The Economic Impact of Private Equity in the UK

Research study undertaken by IE Consulting
## Contents

- Foreword 2
- Executive summary 3
- Private equity and job creation 5
- Private equity and the UK economy 6
- Economic impact of venture companies 9
- Economic impact of MBOs 10
- Private equity in the regions 12
- The added value of private equity 14
- Private equity and the public markets 17
- The UK private equity industry 18
- Participant profile 21
- About the survey 22
- What is private equity? 24
Private equity-backed companies continue to be a significant driver of the UK economy and its global competitiveness. This is the key finding of this ninth report in the series, conducted by IE Consulting, supporting the previous surveys commissioned by the BVCA.

Private equity-backed companies create jobs at a considerably faster rate than other private sector companies. Over the five years to 2006/7, the number of people employed worldwide by UK private equity-backed companies increased by an average of 8% p.a. This compares dramatically with FTSE 100 and FTSE Mid-250 companies, at 0.4% p.a. and 3% p.a. respectively. Furthermore, 84% of responding companies said their growth was organic, rather than by acquisition, since they had private equity backing.

It is estimated that companies that have received private equity funding account for the employment of around 3 million people in the UK, equivalent to 21% of UK private sector employees.

Private equity-backed companies boost the UK economy. Over the five years to 2006/7, on average private equity-backed companies’ sales rose by 8% p.a., compared with FTSE 100 companies (6% p.a.) and FTSE Mid-250 companies (5% p.a.).

Exports grew by 10% p.a., compared with a national growth rate of just 4% and corporate investment rose by 11% p.a., compared with 3% nationally. In addition, R&D expenditure increased by 14% p.a., compared with national growth of 1% p.a.

91% of responding companies said that without private equity the business would not have existed at all or would have developed less rapidly.

Private equity investment is more than just the provision of capital. Nearly half of respondents listed strategic direction, financial advice and help with contacts as the three key ways in which private equity houses had helped with the development of their businesses.

For the financial year 2006/7, it is estimated that private equity-backed companies generated total sales of £310 billion, exports of £60 billion and contributed nearly £35 billion in taxes.

Accumulated over five years, total sales revenue of these companies adds up to an estimated £1,331 billion, with export value of £188 billion and tax contributions totalling £140 billion.
In just one generation, the venture capital and private equity industry has grown to become a dynamo for growth, innovation and enterprise. Britain is now a world leader in this sector – with one of the largest private equity markets globally, second only to the US.

This rapid growth has provoked debate. We welcome that debate, so long as it is based on fact. Sadly, too many of the criticisms we have faced are based on fiction. We need to do more to explain how our industry works, as transparency builds trust.

This extensive study – the ninth of its kind – is part of our effort to do just that. It shows the massive contribution that private equity and venture capital make to Britain, providing the seed capital for new businesses, helping existing businesses to grow, and making the whole economy more productive and competitive. Companies currently backed by private equity employ just over a million people, working across all regions and all sectors of the UK economy. Jobs and sales have both risen faster in companies backed by private equity than they have in companies in the FTSE 100.

Britain benefits from this success in other ways too. In just one year, 2006-7, it is estimated that private equity-backed companies contributed nearly £35 billion in taxes – enough to cover the entire amount the Government spends on Britain’s armed forces. Or, to put it another way, £35 billion would pay for all the nurses in the NHS in England, for three years. Meanwhile, today’s pensioners have also benefited from private equity – pension funds have been major investors in private equity, attracted by the superior returns it offers.

Making the British economy more productive, funding public services, securing tomorrow’s pensions: these are the foundations for the healthy, strong society we all want. And these foundations are being secured with the help of private equity. Our success to date is something of which we should be proud – and on which we now must build.

I would like to take this opportunity to thank our research team, led by Elissa Brodey, and IE Consulting for again producing this important research.

Wol Kolade
Chairman
BVCA – The British Private Equity and Venture Capital Association
February 2008
Private equity-backed companies have continued to increase staff numbers at a faster rate than other UK private sector companies.

During the five-year period to 2006/7, UK private equity-backed companies increased their worldwide staff levels by an average of 8% p.a. This is a significantly faster rate of growth than FTSE 100 and FTSE Mid-250 companies, at 0.4% and 3% respectively (see Figure 1).

Furthermore, 84% of responding companies reported their growth to be organic, rather than by acquisition, since they had private equity backing.

In the UK, we estimate that companies that have received private equity backing account for the employment of approximately 3 million people. This is equivalent to 21% of UK private sector employees. The average annual growth in UK staff levels of private equity-backed companies was 4% p.a., compared to the overall national level of 1%.

This year we have again estimated the number of people employed by companies that are currently backed by private equity. This figure stands at 1.1 million for the UK – 8% of UK private sector employees.

"UK employment growth in private equity-backed companies was four times that of the national average growth rate"
Around 1,300 UK businesses receive private equity investment each year. The exceptional growth of these companies has had a significant impact on the UK economy.

The performance of private equity-backed companies significantly strengthens the UK economy and improves our international competitiveness.

Annual sales growth rates for private equity-backed companies was 8% p.a., in the five years to 2006/7, compared to FTSE 100 and FTSE Mid-250 companies at 6% and 5% respectively (see Figure 2).

Exports grew by 10% p.a. over the five years, compared with a national growth rate of 4% and investment rose by 11% p.a., compared with the overall national level of 3%. In addition, R&D expenditure increased by 14% p.a., compared with national growth of 1% p.a.

Public revenues receive significant contributions from private equity-backed firms. It is estimated that, during the last tax year, they collectively contributed £4.6 billion in corporation tax, £13.8 billion in PAYE & NIC, £11.9 billion in VAT and a further £4.6 billion in excise, etc – a total of nearly £35 billion in taxes.

In aggregate, in the last financial year, private equity-backed companies generated an estimated £310 billion in sales revenue and £60 billion in export sales.

Accumulated over five years, total sales revenue of these companies adds up to an estimated £1,331 billion, with export value of £188 billion and tax contributions totalling £140 billion.

There are also the additional economic benefits resulting from increased competition such as economic efficiency, flexibility, innovation and capital investment. Furthermore, there is the second-order impact of purchases of goods and services by private equity-backed companies, which amount to a substantial proportion of aggregate turnover.

Figure 2. Comparative Annual Growth in Sales Revenue
Economic impact of venture companies

Venture companies have the potential for innovation and rapid growth – they are the foundation for the UK's future economic advancement.

Venture companies are at the start-up to expansion stage of their lives and therefore have huge growth potential. They use venture capital funding for product development and marketing, to set up their manufacturing and sales operations and to expand their business by employing new staff.

Of the companies that responded to the survey, 489 (51%) were venture-backed (non-MBOs).

Over the five-year period to 2006/7, venture firms in the sample increased their worldwide employment by 8% p.a., a much higher rate of growth than FTSE Mid-250 companies (at 3% p.a.). Their UK employment also grew by 6%, compared to a national rise in employment of 1% p.a.

86% of responding venture firms said that the growth of the business had been organic since receiving venture capital funding.

Sales growth over the five years was 12% p.a., again a higher rate of growth than FTSE Mid-250 companies (5% p.a.).

Venture firms grew their levels of corporate investment by 14% p.a. and R&D expenditure increased by 12% p.a. (compared with national growth rates of 3% and 1% p.a. respectively). The average value of exports from the UK increased by 14% p.a. (compared with 4% nationally).

69% of venture companies have introduced new products or services in the past two years and the majority thought that their level of investment was higher as a result of venture capital funding.

91% said that venture capital was responsible for the existence/survival of their businesses and allowed them to grow more rapidly.

Over half of venture companies felt that corporate investments and R&D expenditure were higher as a result of venture backing (57% and 54% respectively) and nearly half (49%) said that their levels of employment had been higher.
MBOs, by nature larger companies with higher sales revenues and more staff than venture companies, make up a substantial proportion of the economic contribution of private equity-backed companies.

MBOs in the sample accounted for 72% of aggregate turnover and 80% of UK employment reported by respondents.

They increased their worldwide employment over the five years to 2006/7 by 8% p.a., outstripping those of FTSE 100 and Mid-250 companies (each at 0.4% and 3% p.a. respectively). UK employment also grew by 4% p.a., compared to the 1% p.a. national increase.

MBOs increased their sales revenue over the period by 8% p.a., also higher than those of FTSE 100 and Mid-250 companies (at 6% and 5% respectively).

R&D expenditure and investment by MBO companies increased at an average annual rate of 17% and 11% respectively (compared to national rises of 1% and 3%).

75% of respondents thought that their MBO had had either a positive or a very positive impact in terms of more effective management and 68% thought that the MBO had given them more freedom to innovate.

Furthermore, our sample indicated that MBOs had a further impact at a micro-economic level in terms of providing more effective management and better incentives for their staff. For instance, only 22% of firms had an employee share ownership scheme before the MBO against 55% after. The proportion of employees participating in the share ownership schemes more than doubled during the period, from 9% to 22%.

In addition to the provision of finance, exactly half of MBOs considered that ‘financial advice’ was the most important contribution from their private equity investor.
Private equity in the regions

Throughout the UK, the benefits of private equity investment are evident

UK private equity firms invest across all sectors of the economy and all regions of the UK. The industry is supported by an extensive regional network of financial, professional and business service providers.

Aggregate statistics
By region, private equity-backed businesses in the South East and London made the largest contributions to the UK economy with combined sales of 51% of the total activity, 52% of total employment and 52% of total exports. It is estimated that over 200,000 work in businesses that have been backed by private equity in each of three other UK regions – North West, Yorkshire & Humber and Eastern.

Proportionally, private equity-backed businesses in London and the South East also make the largest contribution to UK taxes (51%). Elsewhere in the UK, the North West, Yorkshire & Humber and Scotland all represent a significant proportion of taxes.

Growth
In all regions, organic growth played a major role in the development of companies prior to private equity backing. In all regions, acquisition levels increased after the company received private equity funding, although organic growth remained the leading source of expansion. The West Midlands, Eastern, North West & Merseyside and the East Midlands are home to the largest proportion of companies (each accounting for over 20%) growing through acquisition.

The regional breakdown reveals that 82% of respondents from the North East have introduced new products and services over the past two years, followed by 71% in the South West and 70% in Wales.

Exits
Regional trends show that the North East region has the highest level of companies that still retain private equity-backing (80%). The South East, West Midlands, Wales and Eastern regions all accounted for over 70% of companies retaining private equity investment.

Contribution of private equity providers
On the whole, each region showed a similar trend in their positive view towards the contribution to their businesses by private equity houses. Companies in the Eastern region had the highest number of respondents that considered private equity to have been responsible for the existence/survival of the business (80%), while in Scotland, 88% of respondents believed that private equity had allowed the business to grow faster.

Overall, most regions have experienced a high impact on performance after private equity backing, with the North East, Northern Ireland, Wales and London standing out from the crowd. Highlights include R&D expenditure, where 56% of respondents in the North East have seen improved commitment. Some 83% and 80% of Northern Ireland investees have experienced both higher levels of investment and exports respectively since private equity funding; 46% of respondents in Wales saw an improvement in efficiency and 54% of respondents in London outlined profits as an area where they had experienced a positive impact on performance since receiving private equity backing.
Table 11. Investment by region

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of companies</th>
<th>% of companies</th>
<th>Amount invested (£m)</th>
<th>% of amount invested</th>
</tr>
</thead>
<tbody>
<tr>
<td>South East</td>
<td>224</td>
<td>17</td>
<td>1,835</td>
<td>18</td>
</tr>
<tr>
<td>London</td>
<td>330</td>
<td>25</td>
<td>4,297</td>
<td>42</td>
</tr>
<tr>
<td>South East &amp; London</td>
<td>554</td>
<td>42</td>
<td>6,132</td>
<td>60</td>
</tr>
<tr>
<td>South West</td>
<td>98</td>
<td>7</td>
<td>532</td>
<td>5</td>
</tr>
<tr>
<td>East of England</td>
<td>95</td>
<td>7</td>
<td>639</td>
<td>6</td>
</tr>
<tr>
<td>West Midlands</td>
<td>90</td>
<td>7</td>
<td>276</td>
<td>3</td>
</tr>
<tr>
<td>East Midlands</td>
<td>59</td>
<td>4</td>
<td>401</td>
<td>4</td>
</tr>
<tr>
<td>Yorkshire &amp; Humber</td>
<td>83</td>
<td>6</td>
<td>1,201</td>
<td>12</td>
</tr>
<tr>
<td>North West</td>
<td>146</td>
<td>11</td>
<td>614</td>
<td>6</td>
</tr>
<tr>
<td>North East</td>
<td>28</td>
<td>2</td>
<td>184</td>
<td>2</td>
</tr>
<tr>
<td>Scotland</td>
<td>78</td>
<td>6</td>
<td>174</td>
<td>2</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>28</td>
<td>2</td>
<td>13</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>1,318</td>
<td>100</td>
<td>10,227</td>
<td>100</td>
</tr>
</tbody>
</table>

NOTES

For previous years’ figures, see Appendix 5, Tables Ii-ii and Ji-ii.
Appendix 4 lists the counties included in the regions above.

- indicates a value of more than 0 but less than 0.5.

1. The above figures are estimated based on financial information provided by survey respondents for the 2006/7 tax year.
2. Northern Ireland could not be included in this analysis due to insufficient financial data received from the survey sample.
Private equity firms provide more than just financial contributions to their investee companies – they are also an invaluable source of guidance and advice.

Private equity-backed companies continue to view the contribution to their businesses by private equity investors as positive. 91% of respondents said that without private equity the business would not have existed at all or would have developed less rapidly.

50% of firms said that with private equity backing their level of investment was higher than would have otherwise been possible. Sales and employment growth were also cited as key factors in value added from private equity investment.

Respondents felt that their private equity investors contributed in ways other than the provision of funding (see Figure 4). Overall, they identified financial advice (49%), strategic direction (47%), and help with contacts (45%) as being key ways in which their investors had helped with the development of their business.
The UK stock markets are an important exit route for companies that have grown and flourished as a result of private equity backing.

In the ten years to 2006, approximately 30% of UK companies that floated on the London Stock Exchange (LSE) main market were private equity-backed. Furthermore, recent research commissioned by the BVCA and the LSE showed the after-market performance of private equity-backed IPOs was better than for those that did not receive private equity funding.

Since its establishment in 1995, the relative importance of the Alternative Investment Market (AIM) has also been increasing, with more and more companies choosing to list on it. 241 companies (including those backed by private equity) were admitted onto AIM in 2006, accounting for over a third (37%) of total IPOs in Europe, compared to 53 companies on the LSE Main Market.

The public-to-private market is also strong and is expected to remain so for the foreseeable future. Private equity firms took 21 companies private during 2006.

Of the private equity-backed companies responding to the survey, 27% said they were anticipating obtaining a stock exchange quotation. Of these, 25% expected to list within two years and a further 24% in three years.

Asked on which stock market they would pursue a listing, 57% of respondents expected to seek quotation on AIM, 21% on the Main Market of the London Stock Exchange and 5% on NASDAQ.

Figure 5. Preferred Stock Market of Private Equity-backed Respondents Expecting to List

1 Source: PricewaterhouseCoopers IPO Watch Europe – Review of the year 2006.
The UK private equity industry has been an important contributor to UK investment for decades. Since 1984, the amount invested by the UK private equity industry into UK businesses totals over £70 billion in around 25,000 companies.

The UK private equity industry continues to be the largest and most developed in Europe, and second only to the USA in world terms, accounting for 57% of total European private equity investment in 2006.

The BVCA was founded in 1983. In 1984 there were fewer than 50 full members and in that year they made 479 investments totaling £190 million. In 2006, BVCA full members invested £21.6 billion in 1,630 companies worldwide (£10.2 billion in 1,318 UK companies). Of those UK businesses invested in, 68% received amounts of less than £1 million.

There is also the economic impact of the private equity industry itself to take into account. The private equity industry is a significant component of the City of London and UK’s financial service sector. UK private equity firms employ over 9,000 people, of which some 5,000 professional executives actively invest in unquoted companies. There is a considerable infrastructure of firms supporting the industry. Very significant revenues (over £5bn in 2006) are generated in fees for accountants, lawyers, banks and other professional advisers through the industry’s fundraising, investment and divestment activities. A recently published report, The Impact of Private Equity as a UK Financial Service, shows the full extent of the UK private equity industry’s impact on the UK economy.

Figure 6. Value of Private Equity Invested Annually in the UK
Private equity firms invest in many different types of companies, which span a wide range of industries, regions and stages of development.

£47 million average turnover. The majority of private equity-backed companies are medium-sized and fast growing. The average sales revenue of the respondent company was exactly £47 million. The average respondent company employed just over 500 staff in the UK.

Private equity-backed companies often require further investments of equity capital to support growth. Many of the companies surveyed believed they would require further investments of equity capital to support rapid growth. 60% of responding companies received more than one round of investment.

Respondents ranged from small start-up companies to large buy-outs. Private equity investors provided funds for managers to buy out or buy into their company in 49% of cases and for 51% of the responding companies at the start-up to expansion stages.

71% of respondents reported that a private equity firm still held a stake in their company. It is not unusual for private equity investors to retain an equity holding after the flotation of their investee company. Investments have been held for an average period of around 3-5 years.

44% of responding companies were based in London and the South East.
This 2007 edition of the report continues to show evidence of the effect private equity funding has on investee companies' growth and the national economy.

Over the course of spring/summer 2007, details of the names and contact details of a random sample of private equity-backed businesses were compiled from information provided by the BVCA (from previous year’s surveys and private equity groups) and IE Consulting’s databases of private equity transactions. Where necessary, this information was supplemented with additional research to establish contact information.

Between April and July 2007, 6,100 potential respondents were contacted by post and email to explain the nature of the project and invite them to participate. Responses were gathered both as a result of unprompted returns as well as returns following a telephone prompt. By the cut-off date of 1st August 2007, 1,013 replies had been collected. The full report was then written up, being finalised in December 2007.

Companies included and defined in this report as ‘private equity-backed companies’ are companies that have, at some time, received private equity investment, regardless of whether a private equity investor still holds a stake in the company.

Since the 2006 report, however, we have been calculating the estimated number of people employed by currently private equity-backed companies.

The BVCA commissioned and sponsored the survey and provided overall guidance and support.

IE Consulting undertook the survey and analysis of the responses.

There is also a full, in-depth report of the survey available on request. For details of each of the organisations above or to find out how to order more copies of this and the full report from the BVCA, please see opposite.

The images used within this report represent the types of products manufactured or services provided by private equity-backed companies.
In the UK, Continental Europe and much of the rest of the world, 'private equity' means the equity financing of unquoted companies at many stages in the life of a company from start-up to expansion or even management buy-outs (MBOs) or buy-ins (MBIs) of established companies. 'Venture capital' is a subset of private equity, covering the seed to expansion stages of investment. Where this report uses the term 'private equity' it is taken to include 'venture capital'. 'Venture' or 'venture capital' has only been used when referring to that particular subset.

**The key elements of private equity and venture capital are:**

- investments in unquoted companies;
- equity capital by nature;
- medium to long term;
- targeted at companies with growth potential.

Private equity is invested in exchange for a stake in a company and, as shareholders, the investors' returns are dependent on the growth and profitability of the business.

The superior returns achieved by private equity investors have continued to attract funds from UK and foreign institutional investors, significantly increasing the flow of capital into this important and growing sector of the UK economy.
BVCA

The BVCA – The British Private Equity and Venture Capital Association – is the industry body for the UK private equity and venture capital industry. Our membership of well over 400 members represents the overwhelming number of UK-based private equity and venture capital providers and their advisers. The BVCA has 25 years of experience representing the industry, which currently accounts for 57% of the whole of the European market, to government, the European Commission and Parliament, the media, regulatory and other statutory bodies at home, across Europe and around the world. We promote the industry to entrepreneurs and investors, as well as providing services and best practice standards to our members.

3 Clements Inn
London WC2A 2AZ
T 020-7025 2950
F 020-7025 2951
bvca@bvca.co.uk
www.bvca.co.uk

For further copies of this report and/or copies of the full report, please contact the BVCA (contact details as above).

IE Consulting

IE Consulting is a global private equity consultancy specialising in research solutions and advisory services, with offices in London, Hong Kong and New York. The team has considerable experience in conducting primary research with private equity houses, institutional investors, investee company managers and intermediaries. Their work is widely used to aid strategic decision-making and performance assessments, to develop fundraising initiatives and streamline investor relations’ processes.

IE Consulting was founded as an affiliate of Initiative Europe, which has been researching Europe’s private equity industry since 1988 and, along with the AVCJ in Hong Kong, is part of the Alternative Assets Division of Incisive Media.

Incisive Media
Haymarket House
28-29 Haymarket
London SW1Y 4RX
T 020-7004 7461
F 020-7004 7545
info@ieconsulting.co.uk
www.engage-iec.com

Designed and produced by iUVO Design www.iuvodesign.com