long-term trends show there is no exponential growth of the private equity market when the impact of the 2000 bubble is eliminated from the data set. Moreover, due to easy access to bank debt, bigger sized companies were in reach of buyout funds. This enlarged radar screen of potential target companies increases the otherwise limited investment opportunities that Europe is often said to offer. However, this problem can not be totally eliminated, because companies in need of early stage funding, due to their small scale, often do not meet the screening criteria.

The reasoning for our no overheating statement is based on EVCA methodology – the heating pulse is taken at the fund level. Specific hybrids like mezzanine funds or real estate funds are not included in the data, and the impact of leverage is not taken into account since EVCA data comprise only equity amounts. Debt is only included if it is provided by a private equity house. When considering that the size of buyout activity represents 70% of the investment value, the impact of discounting leverage proves to be substantial, especially if EVCA data is compared to other data sets available in the market that provide transaction value and hence much higher amounts.

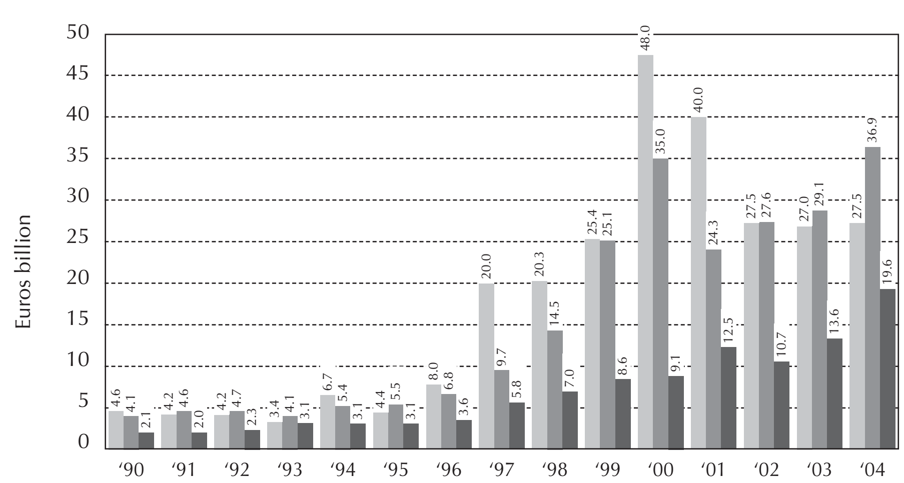
Herman Daems, the current EVCA chairman, considers – in his article in this Conference Journal – that there is room for the external growth of the private equity industry. This is due to a possible further increase in asset allocation from institutional investors to the asset class. The medium-term growth target he set out for our industry of 0.2% of GDP in venture capital investments and 0.4% of GDP in buyouts, would mean that the asset allocation to private equity and the deal flows need to grow by 50% from today's levels.

How to convince investors to make higher allocations to private equity? And especially institutional investors (i.e. banks, pension funds and insurance companies), which historically are the main investors in European private equity and in 2004 are representing around 50% of new funds raised. In addition and more broadly, how to convince the asset management community at large that starting allocating to private equity is good for managing risk and increasing returns?

Offering relevant benchmarks with transparent methodology and a representative universe are key. So not surprisingly EVCA set up an independent Performance Review Committee made up of prominent players in the industry who assessed information from VentureXpert users and Thomson Venture Economics, the performance data provider for EVCA. The review found the processes of the performance benchmark sound and the methodology reliable.

On behalf of EVCA, Thomson Venture Economics not only prepares pooled and horizon IRRs per vintage years and stages, but also comparisons with public markets for the European market. The equivalent IRR returns are computed for Europe assuming that the same pattern of cash flows over time is invested in and divested from the public markets as in the private equity data set. These index benchmarks allow institutional investors to consider comparable returns of asset classes when deciding upon their asset allocation and upon rebalancing their portfolio throughout the investment process.

Evolution of the three main activity flows of the European Private Equity Houses



Source: EVCA Survey of Pan-European Private Equity and Venture Capital Activity 2004
Conducted by Thomson Venture Economics and PricewaterhouseCoopers

The contribution of private equity to the succession of family business in Europe…

… and to the enhancement of their competitiveness

Fabio Sattin, *Chairman and Founding Partner, Private Equity Partners SGR Spa and Member of the EVCA Buyout Committee*

The study "Private Equity and Generational Change", recently conducted by EVCA in cooperation with the Centre of Management Buy-out Research at the University of Nottingham (CMBOR) – with additional input for Italy from Professor Buttignon from the University of Padua – has clearly demonstrated that private equity has been an optimal and very efficient solution to manage the delicate process of the generational change that many of the family-owned European companies are facing.

It has been shown that companies, which in a situation of generational change have received investments by private equity funds, have developed faster in terms of occupancy, profitability, international activities and export than those without this form of funding. In addition, they also have significantly increased their competitiveness. All these achievements have been successfully reached by the surveyed companies - even if in most of the cases the transactions, typically buyouts, have been conducted with the use of a leveraged financial structure. Leveraged structures, in fact, allow those who have the expertise and experience to run the company (typically the management), but not the financial resources, to buy the company with the help and cooperation of a private equity fund. Thus, assuring that business continuity and expansion will be based on the fundamental criteria of professionalism and competence and not on the inherent (genetic) relationship that in many cases, as demonstrated by the research, does not offer viable or sufficient professional solutions. This is probably one of the main findings of the research.

From the data provided, it is clear that the temporary effect of a leveraged structure has been more than offset by the strong commitment, motivation and professionalism of the management. This is especially true, if one considers that in these investment structures the management is often directly involved in the transaction and, investing alongside the private equity firm, is directly exposed, in the pros and cons, to the development and success of the company. And this is probably the great advantage that a private equity fund has compared to the industrial or strategic investor. Even if the industrial investor may have, in certain cases, an advantage linked to the possible synergetic effects that may be present within the group, he is also in some way limited by this situation, as far as the management changes and direct investment aligning mechanism are concerned.

Being a generalist investor, when a private equity fund buys a company, the quality and professionalism of the management always comes first and is the most important element to be considered. While buying a company, the private equity fund does not put in place his own management but the best available management. In fact, the private equity fund is asking the management to co-invest alongside with him and, at the same time, is perfectly aligning the management's with his own interests via very sophisticated and detailed incentive mechanisms. This is probably the reason why the Department of Strategy & Management of INSEAD has underlined, in their interesting research titled "Why Financial Investors do it Better", that financial investors, typically represented by private equity players, "create substantially more value (in the acquired companies) than operating (or "strategic") acquirers in spite of the fact that the former cannot rely on any resource sharing and redeployment advantage than the latter by definition have".

This is why we all have to hope that the great contribution of private equity to the succession of family businesses in Europe will continue and develop. We also have to make sure that all the social and financial community representatives, at European level, but not only, fully understand and support the development of such an ideal solution and investment scheme that has proven, with facts, to really enhance the competitiveness and expansion of European family-owned companies, while allowing them to compete in an always more problematic and highly competitive international scenario.

Strong fundamentals for growth

Keith Arundale, *European Venture Capital Leader, PricewaterhouseCoopers Technology Industry Group*

With the 2004 investment activity and funds-raised figures currently being finalised for presentation at the EVCA London Symposium, the latest available data for 2004 suggests an industry in relatively good shape for the future.

According to the preliminary data that I presented at EVCA's Investors Forum, the industry is – broadly speaking – right to be optimistic. Based on the 55% response rate received at that time, funds raised in 2004 – at €25 billion – were on track to match or exceed funds raised the previous year. There were few surprises when it came to the expected allocation of those funds. The ongoing decline in early-stage investing is still very much in evidence: just 7.5% of the total amount is allocated to technology venture capital (down from 9.5% in 2003, 15% in 2002 and 31% in 2000). In contrast, 73% of funds raised are earmarked for buyouts.

These findings do raise questions about the extent to which European high-tech will be disadvantaged by a funding under supply. For the moment, however, little is likely to change, principally because of the average-to-poor returns achieved overall by European high-tech venture capital funds. Of course, there is a prominent top-quarter of high-performing venture capital funds, and several of these have enjoyed successful fundraisings in 2005. This polarisation, with the top 10% of venture funds generating up to 75% returns (compared with overall poor returns on venture investments in technology) point to an increasingly tough and selective fundraising market, especially so as it becomes clearer which funds are performing well and which are not.

Even at the preliminary results stage, it was clear that 2004 was going to be a good year for investing, with activity showing a 5% increase on 2003 levels. On the face of it, 2004 has therefore been the second-best year ever for private equity investing in Europe (after 2000). Of the total €31bn invested in 2004, 68% (€21 billion) went into buyouts, as compared with 63% in 2003. Meanwhile 22% of the overall total (€7 billion) was invested in expansion, while seed/start-up investment remained constant at 7% of total amounts (just over €2 billion).

Notwithstanding the fact that a number of industry commentators continue to talk about an "overhang" of private equity money in Europe, our figures show that there is at most around a one and a half year supply for private equity funds, and slightly less on the technology venture capital side. This suggests that the wall of money refrain is over-stated.

Preliminary data shows divestments at their highest level ever (over €14 billion). Trade sales accounted for the majority of these (25% of the total), while write-offs (10% of the total) were down from 2003.

All of the above shows that we are, on balance, justified in being positive about the industry outlook. Of course, there is some cause for concern on the technology focused venture capital side, not least because of the mixed results currently coming through from the large corporate technology companies and the declining level of funds allocated to technology focused venture investments. Even so, with M&A activity picking up momentum in this sector and evidence of some uptake in interest amongst technology sector venture capital specialists, the overall picture is not uniformly bleak.

It is worth mentioning in passing that the latest findings from the MoneyTree Survey (conducted by PricewaterhouseCoopers, Thomson Venture Economics and the National Venture Capital Association) show a US venture capital industry investing within its established quarterly range. Q1 2005 figures show total venture capital investments of $4.6 billion, below Q4 2004 levels ($5.4 billion), but nevertheless squarely in the $4-6 billion comfort zone. These figures suggest stable industry activity on the other side of the Atlantic.

The full-year EVCA Survey (conducted by Thomson Venture Economics and Pricewater-houseCoopers on behalf of EVCA) is the largest independent survey of private equity firms in Europe, canvassing over 1,600 firms and – thanks to the efforts of all concerned, as well as national industry associations – achieving in most years an overall 70% response rate. The final results for 2004 will be published at this year's Symposium. Delegates wishing to examine it in more depth are encouraged to join in our Interactive Workshop Discussion on the private equity data during the course of the event.

An easterly breeze in Southeast Europe

Murat Cavusoglu and David Mathewson,
Managing Directors, Bedminster Capital Management LLC

Throughout 2004 and into 2005, Turkish Prime Minister Recep Erdogan and other senior Turkish officials travelled widely in Southeast Europe, opening new branches of Turkish business associations, participating in groundbreaking ceremonies for new corporate investments, and meeting with political counterparts to strengthen Turkish-Balkan relations. The historical Turkish linkages with the markets of Albania, Kosovo, and Bosnia are obvious and are built on cultural heritage. The more recent development of Bulgarian-Turkish and Romanian-Turkish relations flow from geographic proximity and common goals for integration into NATO and European Union (EU) structures, i.e. Turkish support for Bulgaria/Romania entrance into NATO reciprocated by Bulgarian/Romanian support for Turkey's accession to the EU.

In parallel with political developments in the region, the Turkish business community has accelerated its involvement in and investment throughout Southeast Europe. Examples of this increasing commitment and activity are numerous, ranging from Sisecam's $160 million greenfield glass factory in Bulgaria to Arcelik's acquisition of Artic in Romania to Anadolu Efes' early investment in the beer industry in Serbia. Foreign trade flows are also increasing. Romania and Bulgaria are significant foreign trade partners for Turkey, and trade flows are increasing with other Balkan countries.

Although many observers of Southeast Europe tend, by habit or instinct, to focus on the region's commercial and political ties with Western Europe, we expect that one of the most visible trends over the next five years in the Balkans will be the acceleration of Turkish investment and influence in the region.

Some may feel that they have seen this movie before; significant Turkish investments in Romania and other Balkan countries in the late 1990s gave rise to predictions of a coming wave of Turkish activity. As with prior periods of optimistic activity, this wave was cut short by a sharp Turkish financial crisis in February 2001 that caused many Turkish companies to pull back and/or significantly downsize their expansion plans.

This time is different. Turkey has accomplished an impressive and unprecedented restructuring of its economy over the past four years. Through an effective combination of sheer necessity and external pressure, Turkey implemented a series of tough economic, political, and social reforms that have resulted in significant economic expansion. Turkey in 2004 was the fastest-growing large economy in the world. In Q4 of 2004, the GDP growth rate was higher than inflation growth for the first time in history. The currency is stable, having lopped off six zeros at year-end in smooth fashion, the government is popular and in the efficient hands of a single majority party for the first time in years, and in October 2005 Turkey will begin negotiations for EU accession. All-in-all, an impressive turnaround from the dark days of 2001. Most importantly, the structural reforms and improving fundamentals have moved Turkey to the point wherein the likelihood of another bust is viewed as remote.

With their own houses in order, Turkish businesses have increasing confidence to look beyond Turkey for opportunities. Turkey has one of the largest pools of top management talent in Southeast Europe. With no history of communism to overcome and with decades of international education and work experience under their belts, top Turkish managers are eager to move aggressively into new markets throughout the region. These managers increasingly have capital with which to work following the stabilisation of the domestic economy. With expectations for long-term stability sinking deeper roots into the Turkish psyche, company owners and family groups are increasingly willing to let their managers invest capital in new ventures, and the natural place to go is the near-abroad countries of Southeast Europe and Central Asia.

We are aware that many Turkish companies are developing business plans and strategies which call for substantial new investment in Southeast Europe in 2006 and beyond. This investment strategy is based not only on the heightened confidence and capabilities of Turkish companies but also on the practical realities of Bulgarian and Romanian EU membership in 2007, which may provide Turkish companies an EU base of operations prior to Turkey's potential accession.

The implications for private equity investors in Southeast Europe are obvious: we need to look east as well as west when seeking strategic partners and/or operating relationships for portfolio company investments in the region. In addition, we should consider Turkish opportunities for exit, either through trade sales to expanding Turkish companies or through access to the Istanbul Stock Exchange, by far the most liquid securities market in the region. If the Turkish angle is not considered when investing in the region, a private equity manager may miss opportunities for dynamic portfolio partnerships or fail to recognize the competitive implications of potent new entrants in the market.

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About EVCA

The European Private Equity and Venture Capital Association (EVCA) was established in 1983 and is based in Brussels. EVCA represents the European private equity sector and promotes the asset class both within Europe and throughout the world.

With well over 900 members in Europe, EVCA's role includes representing the interests of the industry to regulators and standard setters; developing professional standards; providing industry research; professional development and forums, facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics.

EVCA's activities cover the whole range of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins.

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