Venture and enterprise capital: Smart finance for SMEs

Dörte Höppner, secretary general

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CREATING LASTING VALUE

Introducing EVCA

- Established in 1983 at the instigation of the European Commission
- We have 12,000 members, including 800+ venture and enterprise capital firms across 50+ countries.
- We promote the long-term interests of the venture and enterprise capital industry in Europe. Our goal is to create a more favourable environment for equity investment and entrepreneurship .

Jargon Buster

Private equity: an umbrella term for a method of owning and investing in companies.

Venture capital: this is when private equity is invested into young, entrepreneur-led, high-potential companies that are typically driven by technological innovation.

Enterprise capital: private equity investment into more established businesses that want to internationalise, professionalise or develop their products and services.

Buyouts: private equity can be used to acquire (or 'buy out') all or the majority of an established business. After that, the private equity method of ownership and governance kicks in.

Snapshot – European Private Equity Industry

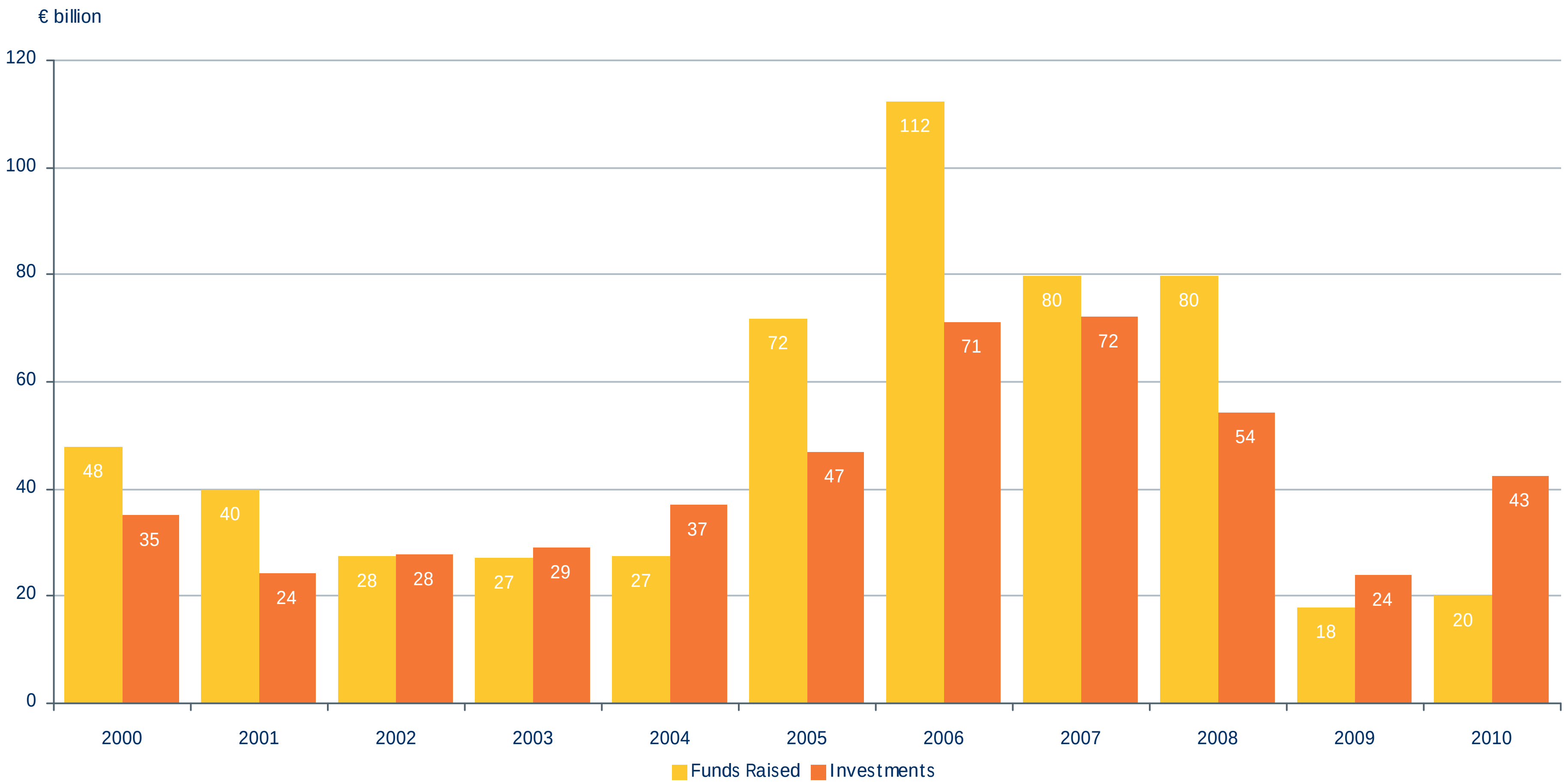
1,700 active private equity firms:

- Employing around 29,000 people
- Managing 4,200 active funds
- With a capital under management of €524bn

Access to finance for SMEs

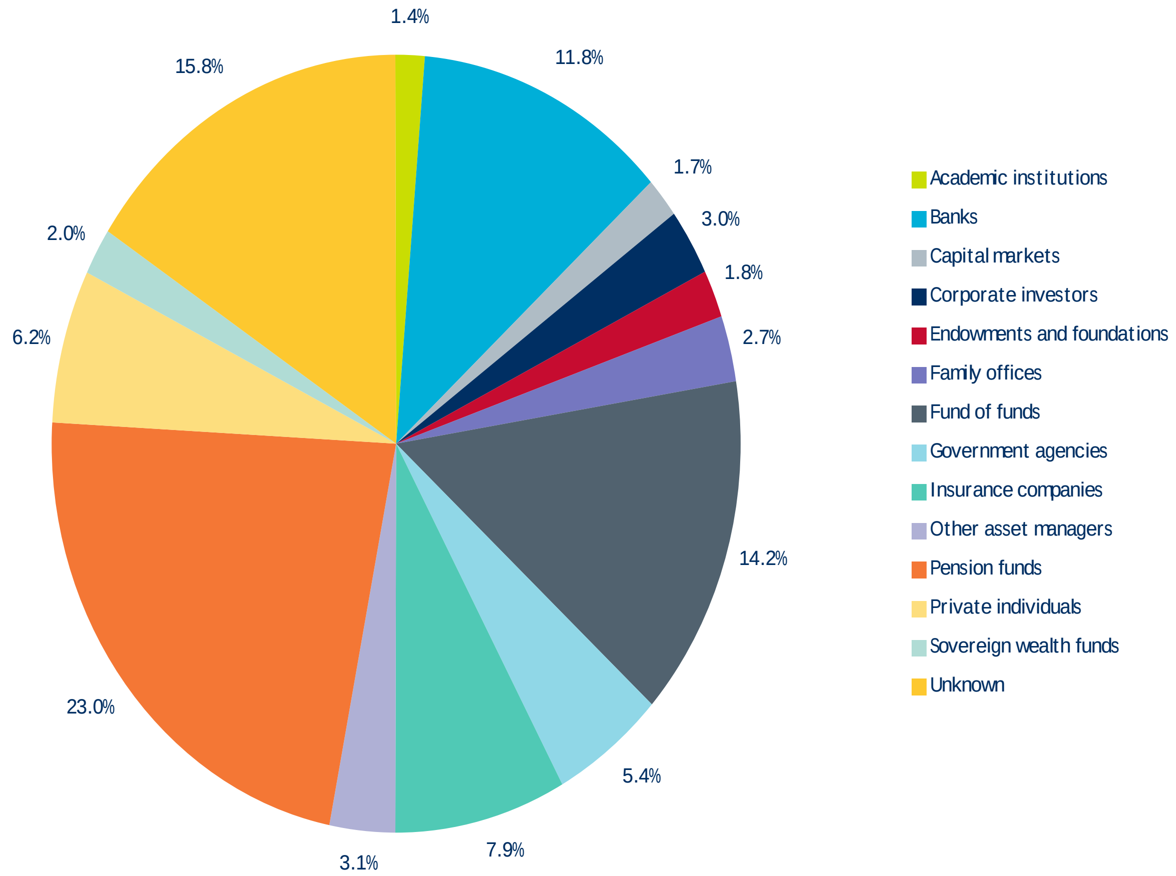
- 26,000 European companies have venture and enterprise capital investment
- More than 22,000 are Small and Medium Sized Enterprises

Funds raised and investments - evolution



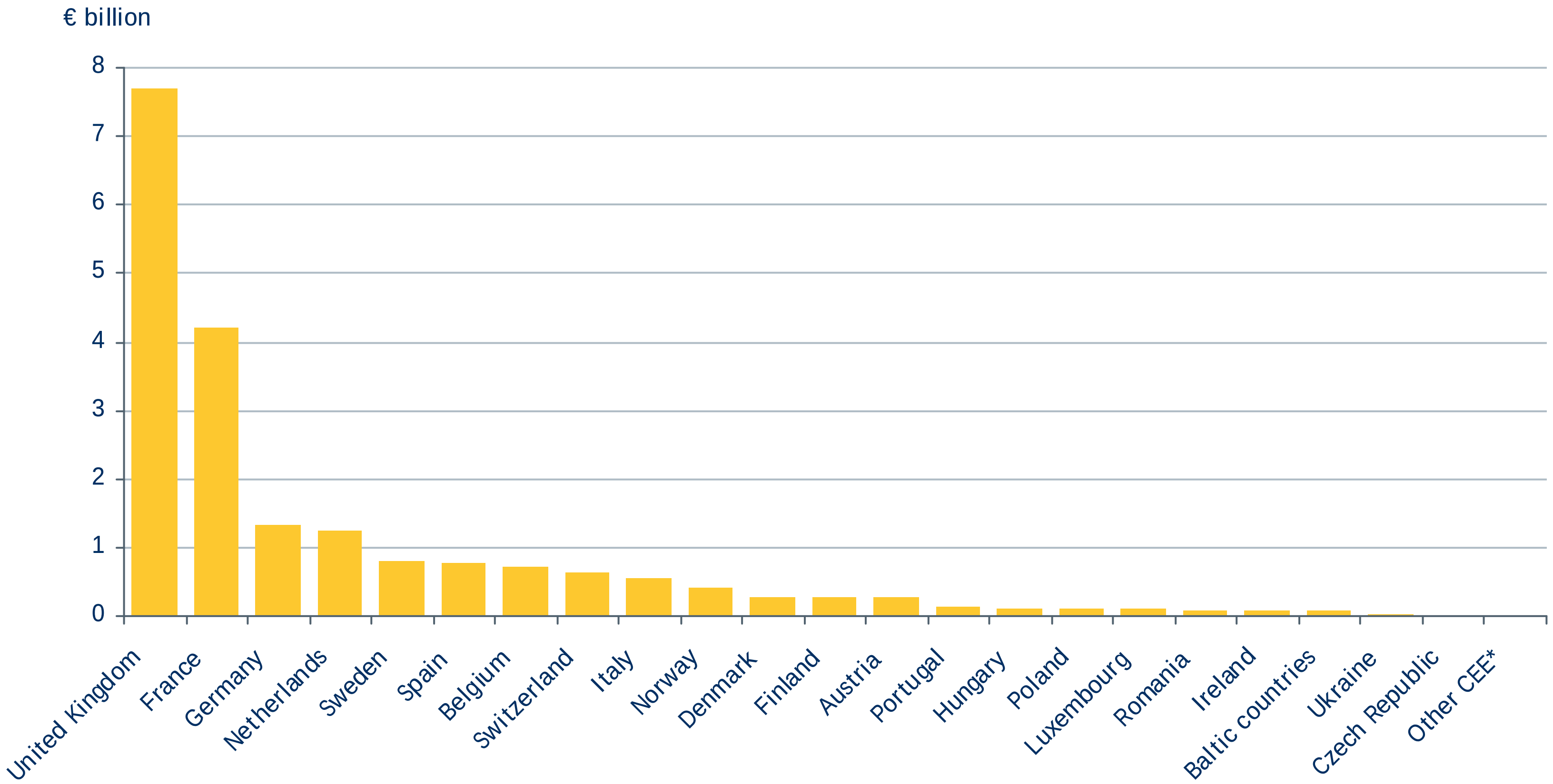
Source: EVCA/PEREP_Analytics

Funds raised by type of investor in 2006-2010



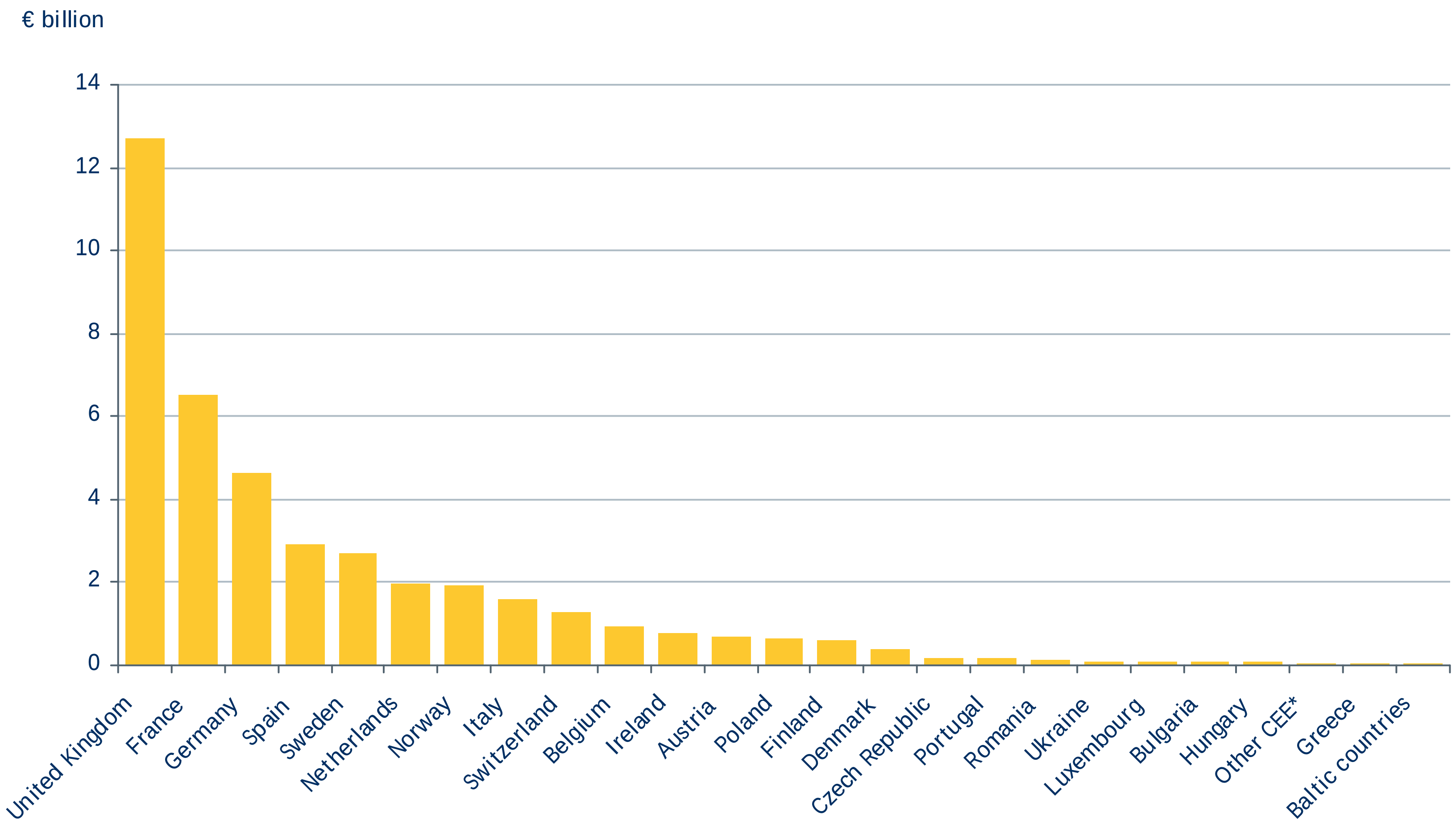
Source: EVCA/PEREP_Analytics

Funds raised by country of management



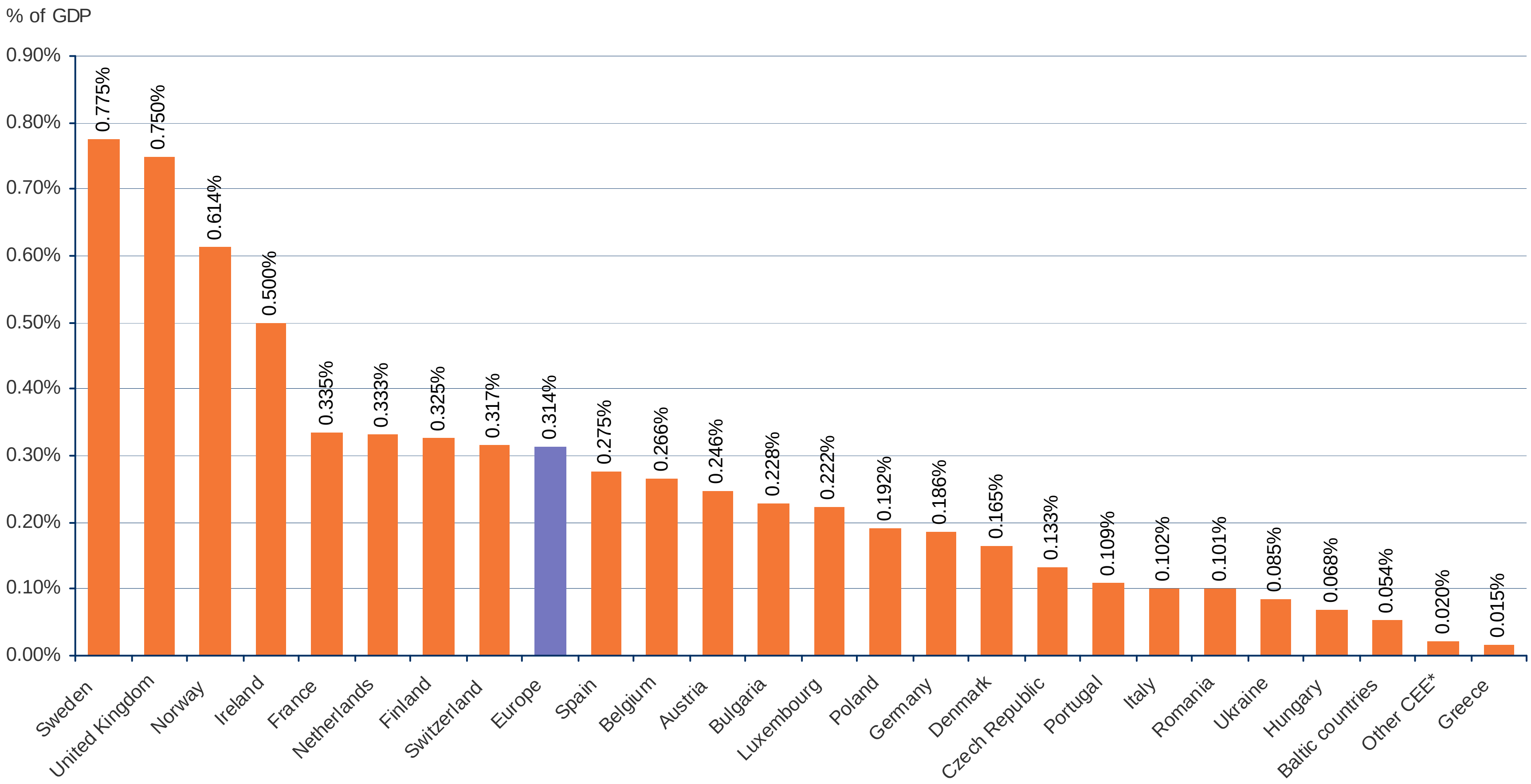
Source: EVCA/PEREP_Analytics

Investment by country of destination



Source: EVCA/PEREP_Analytics

Private equity investment as % of GDP in 2010
(market statistics)



*Other CEE consists of Ex-Yugoslavia and Slovakia

Source: EVCA/PEREP_Analytics

Venture investment as % of GDP in 2010
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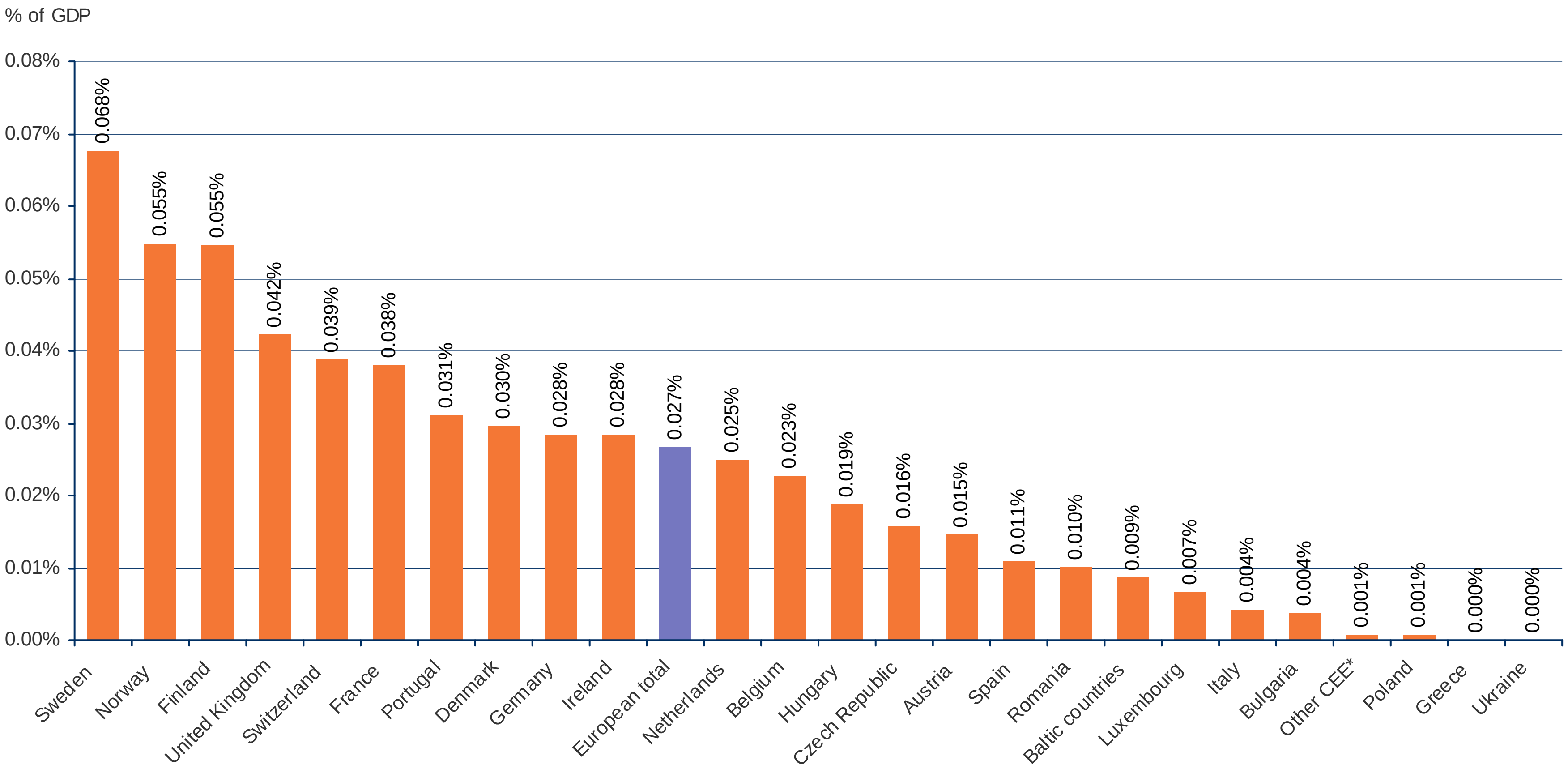

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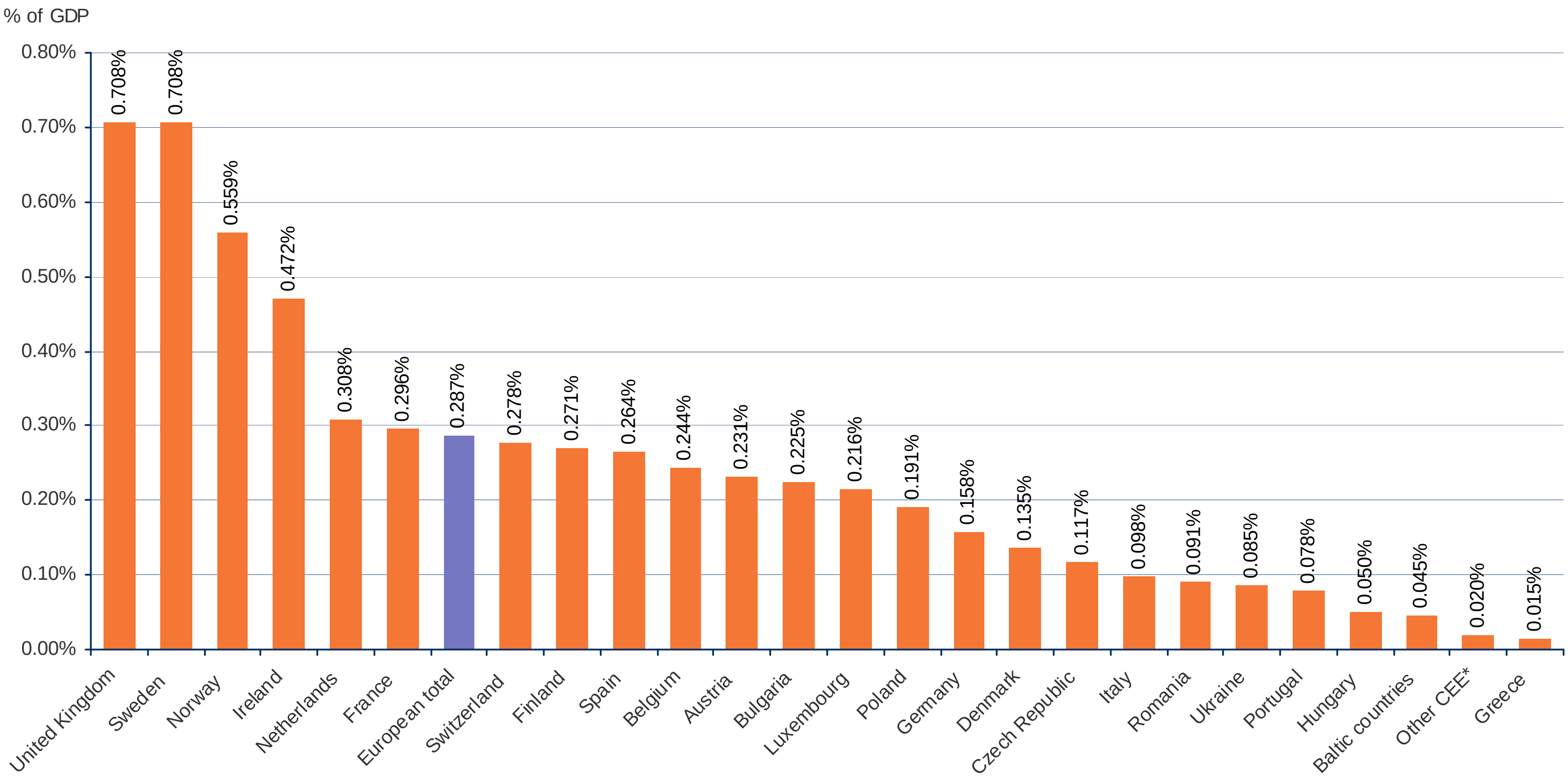
Source: EVCA/PEREP_Analytics

Enterprise capital investment as % of GDP in 2010
(market statistics)



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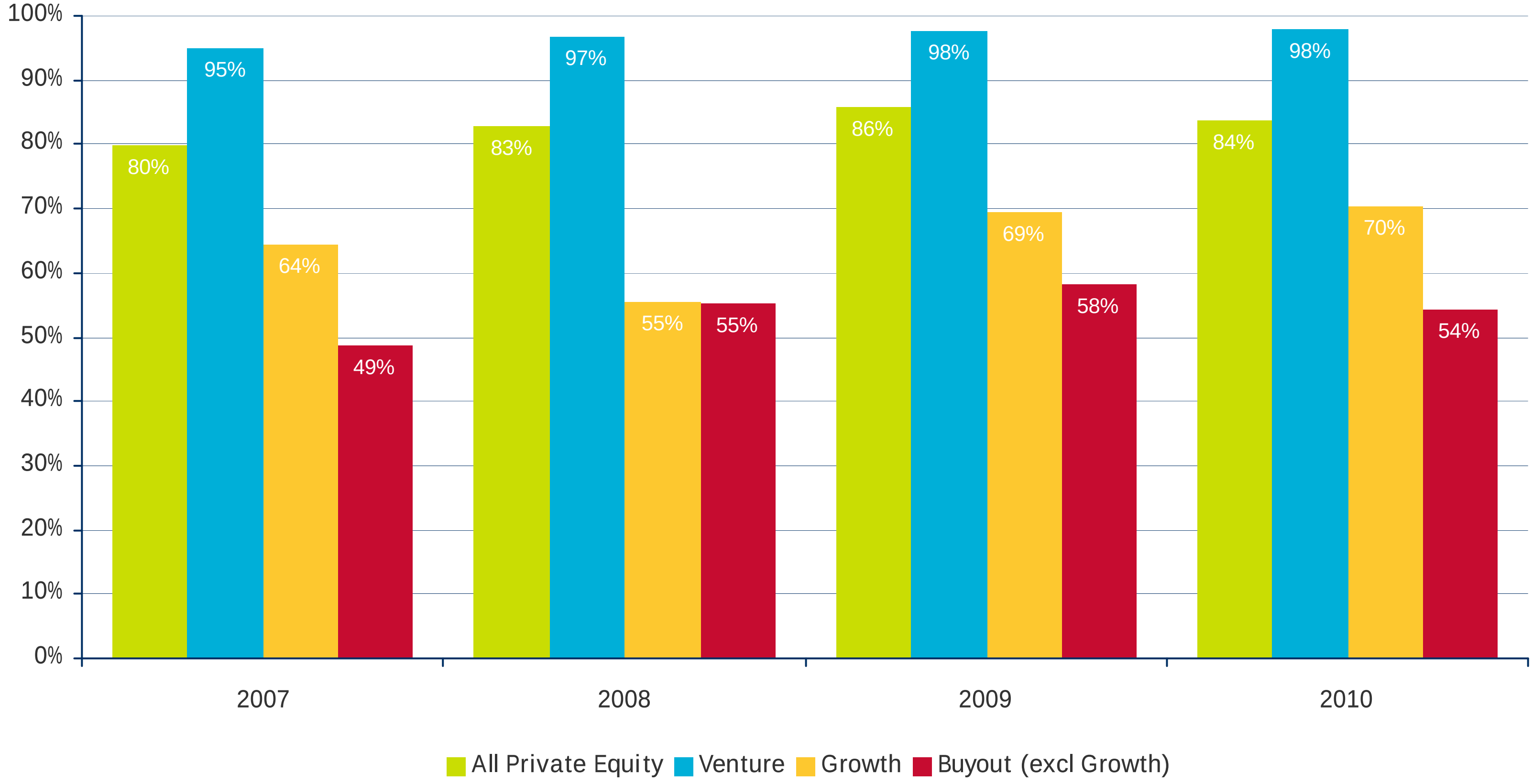
Source: EVCA/PEREP_Analytics

Investments in SMEs by European private equity firms, as a % of total number of companies financed



Source: EVCA/PEREP_Analytics

Private equity investments in SMEs in 2007-2010

- 16,700 European SMEs financed, of which:
  - 12,550 in venture
  - 4,150 in enterprise capital

- €46.5bn provided to European SMEs
  - €17.5bn went to venture-backed companies
  - €29bn went to enterprise-capital-backed companies

Source: EVCA/PEREP_Analytics

Whose money is it?

Pension funds, insurance policies, family offices and endowments

Seeking strong and diversified returns

How to access ‘venture capital’

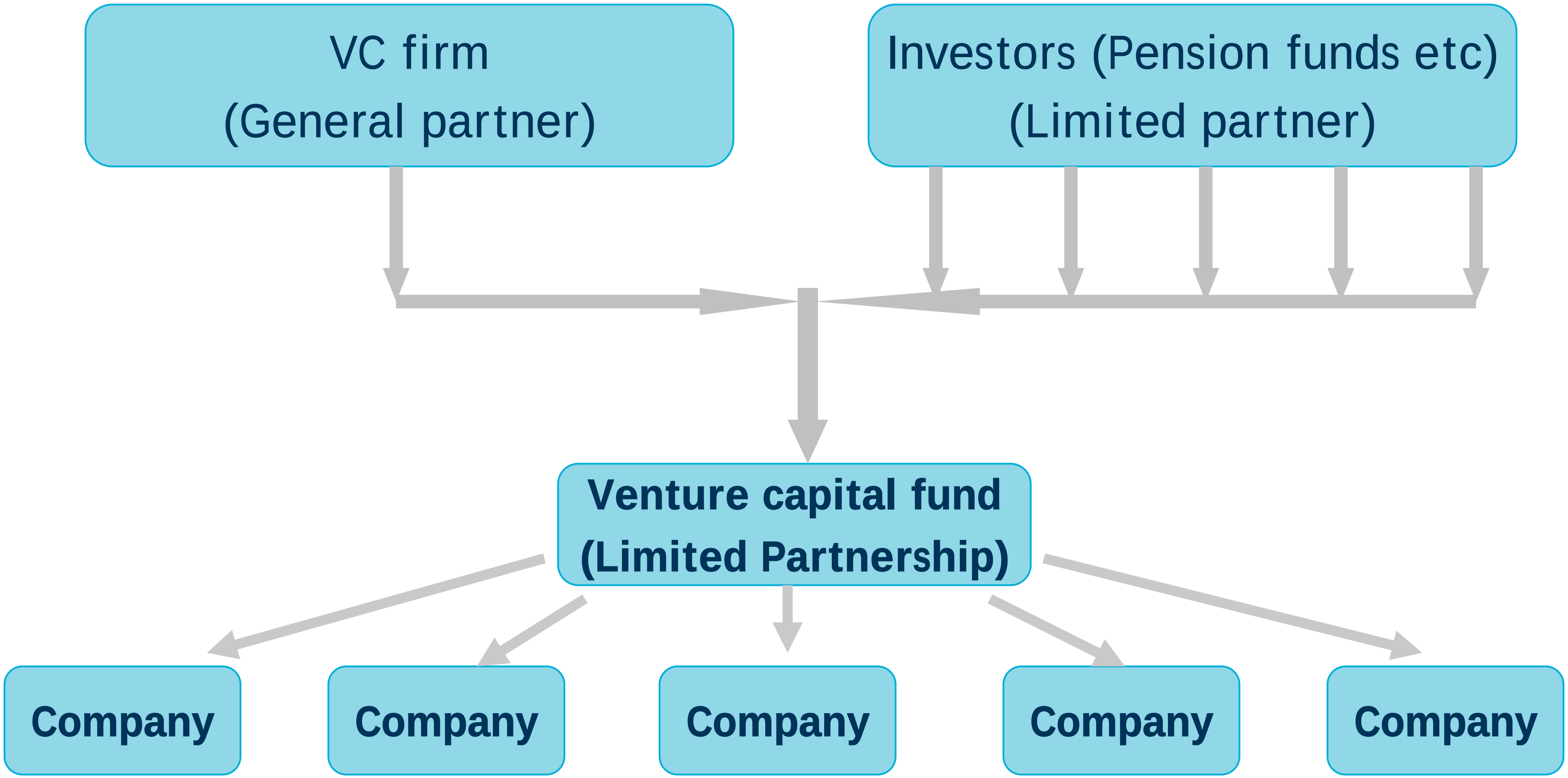
- Invest directly in a ‘venture capital fund’
  Unquoted ('Limited partnership')

- Invest through a ‘fund of funds’

- Co-invest directly into companies, alongside VC fund.

Source: EVCA

Direct fund investment: the Limited Partnership

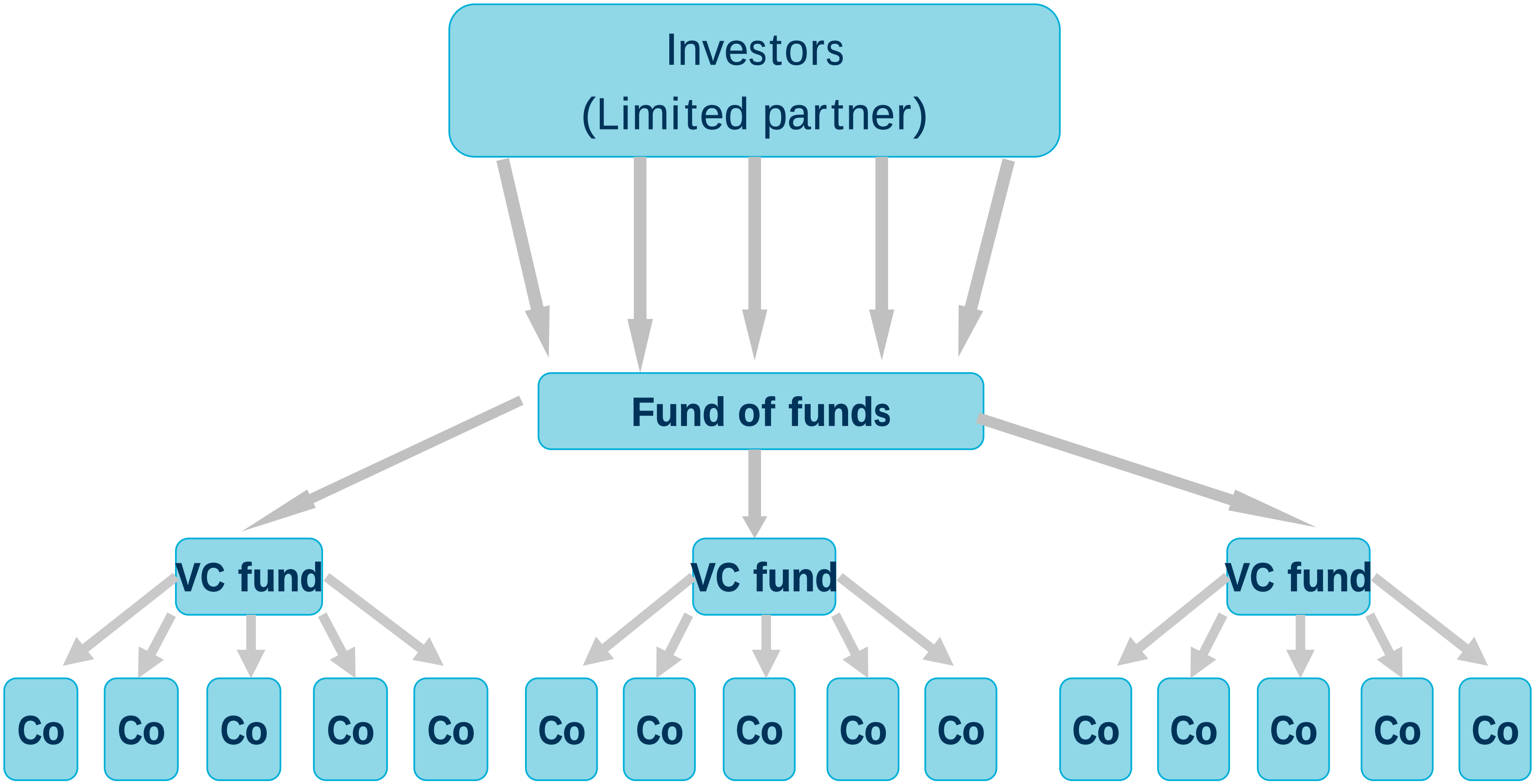


Source: EVCA

Characteristics of limited partnership funds

- Fixed life, ten-year limited partnership (terms negotiated between GP and LP)
- Strong alignment of interest from company managers, VC fund managers, to fund
- Manager receives a performance based compensation (carried interest) based on performance targets
- Illiquid investments but there is a small market for secondary interests

Fund of funds investment



Source: EVCA

Advantages of Fund of funds

- Enables large pension funds to access much smaller venture capital and enterprise capital funds – many pension funds need to allocate more capital in single investments than venture capital funds can cope with

- Provides "instant access" to venture capital without having to have knowledge of market

- Provides a learning opportunity for investors as they monitor the progress of their investments through the limited partnership structure

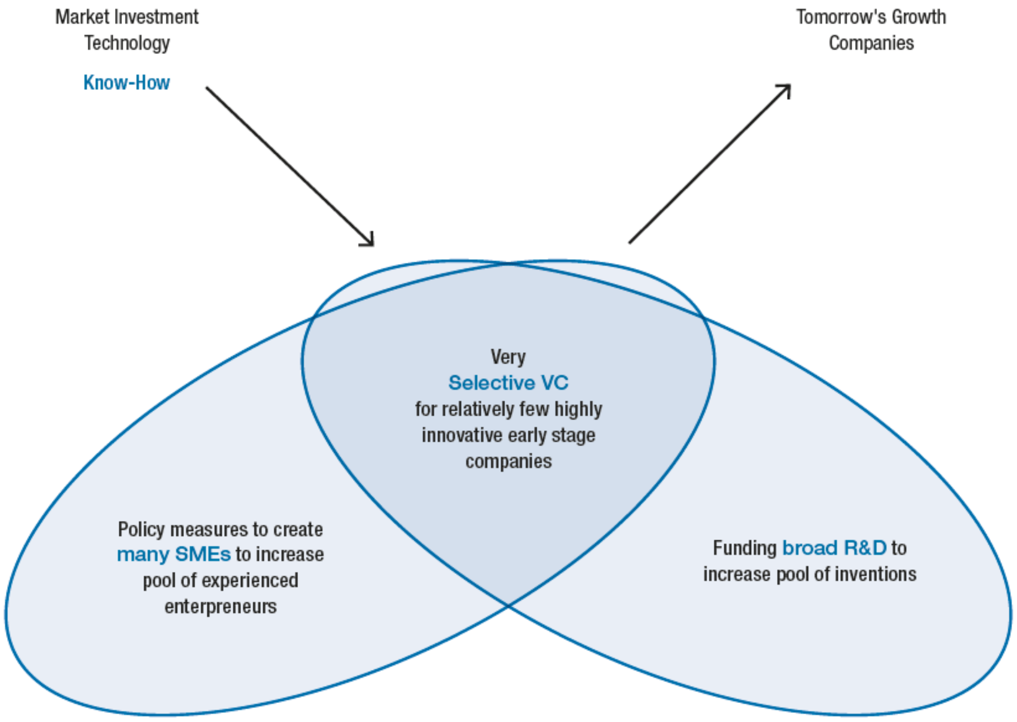
- Provides diversification, reducing risk, across a number of venture capital funds

The investment and governance model

- Dedicated team of professionals (the GP) trusted to identify, invest, support and sell stakes in high potential, private businesses
- Active and informed ownership (both strategic and financial support) driving value creation
- Medium to long term strategy and holding period
- Months, even years spent finding companies with the 'X' factor and conducting deep due diligence

Venture capital is highly selective

- Venture capital is not suitable for every start up with an idea
- Throwing money at a large group of companies does not increase the chance of success and will only decrease overall profits
- Venture capital relies on an existing pool of new ideas and technologies and entrepreneurs that want to pursue them



How do Venture and Enterprise Capital firms sell?

- **Businesses can be listed through "IPOs" on the stock market**
- **Many hi-tech growth companies are bought by larger corporations – this is common in venture capital**
- **Companies can be sold to other venture capital and enterprise capital funds – this is common in enterprise capital funds as funds often specialise in certain sizes of companies**

EUROPEAN PRIVATE EQUITY AND
VENTURE CAPITAL ASSOCIATION

Main Challenges for the industry: structural barriers to fundraising

Venture capital faces structural barriers to fundraising

There is an absence of a class of long-term investors with skills and interest in innovation & entrepreneurship. (e.g. university endowments, foundations and family offices).

For example there are only 2, 500 family offices in the EU, and 11, 000 in the US. There is a similar ratio in respect to pension funds and university endowments.

University Endowments within the EU allocate less than 2% of their assets to private equity as a whole, so even if the number or size of endowments grew significantly this would not be material to addressing the gap in financing for European venture.

In March 2010 EVCA published a white paper outlining a solution. Public sector financing could be used to attract private sector financing through a funds of funds scheme.

Main Challenges for the industry: increased and cumulative effect of direct and in-direct regulation

- Capital Requirement Adequacy Based Regulation for investors
  - Solvency II for insurance companies
  - IORP (Institutions for ocupational retirment provision) Directive Review – the potential reproduction of solvency II for IORPs
  - CRD III for Banks – CRD II has already seen many banks turn away from the industry

- Alternative Investment Fund Managers Directive
  - Although fund managers with less than €500 million do not fall under the directive this causes two problems:
    - They do not have access to a fund raising passport
    - They do not have the credibility with investors such as pension funds as they are not regulated.

Regulatory uncertainty can cause as many problems as the regulation itself with many investors, particularly insurance firms, freezing investment programmes.

Where can EU policy efforts help?

EU:

1. **Multiannnual programme for fund of funds**

2. **EU passport for small funds' managers**

Conclusions

- Venture and Enterprise capital cross many industry sectors and geographies. Its potential can not be fulfilled with narrow geographical, sectoral or stage oriented investment boundaries.

- To the help the industry to become sustainable, funding alone is insufficient, it is the smart deployment of capital that will build know-how which is critical.

- Private sector's involvement is necessary to bring in know-how.

- EU public policy efforts to be oriented to attract the private sector that would have significant impact on many EU companies by increasing the supply of VC.