

A high-angle, slightly blurred photograph of a large crowd of people walking in a public space, possibly a transit station or a busy street. The lighting is bright, creating strong shadows on the ground. In the foreground, a person is walking away from the camera, carrying a bag. This person is highlighted with a solid blue color, while the rest of the crowd is in grayscale. The overall atmosphere is one of a busy, public environment.

Apax
PARTNERS

**Private
equity
in the
public eye**

2007 global private equity environment rankings



Apax Partners is one of the world's leading private equity investment groups. It operates across the United States, Europe and Asia and has more than 30 years of investing experience. Funds under the advice of Apax Partners total \$20 billion around the world. These Funds provide long-term equity financing to build and strengthen world-class companies. Apax Partners Funds invest in companies across its global sectors of Tech & Telecom, Retail & Consumer, Media, Healthcare and Financial & Business Services.

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ABOUT THIS REPORT

This report was prepared by Apax Partners with the help of the Economist Intelligence Unit and contains the 2007 global private equity environment rankings. At a time when the industry is under fire like never before, the purpose of the ranking is to judge how easy it is for private equity firms to operate within a country.

The report also contains a discussion of some of the most important issues that the industry is currently facing. We would like to thank Phil Davis, Gareth Lofthouse, William Ridgers and Mike Kenny of the Economist Intelligence Unit.

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Foreword

Martin Halusa, CEO, Apax Partners

After years of relative obscurity, private equity has been thrust into the limelight and it is likely to stay there. In part a victim of its own success, the asset class has been accused of 'myopia' because its explosive growth has been matched by an unwillingness to explain its actions.

As the pendulum continues to swing from public to private ownership, the private equity model will come under even more intense scrutiny from the media, unions and politicians in years to come. For many in the industry who have worked in relative obscurity for most of their careers, this will continue to be an uncomfortable experience, but it is an inevitable part of a maturing asset class.

The concerns raised have differed from country to country, but have centred on the lack of transparency and accountability, the excessive debt levels and the narrow sense of fiduciary duty that are perceived to be hallmarks of private equity.

This political and media onslaught has certainly exposed a lack of preparedness and PR savvy. Most crucially, the industry has not been adequately geared-up to answer critics with robust data on its overall economic and social impact.

We recognise that, as owners of blue-chip companies, and as major employers, we have a duty to explain the benefits of private equity more thoroughly.

To do this we need to back up our pronouncements with concrete figures. The industry is already taking voluntary steps to improve its disclosure levels and it is also working hard to fill the void that exists in terms of statistics.

We already have a strong story to tell. Available studies show that private-equity-backed companies grow employment at a faster rate than their quoted counterparts. Top-line growth in the companies in which we invest also exceeds stockmarket benchmarks. Industry returns are strong and, especially among the larger buyout firms, have consistently out-performed other asset classes. The ultimate beneficiaries of this out-performance are the millions of individual investors that commit to the pension funds which are our largest investors.

This year's Apax Global Ranking Report in part reflects the importance of telling this story and winning the perception battle. Waning policy support in many European countries is already having a subtle impact on the rankings; if the backlash continues, it will surely have a more pronounced impact on the rankings in years to come, in what is a global and highly mobile industry.

May, 2007

EXECUTIVE SUMMARY

Private equity is an industry in the pink. New assets soared by 38% last year, returns are as strong as ever and financial services groups are reaping the rewards of working alongside private equity groups. Investors, including the growing ranks of pension fund investors, are generally satisfied with their risk-adjusted returns.

Yet all is not well. Public and political opinion in some countries has turned against private equity in recent times, and the industry stands accused of secrecy, asset-stripping and profiteering. It is hard to think of another industry that has grown by more than one-third, creating jobs and paying its taxes along the way, yet has been vilified to such an extent.

To a certain degree, private equity has become a victim of its own success. Excellent performance has attracted ever more assets into the industry and these have been deployed in some of the largest and highest-profile companies. Thus, for the first time, private equity has been brought into the public arena. And it finds itself facing a rather angry lion. The industry, perhaps belatedly, has realised that ignoring the danger could lead to a worsening of the current situation and has started to mobilise. It is now busy proclaiming its virtues through a network of industry bodies and individual firms. It has also—wisely—started to listen to concerns and is taking steps to address some of them directly. In this way it has avoided further accusations that it is aloof and does not take some of the fears seriously.

Such efforts are vital. It would be costly if the industry's achievements continued to be overshadowed by issues that could, with effort, be resolved. These very achievements have persuaded more diverse and larger numbers of investors to participate in private equity. Pension funds raised 25% of private equity assets in Europe last year, overtaking banks for the first time, with the lion's share going to those funds demonstrat-

ing the best performance. Funds of private equity funds and listed vehicles, with smaller minimum investment levels, are bringing a degree of democracy to the asset class. And the possibility of a US\$30bn buyout fund this year has been suggested by a senior industry figure.

Predictions of ever larger funds are all the more credible in the light of evidence from the rankings compiled especially for this report. A new risk indicator has been added that strengthens the position within the rankings of the developed countries. Rational private equity industry participants will undoubtedly have concluded that the risks associated with larger funds are mitigated by a stable environment for currencies, interest rates and asset prices in developed economies.

This is not to say that emerging markets do not offer substantial opportunities. Despite the relative difficulties of completing transactions in India and China, much attention is now focused on these countries. Private equity firms will probably bide their time before committing large parts of their capital base to emerging markets, but they also know that geographical diversification and establishing a global presence are key for the top tier investors.



PRIVATE EQUITY IN THE PUBLIC EYE

It is no exaggeration to say that the image of private equity is reeling from the weight and range of attacks it has endured in recent times. Scrutiny of the buyout segment of the industry by media, politicians and trades unions has reached fever pitch in many countries. The accusers allege a lack of transparency, asset-stripping, value destruction, job losses and overpaid private equity executives. The UK, second only to the US in the Economist Intelligence Unit's rankings of national private equity environments, has witnessed some of the most trenchant criticism in recent months. But dissenting voices are heard elsewhere in Europe and even in the US, the frontline of capitalism.

In deciding how to respond, the industry has been unsure whether to regard itself as a victim of baseless attacks or at fault for not better explaining its mission. The reality probably lies somewhere in between. It is not widely acknowledged, for example, that a private equity buyout is likely to create jobs, not destroy them. Or that it usually improves a company's performance. As Rod Selkirk, chairman of the British Venture Capital Association (BVCA), says: "We are portrayed as asset-strippers and destroyers, which is at odds with the facts. However, we acknowledge the concerns—deals involving high-profile companies are bound to attract scrutiny."

Another, longer-standing, debate over private equity has also heated up over the past year. Some investors and market participants have expressed concerns that the wall of money the industry has attracted has inflated buyout prices and debt levels. Indeed, private equity raised a record US\$102bn in 2006, according to Thomson VentureXpert, up 20% on 2005. Trades unions in several European countries have warned of the consequences of overburdening companies with debt. Even Wellcome Trust, Europe's largest charity and one of its largest private equity investors, urged caution over prices and debt levels in its annual report.

But Wellcome also said the risks could be mitigated by finding new return seams. Danny Truell, chief investment officer of Wellcome, says: "We look for groups with clear advantages in terms of size, area of expertise or geography." As with any industry, innovation is the key to ongoing growth.

Any doubts over prices and performance must be met head-on with hard facts. And the fact is that private equity returns have powered ahead. Figures released by the European Private Equity and Venture Capital Association (EVCA) in March 2007 showed that upper-quartile buyout funds generated returns of 37.6% in 2006, although the bottom quartile suffered a negative return of 10.2%. In the US, preliminary figures from the National Venture Capital Association (NVCA) indicate average buyout returns of more than 20%.

Venture capital, the smaller cousin, has been resurgent. A record €6.55bn (US\$8.2bn) was raised in Europe last year, according to data from Library House, a research company. Doug Richard, chairman of Library House, says: "Venture capital is flowing into Europe right now at an accelerated pace. As an asset class it is starting to show returns comparable to the US."

This asset-raising reflects attractive performance although, even more so than in the buyout sector, fund selection is crucial: upper-quartile venture capital funds

Global funds over US\$5bn

| Fund Year | Firms | No. of Funds | Aggregate capitalisation (US\$m) | Average capitalisation (US\$m) |
|-----------|-------|--------------|----------------------------------|--------------------------------|
| 2000 | 4 | 4 | 23,155.6 | 5,788.9 |
| 2001 | 3 | 3 | 17,121.4 | 5,707.1 |
| 2003 | 4 | 4 | 23,634.1 | 5,908.5 |
| 2005 | 9 | 10 | 80,145.4 | 8,014.5 |
| 2006 | 11 | 12 | 106,169.5 | 8,847.5 |

Source: Dealogic.

Private equity fundraising

2006

| | No. of funds | Amount (US\$bn) |
|-----------------------|--------------|-----------------|
| Buyout funds | 138 | 149.6 |
| Venture capital funds | 279 | 40.6 |

Source: Thomson VentureXpert.

generated annual returns of 23.6% in 2006, whereas bottom quartile generated negative returns of 20.4%, according to the EVCA. In the US, the average venture capital return was 11%, according to the NVCA.

The long-term return trends are particularly persuasive: private equity funds on average generated net annual returns of 10.3% over the ten years to end-2006, according to the EVCA. This compares with an adjusted 5.5% annual return over ten years in the Morgan Stanley Euro Equity index.

Taken together, these figures belie the suggestion of an industry in turmoil. And yet, privately and publicly, “turmoil” and “crisis” are the words on the lips of many private equity professionals.

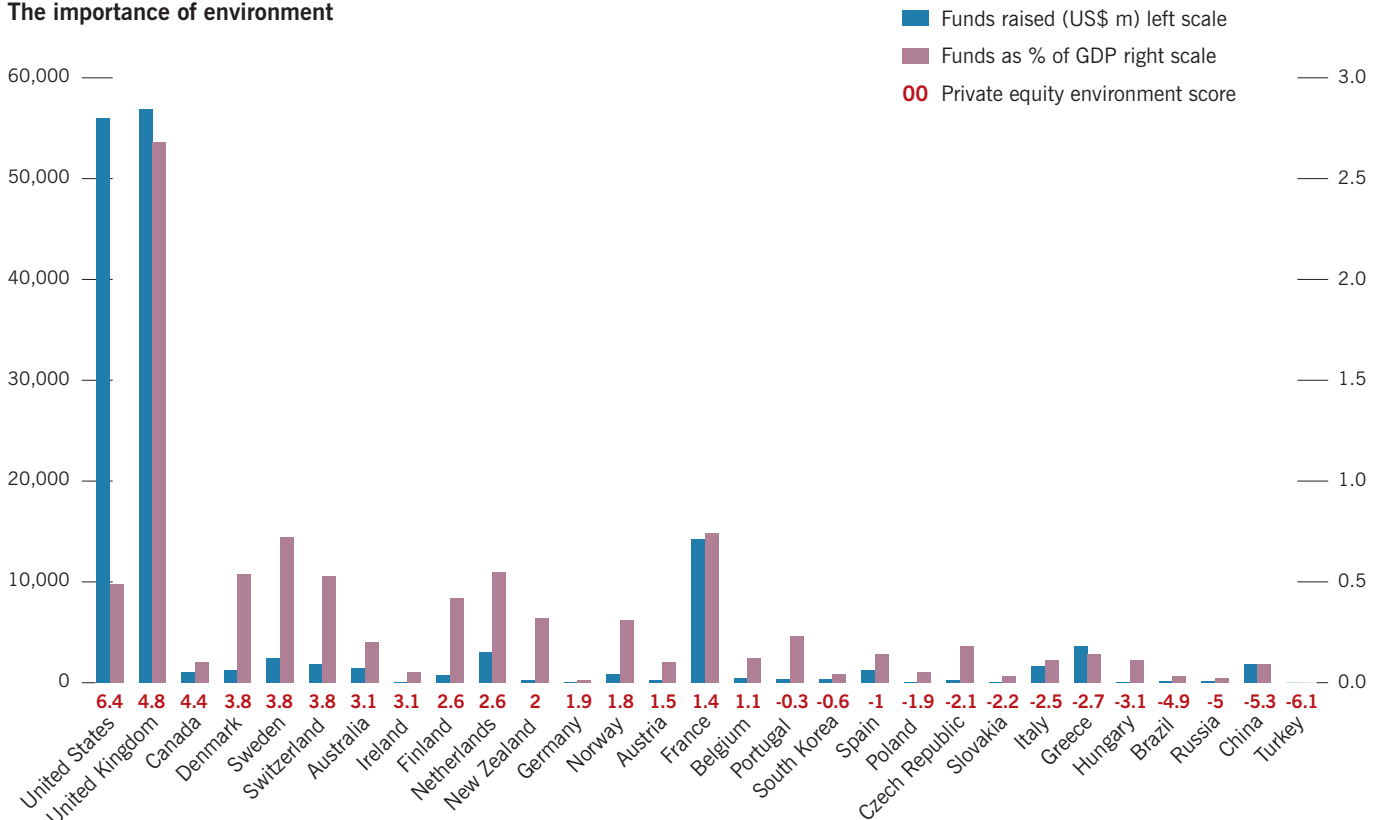
The politicised private equity landscape

The US and the UK are firmly at the top of our private equity rankings, unchanged from last year. Indeed, a new set of risk indicators this year, factoring in stockmarket, currency and interest rate volatility, has cemented the position of all the developed nations at the high end of the rankings.

Conversely, Russia and China remain among the worst environments for the industry, while Turkey has become the least hospitable of all. Financial risk factors play strongly against all of them. This ought to make the myriad firms currently setting up shop in China tread a little more cautiously than they might have done anyway.

But the key indicators this year—and the ones to watch in the future—are those that reflect the shifting political environment. Before examining the rankings, it is worth outlining exactly what has driven the political debate. Ostensibly, private equity entered the European public consciousness for the first time in 2005, when a German minister labelled its exponents “locusts”. The throwaway nature of the jibe should not be allowed to hide the issues that lie

The importance of environment



Sources: Economist Intelligence Unit; EVCA; Thomson VentureXpert.

beneath it. These include:

- Globalisation and the fear of foreign corporate “raiders”.
- The increasing wealth gap between the haves and have-nots in general and concern over high levels of executive pay.
- The different perceptions of fiduciary duty. In mainland Europe it is skewed towards stakeholders such as staff and suppliers, whereas the Anglo-Saxon model champions the shareholder.
- Larger deals mean big-name companies are controlled by buyout firms of which the public has little or no knowledge.

The result, regardless of whether it is deserved, is that in some countries private equity has become a symbol of unfettered capitalism that creates inequality and an unfair distribution of wealth.

The effects can be seen in the rankings (see the legal and policy environment indicator) in the cases of Germany and Hungary, two countries in which politicians have been particularly outspoken. Hungary has held back approval for private equity deals, and Peer Steinbrück, Germany’s finance minister, is introducing a bill to stop German companies deducting unlimited interest payments from profits. Companies in Denmark, Holland and Sweden have also been criticised in the media for dealing with private equity groups.

As noted above, there is also growing scrutiny of private equity from some quarters in the US and the UK. Attitudes among trades unions in the UK have hardened. Brendon Barber, the secretary-general of the Trades Union Congress (TUC) and the highest-ranking official in the UK’s trades union movement, argues that private equity firms have made high returns by ruthlessly reducing companies to their core functions, exploiting tax relief and offshoring, and saddling companies with added debt.

The UK authorities may also take limited action to tighten up regulation. A Treasury select committee has been set up to look into the industry and will call on executives from some of the UK’s leading firms to appear before it. The Treasury, a significant beneficiary of private equity tax receipts, is known to be looking closely at the use of loan notes by equity providers. Interest on these notes is unlikely to qualify for tax breaks in the future.

In the US, some congressmen and trade union leaders are arguing for a change in the way that private

equity is taxed. Most notably, Democrat congressman Barney Frank is expressing concern over the effect that buy-outs have on a company’s workforce.

The crucial question centres on whether the current wave of unrest will have a concrete impact on the private equity industry. The BVCA’s Mr Selkirk, who also presides over Hermes’s £1.8bn (US\$3.6bn) private equity portfolio, does not believe so. “It doesn’t make it any easier to do deals, but it won’t stop them either,” says Mr Selkirk. “In the end it comes down to a commercial decision. Every deal needs a counterparty—if institutional shareholders don’t sell, it won’t happen.”

Selling the message: private equity learns to communicate

Certainly, the level of fundraising and returns indicate a healthy overall climate for dealmaking. But the industry is starting to realise the dangers of complacency. Allowing the criticism of private equity activity to grow unchecked will undoubtedly create future difficulties. Martin Halusa, chief executive of Apax Partners, says: “This issue is not going to just go away overnight. The industry has been utterly unprepared for this. It has been politically naive.”

The industry has begun to mobilise to deliver the same messages about the benefits of private equity that its clients have been receiving for years. The main industry lobbying bodies, the NVCA, EVCA and BVCA, have been supplemented by the creation of new groupings such as the Private Equity Consortium in the US. Some of the large buyout houses have also independently beefed up their media relations efforts. One of their first tasks has been to defend taper relief on carried interest, as UK Treasury officials examine the ways in which private equity partners are rewarded.

These groups are making sure that the message about the beneficial effects of private equity on the economy and society is spread as far as possible. In their view some of the tangible key benefits are:

- The European private equity industry created 1m jobs between 2000 and 2004, according to a 2005 survey by the EVCA, a compound annual growth rate of 5.5%—or eight times the 0.7% average growth rate in the 25 EU member states.
- In the UK alone, private equity accounts for 19% of all private-sector employees. In the past five years, private equity and venture-backed companies increased staffing by 9%, significantly faster than FTSE 100 companies, which took on employees at the rate of 1% a year.

- Financial and professional services firms in the UK generated £3.3bn in revenue from services to the private equity industry in 2005, 7% of their total turnover.
- Buyouts improve companies. Jerry Cao, a doctoral candidate at Boston College, and Josh Lerner, a Harvard Business School professor, found that buyout offerings from 1980 to 2002 returned 43%, on average, over the subsequent three years, versus just 26% for the S&P 500 over the same period.

In terms of responding to the more nebulous concerns over the transparency provided by buyout funds, private equity firms say the strength of inflows to the industry is the most compelling data indicating that levels of transparency are satisfactory. Mr Halusa, whose firm manages US\$20bn of assets, says: "Investors have zero guarantees and the costs are relatively high, but they believe in our ability to produce sustainable performance."

As well as attempting to change perceptions, the private equity industry is taking tangible measures to assuage fears. Take the issue, exploited with some enthusiasm by trades unions in the UK, that public companies taken into private hands become less accountable to their stakeholders. The notion that some companies should continue to report at the same level as when they were publicly listed has gained widespread support, both inside and outside the industry. The BVCA, for one, believes there is a case to be made for imposing strict reporting rules in some cases. Mr Selkirk says: "Is it appropriate for a £10bn company to be taken private and then only have to file short-form accounts? Probably not. It still has a duty to report to staff, suppliers, pensioners and unions."

This issue is currently being addressed by a BVCA

working group, chaired by Sir David Walker, a former banker and City regulator, and is due to report its findings in the second half of 2007.

But increased transparency needs to be considered carefully. Some argue that only when it is genuinely in the public interest should a private equity house be forced to reveal what could be a significant competitive advantage.

The Wellcome Trust, one of the largest institutional investors in buyout and venture funds, with more than £1bn in private equity, has been vocal in its support for the existing model. Its chief investment officer Danny Truell says: "Too often in the private equity discussion, the views of owners, such as Wellcome, are not taken into consideration. The general partners provide a lot of information to us and it would be a retrograde step if increased transparency was at the expense of the ultimate owners."

Tangible measures can also be applied to smooth the brows of those that say private equity partners have accumulated excessive amounts of personal wealth. Just as Bill Gates and Warren Buffett, the two highest-profile figures in US business, used highly visible donations to charity to bolster their respective images, so the luminaries of private equity could similarly burnish their reputations, they believe. Public efforts have already begun: early this year about 800 executives from US and European buyout firms met to establish the Private Equity Foundation, a charitable trust.

Big buyout funds about to get bigger

The relatively low volatility of mature economies revealed in the rankings is likely to encourage the launch of ever larger buyout funds. As this report was published, Goldman Sachs had just raised a US\$20bn fund and Blackstone was putting the finishing touches to a

Top ten firms

Ranking of private equity firms by capital raised over the last five years

| Rank | Firm name | Headquarters | Capital raised (US\$bn) | % of total* |
|------|---|--------------------------|-------------------------|-------------|
| 1 | The Carlyle Group | Washington, DC | 32.5 | 5.9 |
| 2 | Kohlberg Kravis Roberts | New York | 31.1 | 5.6 |
| 3 | Goldman Sachs Principal Investment Area | New York | 31.0 | 5.6 |
| 4 | The Blackstone Group | New York | 28.4 | 5.2 |
| 5 | TPG | Fort Worth, Texas | 23.5 | 4.3 |
| 6 | Permira | London | 21.5 | 3.9 |
| 7 | Apax Partners | London | 18.9 | 3.4 |
| 8 | Bain Capital | Boston | 17.3 | 3.1 |
| 9 | Providence Equity Partners | Providence, Rhode Island | 16.4 | 3.0 |
| 10 | CVC Capital Partners | London | 15.7 | 2.8 |

*Percentage of the total raised by the PEI 50 companies since 1st January 2002
Source: Private Equity International

Going private

Value of deals in which acquired company subsequently delisted

| Year | Total value of deals (US\$m) | No. of deals |
|------|------------------------------|--------------|
| 2002 | 17,628.57 | 50 |
| 2003 | 29,125.19 | 80 |
| 2004 | 62,218.93 | 70 |
| 2005 | 47,687.45 | 35 |
| 2006 | 118,586.58 | 54 |

Source: Dealogic.

similarly-sized vehicle. Funds of more than US\$10bn are now commonplace. But there is more to come, says Thomas Kubr, managing director of Capital Dynamics, one of the largest allocators to private equity funds. He believes there is a “fifty-fifty chance of a US\$30bn fund being launched before the end of the year”.

Some might doubt the ability of a fund of this size to find a home for all the money. The concern seems valid until you consider that only one S&P 500 company, Sabre Holdings, has been bought. That leaves a lot of market capitalisation for private equity to target.

In fact, the more valid argument is whether current levels of funding would allow the acquisition of a major conglomerate. The fact that club deals, that bring together occasionally reluctant bed partners, are on the rise suggests the private equity market is far from fully mature. As Mr Kubr says: “General partners hate club deals. But if the target is big it’s a reality. If you are buying US\$5bn of equity you may need a US\$50bn fund and that doesn’t exist yet. So club deals will continue.”

Venture capital expands beyond Silicon Valley

With the dividing line between success and failure so thin in venture capital, the entrepreneurial environment is a key factor. Anglo-Saxon countries provide

Demand explosion

Total private equity funds raised, US\$1bn and over (2002-06)

| Year | Gross period amount raised (US\$m) | Total target (US\$m) |
|------|------------------------------------|----------------------|
| 2002 | 70,376.8 | 90,191.0 |
| 2003 | 91,721.9 | 119,947.7 |
| 2004 | 138,732.1 | 163,659.0 |
| 2005 | 275,443.2 | 255,976.5 |
| 2006 | 343,648.4 | 349,191.8 |

Source: Thomson VentureXpert.

the best locations for venture-backed companies, the rankings show, with the US, the UK and Canada leading the pack. France and Japan, two of the world’s biggest economies, do not provide infrastructure at all conducive to venture capital, suggesting that economic growth in those countries could suffer in future years.

With France and Germany languishing outside the top ten, mainland Europe is widely believed to be lacking adequate infrastructure to promote venture capital. Certainly most venture portfolios are trained on California (Wellcome Trust being a prime example) and increasingly on Asia, which has faster growth. Europe still suffers from the fact that, as a latecomer to the late 1990s high-tech boom, it suffered disproportionately when the bust came. Simon Cook, chief executive of Esprit Capital Partners, says: “A lack of a European equivalent of Google means investors are looking elsewhere, but they could be making a mistake.”

Recent deals, including the US\$200m injected this year into Plastic Logic, the largest venture capital investment in Europe, does suggest that Europe’s fortunes are changing. Amadeus Capital, an investor in Plastic Logic, which makes electronic transistors out of plastic, believes the company might just be the Google-equivalent Europe has been searching for. Hermann

Top ten equity buyouts in 2006

| Company | Deal value (US\$m) | Sector | Country |
|--------------------------------|--------------------|-------------------------|-------------|
| Equity Office Properties Trust | 38,886.59 | Real Estate/Property | US |
| HCA Inc | 32,674.98 | Healthcare | US |
| Freescale Semiconductor Inc | 17,600.00 | Computers & Electronics | US |
| Albertson’s Inc | 17,356.00 | Retail | US |
| Hertz Corp | 15,000.00 | Transportation | US |
| TDC A/S (87.9%) | 13,872.39 | Telecommunications | Denmark |
| Univision Communications Inc | 13,632.94 | Telecommunications | US |
| SunGard Data Systems Inc | 11,760.48 | Computers & Electronics | US |
| VNU NV | 10,998.03 | Publishing | Netherlands |
| AWG plc | 9,986.16 | Utility & Energy | UK |

Source: Thomson VentureXpert.

Wellcome Trust

Wellcome Trust, the world's second-largest charity with £13.9bn in total assets, has an unusually high weighting to alternative assets for a European institution. More than 11% of the assets are invested in buyout and venture capital funds, and £6bn in total is allocated to alternatives. Danny Truell, Wellcome's chief investment officer, explains the large allocation to the asset class.

"As a charitable foundation we don't have a defined set of liabilities so we are not preoccupied by short-term returns. This encourages our private equity managers to build up com-

panies rather than seek short-term returns by trading their portfolio companies."

With Wellcome's private equity returns averaging 25% over the past 30 years, the strategy is not in doubt.

Wellcome employs a significant amount of private equity managers: it has 74 managers and 167 funds in its £1.14bn buyout portfolio and 65 managers and 160 funds in its £465m venture capital portfolio. Mr Truell says the large quantity of funds creates diversification so there is not overdependence on, for instance, the US buyout sector. "There is no right amount," he says. "Our selection is driven by the quality of the people and by our desire to position ourselves in different parts of the market."

Hauser, chief executive of Amadeus, says: "This is the first time a new semi-conductor has been made of anything but silicon. These kinds of deals do not come along every week."

Other evidence suggests that Europe may be gaining ground on the US. OECD figures show that the number of US companies among the 250 largest high-tech firms in the world shrank from 153 in 2000 to 116 in 2005. In addition, the US invests nine times more in venture capital than Europe, yet Europe has one in four of the exits by total value. In both regions, the average exit is worth US\$251m, but in Europe input investments are just US\$40m compared to US\$70m in the US, according to Esprit Capital Partners. And then there is the curious case of the iPod, the iconic Silicon Valley success story. Of total input costs of US\$150, just US\$3 goes to US firms, according to analysis by Jeffries & Co, a US investment bank. The rest is earned by companies in Europe and Asia. In fact, there is nine times more European technology in an iPod than US technology.

All comparisons aside, the venture capital industry has rarely looked so attractive. Globology, the convergence of technology and globalisation, has provided a level playing field for entrepreneurs worldwide and facilitating the entry of new participants from all corners of the earth. Venture capital is within a hair's breadth of finally shaking off the stigma of the high-tech boom and bust. Significant flows of money to the asset class will surely follow.

Emerging markets ride out concerns over risk

It is one thing to invest in the publicly traded shares of emerging-market companies but quite another to attempt complicated private equity deals, complete with restructuring of balance sheets and operations.

Many private equity firms have established bases in

Asia, but the challenges are significant. Let us compare the continent with North America, which has two main languages and one main currency, or with Europe, which has 25 countries, 17 languages and one dominant currency. Asia, by contrast, is utterly disparate: no two countries have the same language, currency or culture. Although Japan and China are neighbours, they have almost nothing in common politically, culturally or economically. Even the best minds in private equity have their work cut out identifying and managing such diverse sources of risk.

Nevertheless, the buyout sector in Asia is building at a rapid rate. The big buyout firms have all established a presence: KKR, CVC, Permira, Blackstone, Apax and so on. But a host of regional players, such as Hong Kong-based Affinity Equity Partners, has also sprung up.

India, which moved up four places in the rankings, has proved a particular draw for both buyout and venture funds. The volume of private equity activity in India tripled in 2006 to US\$7.46bn according to Venture Intelligence, and is on course to top US\$10bn in 2007.

Asia just possibly offers venture capital investors the same sort of excitement that California generated back in the 1970s. Mr Cook says: "Silicon Valley has a 20-year track record and has been rewarded for being brave and ambitious. India and China are now seeing lots of VCs setting up and replicating this model." However, while venture capital has taken off in China, the political climate does not yet offer the prospect of a buyout market.

But emerging markets, even Turkey—which languishes at last place in the rankings—represent an undoubted opportunity for private equity to spread its wings and apply its business know-how to a new and dynamic market.

Conclusion

There is no doubt that private equity is fundamentally in good shape. The numbers tell us that fundraising and returns in all private equity deal stages have rarely, if ever, been better. Even new opportunities and approaches, notably in emerging markets, are already bearing fruit.

However, the fortunes of the industry are not just based on sound fundamentals. Perceptions also matter.

Scrutiny of private equity is increasing even in countries that have historically taken a benign view of the industry. Private equity houses appear now to realise the potential the criticism has to damage their business and have started to react. As a consequence, there will be an increased focus on communicating the benefits of private equity to the marketplace. The degree of success private equity firms have in defending their image will ultimately be reflected in the numbers: if they fail to win over hearts and minds, there could be fewer deals to talk about in next year's report and a marked deterioration in the rankings of some of the leading nations. They should not let complacency deter them from their task. Private equity has a good story to tell, but it needs to keep telling it—over and over again.



PRIVATE EQUITY ENVIRONMENT RANKINGS

Private equity environment rankings 2007

| Rank (last year in brackets) | Country | Score |
|------------------------------------|--------------------|-------|
| 1 (1) | UNITED STATES | 6.4 |
| 2 (2) | UNITED KINGDOM | 4.8 |
| 3 (4) | CANADA | 4.4 |
| 4 (5) | DENMARK | 3.8 |
| 5 (8) | SWEDEN | 3.8 |
| 6 (7) | SWITZERLAND | 3.8 |
| 7 (3) | AUSTRALIA | 3.1 |
| 8 (10) | IRELAND | 3.1 |
| 9 (12) | NETHERLANDS | 2.6 |
| 10 (11) | FINLAND | 2.6 |
| 11 (6) | NEW ZEALAND | 2.0 |
| 12 (15) | GERMANY | 1.9 |
| 13 (13) | NORWAY | 1.8 |
| 14 (16) | AUSTRIA | 1.5 |
| 15 (17) | FRANCE | 1.4 |
| 16 (9) | BELGIUM | 1.1 |
| 17 (14) | ISRAEL | -0.1 |
| 18 (18) | PORTUGAL | -0.3 |
| 19 (20) | SOUTH KOREA | -0.6 |
| 20 (21) | SPAIN | -1.0 |
| 21 (23) | JAPAN | -1.7 |
| 22 (19) | POLAND | -1.9 |
| 23 (26) | CZECH REPUBLIC | -2.1 |
| 24 (25) | SLOVAKIA | -2.2 |
| 25 (24) | ITALY | -2.5 |
| 26 (27) | GREECE | -2.7 |
| 27 (22) | HUNGARY | -3.1 |
| 28 (32) | INDIA | -4.5 |
| 29 (31) | MEXICO | -4.5 |
| 30 (29) | BRAZIL | -4.9 |
| 31 (30) | RUSSIAN FEDERATION | -5.0 |
| 32 (33) | CHINA | -5.3 |
| 33 (28) | TURKEY | -6.1 |

Source: Economist Intelligence Unit.

This is the second year that the private equity rankings have been published, and therefore the first in which meaningful observations can be made on whether countries are becoming more or less friendly to private equity.

There was one significant change to the methodology this year: the inclusion of a risk category. The rationale for this is that volatility in economic growth and financial markets can lead to boom-and-bust in the private equity acquisition cycle. Volatility can also hurt corporate performance, increase the burden of debt servicing, make planning difficult for investors and potentially prevent private equity investors from recouping returns from their acquisitions either through initial public offerings (IPOs) or profit growth. The material impact of adding the risk category has been to cement the places of developed economies at the top of the ranking and less developed ones at the bottom.

One example of this is Turkey, which fell five places to bottom of the ranking. It also has the worst risk score of any of the countries surveyed. In Europe, where eleven countries return perfect risk scores, those that perform poorly, such as Belgium and Hungary, have also seen their ranking affected. However, despite generally having their ranking buoyed by the inclusion of the risk rating, many of the large European economies still fare relatively badly. Germany lies in twelfth place, France 15th and Italy a lowly 25th. These economies have less experience of private equity and, indeed, it is often viewed with suspicion. Environments that are geared towards stakeholders, rather than entrepreneurs, also adversely affect their ranking.

There is a perception that private equity is an Anglo-Saxon phenomenon, and this seems to be borne out by the ranking. The top three countries—the US, the UK and Canada—could all be described as conforming to the Anglo-Saxon model; Australia and Ireland also feature in the top ten. All of these countries offer a

stable regulatory framework, encourage market-based competition, have highly developed financial systems (which usually means well-funded pension funds) and foster entrepreneurial policies and attitudes that are likely to encourage higher levels of private equity.

However, despite the countries at the top of the ranking being the source of the majority of private

equity, the ranking is not an indicator of overall private equity activity. Inevitably the lure of large markets such as China and India mean that firms will look to do business in these countries even if the environment is challenging. Perhaps it is more useful to think of the rankings thus: imagine how much more investment there might be, if only the environment were better.

| COUNTRY | Overall rank | Overall environment for private enterprise | Financing environment | Market opportunities | Legal and policy environment | Entrepreneurial environment | Risk |
|--------------------|--------------|--|-----------------------|----------------------|------------------------------|-----------------------------|------|
| AUSTRALIA | 7 | 1 | 6 | 6 | 9 | 5 | 17 |
| AUSTRIA | 14 | 16 | 19 | 30 | 17 | 8 | 1 |
| BELGIUM | 16 | 14 | 12 | 29 | 13 | 14 | 14 |
| BRAZIL | 30 | 28 | 32 | 33 | 27 | 16 | 31 |
| CANADA | 3 | 10 | 8 | 2 | 3 | 3 | 1 |
| CHINA | 32 | 32 | 24 | 22 | 33 | 27 | 29 |
| CZECH REPUBLIC | 23 | 22 | 18 | 24 | 24 | 31 | 20 |
| DENMARK | 4 | 3 | 14 | 14 | 4 | 4 | 1 |
| FINLAND | 10 | 5 | 15 | 5 | 8 | 28 | 1 |
| FRANCE | 15 | 11 | 9 | 12 | 19 | 32 | 1 |
| GERMANY | 12 | 11 | 11 | 13 | 16 | 25 | 1 |
| GREECE | 26 | 26 | 26 | 28 | 25 | 22 | 20 |
| HUNGARY | 27 | 23 | 28 | 26 | 15 | 24 | 32 |
| INDIA | 28 | 31 | 31 | 27 | 32 | 13 | 27 |
| IRELAND | 8 | 13 | 7 | 8 | 5 | 10 | 12 |
| ISRAEL | 17 | 21 | 22 | 11 | 12 | 11 | 20 |
| ITALY | 25 | 27 | 20 | 23 | 26 | 29 | 20 |
| JAPAN | 21 | 18 | 5 | 25 | 29 | 33 | 15 |
| SOUTH KOREA | 19 | 17 | 23 | 17 | 21 | 12 | 20 |
| MEXICO | 29 | 30 | 30 | 32 | 30 | 20 | 28 |
| NETHERLANDS | 9 | 7 | 4 | 16 | 11 | 23 | 1 |
| NEW ZEALAND | 11 | 4 | 17 | 18 | 10 | 2 | 17 |
| NORWAY | 13 | 15 | 13 | 15 | 14 | 19 | 1 |
| POLAND | 22 | 24 | 25 | 20 | 22 | 17 | 20 |
| PORTUGAL | 18 | 19 | 16 | 19 | 18 | 15 | 17 |
| RUSSIAN FEDERATION | 31 | 33 | 27 | 7 | 31 | 21 | 30 |
| SLOVAKIA | 24 | 25 | 29 | 21 | 20 | 18 | 20 |
| SPAIN | 20 | 20 | 21 | 9 | 23 | 26 | 16 |
| SWEDEN | 5 | 9 | 10 | 3 | 6 | 7 | 1 |
| SWITZERLAND | 6 | 6 | 2 | 10 | 7 | 9 | 1 |
| TURKEY | 33 | 29 | 33 | 31 | 28 | 30 | 33 |
| UNITED KINGDOM | 2 | 8 | 3 | 4 | 1 | 6 | 1 |
| UNITED STATES | 1 | 2 | 1 | 1 | 2 | 1 | 12 |

Source: Economist Intelligence Unit.

PRIVATE EQUITY ENVIRONMENT RANKINGS: COUNTRY PROFILES

1

| United States | Rank |
|--|----------|
| Overall rank | 1 (1) |
| Overall environment for private enterprise | 2 (5) |
| Financing environment | 1 (1) |
| Market opportunities | 1 (1) |
| Legal & policy environment | 2 (2) |
| Entrepreneurial environment | 1 (1) |
| Risk | 12 (n/a) |

The US maintains its position as the world's best environment for private equity investment. It remains comfortably ahead of the second-placed UK. Indeed, compared with last year, it has even strengthened its position in the overall environment for private enterprise category.

Strengths

The US scores well virtually across the board. It is the world's pre-eminent economy, and so offers significant market opportunities. This is backed up by a workforce with excellent technical skills and high-quality management. Its financing environment is second to none, unmatched in its ability to provide imaginatively tailored financing for large and small borrowers, for corporations and individuals. Furthermore, with a stockmarket capitalisation many times higher than its competitors, it offers unparalleled financing depth.

Weaknesses

GDP growth is likely to decelerate over the next year, with the housing and manufacturing sectors, in particular, struggling. The US dollar will also come under pressure, adding a modicum of risk for private equity investments compared with euro zone countries.

2

| United Kingdom | Rank |
|--|---------|
| Overall rank | 2 (2) |
| Overall environment for private enterprise | 8 (2) |
| Financing environment | 3 (3) |
| Market opportunities | 4 (2) |
| Legal & policy environment | 1 (1) |
| Entrepreneurial environment | 6 (6) |
| Risk | 1 (n/a) |

The UK remains second in the rankings. It still lags considerably behind the US, while the gap between it and the third-placed country—now Canada—has narrowed noticeably. Despite that—and recent trenchant criticism from media and political figures—it is comfortably the best private equity environment in Europe. The UK government operates with a very light touch in the corporate arena, giving business as much freedom as possible to compete without state intervention.

Strengths

The UK's trump card is its legal and policy environment. Compared with many of its European counterparts, there are few restrictions on private equity fund formation and operation, and the government is encouraging of private equity investment. More generally, the UK's strengths as a business location include a favourable attitude to free enterprise and competition, an unusually relaxed disposition to foreign direct investment (FDI)—particularly to foreign takeovers of domestic companies—flexible labour markets and deep and sophisticated capital markets.

Weaknesses

Despite its strong position, several factors could weigh on the UK's attractiveness as a business location over the next few years. High levels of household indebtedness pose a threat to the stability of the macroeconomic environment. The tax regime is becoming more burdensome, unpredictable and complex. And productivity could be affected by the relatively poor technical skills of the workforce.

3

| Canada | Rank |
|--|---------|
| Overall rank | 3 (4) |
| Overall environment for private enterprise | 10 (9) |
| Financing environment | 8 (4) |
| Market opportunities | 2 (7) |
| Legal & policy environment | 3 (5) |
| Entrepreneurial environment | 3 (4) |
| Risk | 1 (n/a) |

Canada moves up a place to number three in this year's ranking. It is helped by a better performance in the market opportunities category—in which it now ranks second—and by a perfect score in the newly-added risk category. Pension funds accounted for the largest share of new capital (34%) raised by buyout and mezzanine funds in 2005. However, US institutional investors account for a large portion of this, as Canadian pension fund managers tend to be more risk-averse.

Strengths

Alongside a very low risk rating, Canada's main strength is its market opportunities. Canada has a well-educated and growing workforce and also has huge scope for market consolidation. This is aided by favourable merger and acquisition (M&A) and takeover regulation. Canada also scores well for its legal and policy and entrepreneurial environments.

Weaknesses

Canada ranks only moderately for its overall environment for private enterprise. The ability of foreign companies to compete in Canada is limited by federal foreign ownership restrictions in a number of major industries, including banks, insurance companies, airlines and telecommunications. Many smaller industries, such as book publishing, liquor sales and real estate, are affected by either federal or provincial ownership restrictions. There are signs, however, that the Conservative government will attempt to remove restrictions and regulations in a number of sectors, including telecoms.

4

| Denmark | Rank |
|--|---------|
| Overall rank | 4 (5) |
| Overall environment for private enterprise | 3 (3) |
| Financing environment | 14 (12) |
| Market opportunities | 14 (17) |
| Legal & policy environment | 4 (4) |
| Entrepreneurial environment | 1 (5) |
| Risk | 1 (n/a) |

Denmark has improved slightly to number four in the ranking. It is the highest-ranking Scandinavian country. Along with many of the euro zone countries, it returns a perfect risk score. It also ranks first for its entrepreneurial environment, usurping the UK. However, pension funds and insurance companies have quantitative restrictions (10%) on their investments in private equity funds, meaning that its financing environment scores less well.

Strengths

Alongside its entrepreneurial environment, Denmark scores well for its overall environment for private enterprise. The Danish culture is very open to foreign influence. According to the World Bank, it takes just three procedures over five days to start a business in Denmark, compared with an OECD average of 6.2 procedures over 16.6 days. Denmark also scores particularly highly for its transparent and diversified financial system, characterised by a strong, profitable (and hence low-risk) banking sector.

Weaknesses

One of the main risks to Denmark's favourable outlook is the prospect of shortages of qualified labour. With slow population growth and labour force participation already at a high level, a significant tightening of the labour market is expected. The relatively small size of the market will also restrict opportunities.

5

| Sweden | Rank |
|--|---------|
| Overall rank | 5 (8) |
| Overall environment for private enterprise | 9 (11) |
| Financing environment | 10 (18) |
| Market opportunities | 3 (9) |
| Legal & policy environment | 6 (10) |
| Entrepreneurial environment | 7 (8) |
| Risk | 1 (n/a) |

Sweden has moved up to fifth, a rise of three places on last year. It has shown significant improvements in its scores for its financing environment and its market opportunities. According to Eurostat, both early-stage venture capital investment and private equity investments in later-stage companies were about twice the EU15 (pre-accession) average as a percentage of GDP in 2005. However, the industry has become increasingly under fire from the Swedish media.

Strengths

Market opportunities are good. The technical skills of the workforce are high, as is the quality of management. Furthermore, the financing environment is improving. The banking system has experienced a significant turnaround since the mid-1990s, and the leading banks can now boast healthy balance sheets.

Weaknesses

Sweden has a number of areas of weakness, including a high level of personal taxation, the tax treatment of private equity funds and fairly rigid labour market regulations. Moreover, these deficiencies are set to become even more of a drag on the country's overall ranking during the next few years.

6

| Switzerland | Rank |
|--|---------|
| Overall rank | 6 (7) |
| Overall environment for private enterprise | 6 (4) |
| Financing environment | 2 (5) |
| Market opportunities | 10 (16) |
| Legal & policy environment | 7 (7) |
| Entrepreneurial environment | 9 (13) |
| Risk | 1 (n/a) |

Switzerland rises a place to number six in the private equity environment ranking. According to Eurostat it has above-average private equity and venture capital investment, when compared with the EU15. Insurance companies and pension funds can invest in private equity, albeit with certain quantitative restrictions.

Strengths

As one might expect of one of the world's leading banking centres, Switzerland's particular strength is its financing environment. Switzerland's financial markets are highly developed and well regulated. Financing conditions are considered to be among the best in the world. A further favourable factor for businesses is the efficiency of the administration. This, and the relatively low level of government interference, mean that the time spent by companies on government-related administrative tasks is low by European standards.

Weaknesses

The major weak point is limited access to Switzerland's domestic market as a result of the slow pace of liberalisation, the lack of competition in many sectors and remaining barriers separating Switzerland from the EU.

7

| Australia | Rank |
|--|----------|
| Overall rank | 7 (3) |
| Overall environment for private enterprise | 1 (1) |
| Financing environment | 6 (7) |
| Market opportunities | 6 (3) |
| Legal & policy environment | 9 (13) |
| Entrepreneurial environment | 5 (2) |
| Risk | 17 (n/a) |

Australia is one of the big losers in this year's ranking. The introduction of a risk category has seen the country drop from third to seventh position—it rates below many European competitors when it comes to banking, currency, sovereign and economic risk. The government has been a big supporter of private equity. There are clear arrangements for fund formation and venture capital limited partnerships.

Strengths

Australia's biggest strength is its overall environment for private enterprise. Distortions due to state intervention in the economy are relatively low and protection of intellectual property is excellent. Furthermore, the government's overall policy towards business also scores highly. The labour market, often considered a weak spot in the Australian economy, is expected to improve following substantial labour market reforms introduced in early 2006.

Weaknesses

Less attractive features for business investors include Australia's tax system, particularly its high taxes on personal income. The comparatively small size of the Australian market, coupled with sluggish growth, will constrain market opportunities.

8

| Ireland | Rank |
|--|----------|
| Overall rank | 8 (10) |
| Overall environment for private enterprise | 13 (10) |
| Financing environment | 7 (10) |
| Market opportunities | 8 (22) |
| Legal & policy environment | 5 (3) |
| Entrepreneurial environment | 10 (12) |
| Risk | 12 (n/a) |

Rapid economic growth and an ever-improving workforce means that Ireland has improved to eighth in the 2006 ranking, with a sharp rise in its market opportunities rating. Its legal and policy environment remains strong, with the government very open towards private equity investment.

Strengths

Consistency in policy over decades—in the 1950s Ireland was one of the first countries actively to seek FDI—and the professionalism of state agencies have been central to Ireland's recent success in attracting high levels of inward investment. Successive governments have recognised the importance of FDI in boosting Ireland's growth potential and have used it as a fast-track to modernisation from a relatively low level of industrialisation in the 1950s.

Weaknesses

Although growing fast, the small size of the Irish economy will hinder opportunity. Furthermore, there is little public financing for early-stage companies and still a certain degree of suspicion of entrepreneurs engrained in the culture.

9

| Netherlands | Rank |
|--|---------|
| Overall rank | 9 (12) |
| Overall environment for private enterprise | 7 (8) |
| Financing environment | 4 (8) |
| Market opportunities | 16 (15) |
| Legal & policy environment | 11 (12) |
| Entrepreneurial environment | 23 (19) |
| Risk | 1 (n/a) |

The Netherlands ranks ninth globally and sixth in Europe (up from ninth and eighth, respectively, last year). While it scores well in some categories, notably for its financing environment and risk, it continues to perform badly in others—it has now dropped four places to 23rd for its entrepreneurial environment.

Strengths

Financing conditions in the Netherlands are extremely favourable. The banking system is well capitalised, the equity market is liquid, the regulatory system is sound and there is equal access for both domestic and non-resident borrowers to the local capital market. Distortions due to state intervention in the economy are very low and protection of intellectual property is very high.

Weaknesses

The country scores less well for its entrepreneurial environment. It is particularly stymied by high personal and capital taxes, and relatively few fiscal incentives for research and development (R&D).

10

| Finland | Rank |
|--|---------|
| Overall rank | 10 (11) |
| Overall environment for private enterprise | 5 (6) |
| Financing environment | 15 (14) |
| Market opportunities | 5 (5) |
| Legal & policy environment | 8 (8) |
| Entrepreneurial environment | 28 (28) |
| Risk | 1 (n/a) |

Finland has remained fairly stable compared with last year, moving no more than one position in any of the categories. It ranks somewhat lower than two of its Scandinavian counterparts, Denmark and Sweden, but above Norway. Its biggest assets are a strong overall environment for private enterprise and good market opportunities. It lags behind when it comes to its entrepreneurial environment, however.

Strengths

The environment for private enterprise is excellent, when considering factors such as protection of private and intellectual property, competition policy, corruption and the judiciary. A highly skilled labour market and top-notch management are also significant strengths.

Weaknesses

The level of state ownership in the Finnish economy remains high, but successive governments have been gradually reducing public ownership since the mid-1990s through a process of (mainly partial) privatisation. The still rigid labour market will remain one of the less attractive aspects of Finland's business environment.

11

| New Zealand | Rank |
|--|----------|
| Overall rank | 11 (6) |
| Overall environment for private enterprise | 4 (7) |
| Financing environment | 17 (11) |
| Market opportunities | 18 (10) |
| Legal & policy environment | 10 (15) |
| Entrepreneurial environment | 2 (3) |
| Risk | 17 (n/a) |

New Zealand has seen a significant fall in its ranking, dropping from sixth to eleventh. As with its neighbour Australia—ranked four places above it—the major reason for this has been the introduction of the risk category. On the other hand it has slightly improved on its already-excellent ratings for overall environment for private enterprise and entrepreneurial environment.

Strengths

Culturally, New Zealand is one of the most pro-entrepreneur countries in the world. Tax rates are generally positive and fiscal incentives for R&D are good. This is coupled with authorities that encourage competition and cut back on red tape.

Weaknesses

Slow GDP growth and small market size hamper market opportunities. There is little financing depth, compared with many other OECD economies, and there is little demand for local IPOs.

12

| Germany | Rank |
|--|---------|
| Overall rank | 12 (15) |
| Overall environment for private enterprise | 11 (13) |
| Financing environment | 11 (9) |
| Market opportunities | 13 (18) |
| Legal & policy environment | 16 (11) |
| Entrepreneurial environment | 25 (24) |
| Risk | 1 (n/a) |

As Europe's pre-eminent economy, Germany fares relatively badly, ranking 12th globally and eighth in Europe. It has improved by three places on last year, however, mainly owing to its risk rating. Outside of risk, Germany ranks averagely across four categories and distinctly poorly for its entrepreneurial environment. It has also been at the forefront of political criticism of private equity firms—from a government minister's famous description of them as locusts to the plans to stop German companies deducting unlimited interest payments from profits. Despite this, private equity firms have increased their activities in the country over the past three years. According to Ernst & Young, the value of direct investment by private equity firms increased by 17% in the first half of 2006 compared to the previous six-month period, to reach €20.8bn at end-June.

Strengths

The liberal trade and foreign-exchange regime is among the most attractive features of the German economy. It also continues to be a comparatively rich and open economy with sophisticated markets. Its highly developed infrastructure is also an important asset. The legal and regulatory environment for financing is sound, but the conditions for direct capital market access and start-up financing will improve only gradually. Germany does reasonably well on competition policy, general policy towards private enterprise, and policy towards foreign investment and financing conditions.

Weaknesses

Weaknesses include an excessively regulated labour market with high wages and a high tax burden. Unsurprisingly, reform efforts are being targeted at these two areas. Continuing reforms of income and business taxation will improve Germany's relative position in the tax category, and a major overhaul of labour market regulation, which started in 2003 and is still being implemented, will lead to an improvement of Germany's score. However, both will remain less favourable than other aspects of the business environment.

13

| Norway | Rank |
|--|---------|
| Overall rank | 13 (13) |
| Overall environment for private enterprise | 15 (11) |
| Financing environment | 13 (16) |
| Market opportunities | 15 (11) |
| Legal & policy environment | 14 (14) |
| Entrepreneurial environment | 19 (14) |
| Risk | 1 (n/a) |

Norway is the lowest-ranking Scandinavian economy. With the exception of risk, which in common with many west European economies returns a perfect score, it ranks moderately in all categories. Although it offers no significant advantages, it equally offers few significant drawbacks. Insurance firms and pension funds have quantitative limits on private equity investment.

Strengths

Despite its relatively moderate ranking, many features remain highly favourable or are expected to undergo improvement. The macroeconomic environment, in particular, is one of Norway's strong points. The country benefits not only from its huge offshore natural resource endowment, but also from its predictable, and for the most part credible, public policymaking, embodied in transparent fiscal guidelines, an independent central bank, and recent improvements to the conduct of monetary policy.

Weaknesses

To pay for its fiscal priorities, the government is reversing some of the tax cuts implemented by its predecessor. It has also put an end to the process of gradually divesting state shares in strategic companies. Most importantly, the labour market will remain characterised by high unit labour costs, a large proportion of workers seeking early retirement and sickness and disability benefits, and stronger wage growth in many sectors compared with Norway's main trading partners.

14

| Austria | Rank |
|--|---------|
| Overall rank | 14 (16) |
| Overall environment for private enterprise | 16 (16) |
| Financing environment | 19 (17) |
| Market opportunities | 30 (21) |
| Legal & policy environment | 17 (16) |
| Entrepreneurial environment | 8 (11) |
| Risk | 1 (n/a) |

Compared with other west European economies, Austria's private equity environment ranks fairly poorly. However, the financing of innovative, growth-oriented firms through private equity and venture capital is becoming more popular, with a growing number of companies offering their services.

Strengths

Reflecting the government's ambitious structural reform agenda since 2000, there has been a policy shift towards greater liberalisation and privatisation, with the aim of strengthening Austria's attractiveness as a location for inward investment and improving the economy's long-term growth potential. This has led to the streamlining of the large public sector, the implementation of pension and healthcare reform and a reduction in the country's relatively high tax burden.

Weaknesses

Austria's market opportunities ranking is poor—only Turkey, Mexico and Brazil score lower. This is partly attributable to below-average growth, a small market size and concerns over the technical skills of the workforce. Although there has been a steady increase in the flow of immigrants since the mid-1990s, only a low proportion of those entering the country have been highly skilled.

15

| France | Rank |
|--|---------|
| Overall rank | 15 (17) |
| Overall environment for private enterprise | 11 (13) |
| Financing environment | 9 (13) |
| Market opportunities | 12 (6) |
| Legal & policy environment | 19 (18) |
| Entrepreneurial environment | 32 (25) |
| Risk | 1 (n/a) |

France ranks disappointingly. Compared with its euro zone competitors only Belgium, Portugal, Spain, Italy and Greece fare worse. Particularly worrying is its entrepreneurial environment score, in which it ranks 32nd out of 33 countries. French institutional investors tend to be highly conservative. In 2005, no private equity investments registered in the data provided to the French Federation of Insurance Companies.

Strengths

Microeconomic reforms will help to increase competition in sectors previously dominated by state monopolies. The government's direct role in the economy will decline as state assets are sold off, but the process will be driven more by budgetary imperatives than by any doctrinal commitment to privatisation per se.

Weaknesses

The state plays a more interventionist role than in most other EU countries, notably by promoting "national champions" and obstructing foreign takeovers of French companies in sectors that are considered to be "strategic". Meanwhile, the size of the state and the structural weakness of the public finances ensure that the tax burden remains high by international standards, and the labour market is hampered by excessive levels of regulation.

16

| Belgium | Rank |
|--|----------|
| Overall rank | 16 (9) |
| Overall environment for private enterprise | 14 (15) |
| Financing environment | 12 (2) |
| Market opportunities | 29 (12) |
| Legal & policy environment | 13 (17) |
| Entrepreneurial environment | 14 (10) |
| Risk | 14 (n/a) |

Belgium is the biggest faller in the ranking, dropping seven places to 16th. This is mainly down to a worsening in the financing environment—the demand for local IPOs has tailed off over the past year. It can also be attributed to a significant drop in the market opportunities category—partly because of a downgrade in its score for technical skills of the workforce and also because there is now less scope for consolidation in the market.

Strengths

Until recently, Belgian businesses struggled with red tape and local restraints on competition. However, during the past seven years the government's priority has been to transform the ethos of government to one of service to citizens and businesses. For example, the government set itself the target of reducing the number of days required to start up a new business from 56 days in 2003 to only three days in 2005. Although the latter target appears not to have been achieved, there have been considerable improvements—the OECD considers obstacles to business start-ups to be below the OECD average.

Weaknesses

The labour market is one of the less flexible among the member states of the EU. Social insurance costs are high, as are costs of dismissal, so employers are not inclined to take on new employees until they are confident that they will be able to afford high labour costs and need them for a long time ahead. Even if planned changes do something to alleviate the effect on business, the overall level of taxation will remain high.

17

| Israel | Rank |
|--|----------|
| Overall rank | 17 (14) |
| Overall environment for private enterprise | 21 (23) |
| Financing environment | 22 (22) |
| Market opportunities | 11 (14) |
| Legal & policy environment | 12 (6) |
| Entrepreneurial environment | 11 (7) |
| Risk | 20 (n/a) |

Israel remains the highest-ranked non-OECD country. However, it has slipped three places since last year, mainly because of its relatively poor risk rating. The development of the venture capital industry in Israel has been the most impressive and, arguably, one of the most important achievements in the country's financial sector over the past ten years.

Strengths

Israel has recently accelerated the pace of liberalisation and privatisation and is likely to make further advances in these areas—albeit at an unsteady pace, with a lull likely during periods of government instability. The issue of intellectual property rights has received more attention of late, but there is considerable scope for further progress. It also has a strong commitment to promoting foreign investment, a favourable attitude towards investment protection and a business culture that is open to foreign influence.

Weaknesses

The renewed upsurge in fighting in mid-2006, first in the Gaza Strip and then between Israel and Hizbullah in Lebanon, highlights the underlying volatility of, and constant threat to, Israel's political stability.

18

| Portugal | Rank |
|--|----------|
| Overall rank | 18 (18) |
| Overall environment for private enterprise | 19 (18) |
| Financing environment | 16 (19) |
| Market opportunities | 19 (28) |
| Legal & policy environment | 18 (19) |
| Entrepreneurial environment | 15 (9) |
| Risk | 17 (n/a) |

Portugal's ranking is decidedly average. It ranks between 15th and 20th in all categories, and, aside from a fairly significant improvement in market opportunities—mostly because of greater scope for consolidation—its numbers have changed little since last year.

Strengths

The government is expected to make steady progress with its privatisation programme. Portugal's financial sector is efficient, well regulated and competitive, but relatively small in size. It is by far the most modern and competitive of all Portuguese economic sectors.

Weaknesses

Despite the recognition in Portugal of the need for a more flexible labour market, reforms are proceeding slowly. Another problem is the overall low level of skills in the labour force, which inhibits investment in technology. Thus, although Portugal's labour-intensive sectors continue to suffer from lower-cost competition from eastern Europe and Asia, these are not being replaced by technology-intensive industries.

19

| South Korea | Rank |
|--|----------|
| Overall rank | 19 (20) |
| Overall environment for private enterprise | 17 (20) |
| Financing environment | 23 (25) |
| Market opportunities | 17 (8) |
| Legal & policy environment | 21 (23) |
| Entrepreneurial environment | 12 (15) |
| Risk | 20 (n/a) |

South Korea ranks 19th, the highest-placed Asian economy. Given the performance of the Asian countries in this report, however, this is not saying much. With the exception of its entrepreneurial environment, it fares poorly in all categories. It has seen a drop in its market opportunities rating partly because there is deemed to be less scope for consolidation.

Strengths

One of strengths of South Korea's business environment relative to that of its regional peers is the quality of its macroeconomic environment. Its labour force is highly educated and strongly motivated, working the OECD's longest hours.

Weaknesses

Nevertheless, labour will continue to be an issue on at least three fronts: cost, flexibility and militancy. The first is inexorable: although the unions' constant upward pressure on wages may harm competitiveness, as an OECD economy South Korea's comparative advantage can no longer derive principally from cheap labour.

20

| Spain | Rank |
|--|----------|
| Overall rank | 20 (21) |
| Overall environment for private enterprise | 20 (17) |
| Financing environment | 21 (20) |
| Market opportunities | 9 (19) |
| Legal & policy environment | 23 (21) |
| Entrepreneurial environment | 26 (27) |
| Risk | 16 (n/a) |

Spain performs poorly virtually across the board. The exception is in the market opportunities category, where it has climbed ten places to ninth. Spain has less private equity or venture capital investment than the EU15 average. Pension funds have quantitative restrictions on investment—generally no more than 30% of assets in non-listed companies and no more than 30% in private investment funds. Insurance companies are restricted to certain types of assets and may not invest in non-listed firms.

Strengths

Spain's strengths include its economic openness, policy towards foreign investment, the quality of its financial markets, its infrastructure, and its good market opportunities.

Weaknesses

The least attractive aspects of the business environment continue to be the labour market and the tax system. Labour laws remain restrictive, productivity growth is among the lowest in the developed world, and the cost of living is rising steadily. As for taxes, although most direct rates are being reduced, the corporate tax regime is not competitive (particularly vis-à-vis the EU's new east European member states) and social security contribution rates are high and often burdensome.

21

| Japan | Rank |
|--|----------|
| Overall rank | 21 (23) |
| Overall environment for private enterprise | 18 (20) |
| Financing environment | 5 (6) |
| Market opportunities | 25 (13) |
| Legal & policy environment | 29 (30) |
| Entrepreneurial environment | 33 (32) |
| Risk | 15 (n/a) |

Despite its size and wealth, the world's second-largest economy fares poorly. Indeed, it is only saved from being even further down the ranking by its excellent financing environment. It now ranks in last place for its entrepreneurial environment, and fares little better with its legal and policy environment. Venture capital and private equity firms have made some important and high-profile investments in recent years, but constitute only a tiny part of the financial system. There are now no restrictions on institutional investors investing in private equity, but insurance companies and pension funds still invest very conservatively.

Strengths

Japan's healthy position in the financing category reflects the significant improvements made in the financing environment in recent years. Most important, the health of the financial sector has improved to the extent whereby the banks are once again starting to become drivers rather than a drag on overall growth. Japan also boasts political stability and a highly skilled workforce.

Weaknesses

The tax base is very narrow. One issue is the generous minimum tax thresholds. Around one-quarter of Japanese workers pay no income tax at all and exemptions also discourage female participation in the job market. A similar problem arises with corporate taxation, with companies that record losses being exempt from having to pay company tax. Estimates suggest that around 70% of Japanese companies pay no tax for this reason. A further important concern is the inevitability of hefty tax rises over the next few years as the government seeks to restore its wobbly finances.

22

| Poland | Rank |
|--|----------|
| Overall rank | 22 (19) |
| Overall environment for private enterprise | 24 (25) |
| Financing environment | 25 (15) |
| Market opportunities | 20 (20) |
| Legal & policy environment | 22 (20) |
| Entrepreneurial environment | 17 (17) |
| Risk | 20 (n/a) |

Despite slipping three places, Poland remains the best-placed of the central and east European countries. Its fall is mainly because of a deterioration in its financing environment—it has seen a fall in demand for local IPOs. Venture capital investment in Poland is barely measurable. The private equity market is a little stronger, but still low in EU terms.

Strengths

The macroeconomic environment on offer to foreign investors is set to improve over the next five years, and the combination of relatively slow growth in wages and rapid growth in productivity will do much to maintain the attractiveness of Poland as an investment location, especially as several of its regional rivals may suffer from faster wage growth in the forecast period. The sharp cut in the corporate tax rate in 2004 has helped Poland to improve its attractiveness to foreign investors.

Weaknesses

The problem of public-sector corruption has become a major issue in Poland, and we expect an increasingly assertive press to keep the issue in the public eye. As well as corruption, businesses in Poland have complained vociferously about the excessive regulatory burden placed on them by the government. The World Bank's Doing Business report ranks Poland as the worst performer among the EU's new member states in terms of the ease of starting a new business and in dealing with government-required licences.

23

| Czech Republic | Rank |
|--|----------|
| Overall rank | 23 (26) |
| Overall environment for private enterprise | 22 (22) |
| Financing environment | 18 (23) |
| Market opportunities | 24 (23) |
| Legal & policy environment | 24 (28) |
| Entrepreneurial environment | 31 (33) |
| Risk | 20 (n/a) |

The Czech Republic has improved to 23rd in the ranking, in the process overtaking Hungary and Slovakia to become the second-placed central and east European country. Neither pension funds nor insurance companies have quantitative limits on investing in private equity, although they are often risk-averse. Furthermore, a lack of long-term investors, such as pension funds and banks, makes it difficult for private equity firms to enter the market.

Strengths

Although there are still many problems related to the financing environment in the Czech Republic, the country scores relatively well owing to the strength of its banking system. Banking sector privatisation, which was completed in 2002, has placed 95% of all solvent bank assets in foreign hands. In addition, before the transition, the banking sector was already far more sophisticated in the Czech Republic than in other east European countries.

Weaknesses

Although the country has implemented extensive reforms in many areas and often almost approximates EU practice, it continues to lag significantly behind the EU15 in a number of respects. Inefficient bureaucracies are unlikely to be up to the task of implementing many EU laws properly. The lag is also considerable when it comes to general institutional reforms (effectiveness of government, corruption, the rule of law and quality of the bureaucracy).

24

| Slovakia | Rank |
|--|----------|
| Overall rank | 24 (25) |
| Overall environment for private enterprise | 25 (24) |
| Financing environment | 29 (30) |
| Market opportunities | 21 (27) |
| Legal & policy environment | 20 (22) |
| Entrepreneurial environment | 18 (18) |
| Risk | 20 (n/a) |

Slovakia moves up a place in the ranking to 24th, although it now ranks below its neighbour, the Czech Republic. The financing environment for private equity firms is poor. Pension funds and insurance companies are not allowed to invest in private investment funds. Furthermore there is no legal fund structure for private equity.

Strengths

The country is clearly benefiting from reforms adopted in 2002-05 that markedly improved the business environment and put financing of healthcare and social benefits on a sustainable footing. Furthermore, the government's responsible fiscal policies stabilised the economy, which suffered from excessively high public finance deficits until 2002. Tax reform, which cut income taxes and placed more emphasis on indirect taxation, increased the tax take, and has made Slovakia more attractive for foreign investors.

Weaknesses

Slovakia has room to make serious improvement in its environment for private enterprise, including giving businesses greater freedom to compete, cutting corruption and red tape, and protecting intellectual property.

25

| Italy | Rank |
|--|----------|
| Overall rank | 25 (24) |
| Overall environment for private enterprise | 27 (26) |
| Financing environment | 20 (21) |
| Market opportunities | 23 (25) |
| Legal & policy environment | 26 (24) |
| Entrepreneurial environment | 29 (26) |
| Risk | 20 (n/a) |

For one of Europe's biggest economies, Italy performs abysmally in the ranking. Indeed, there is no category in which it claims to offer a significant advantage to private equity firms. Despite this, venture capital and asset-management firms are making gains in the financial sector. However, they are hampered by the failure of the pension fund industry to play a stronger role and by a regulatory environment which could do more to promote the industry.

Strengths

Perhaps the best that can be said of Italy is that there is plenty of scope for improvement. A slight improvement is expected in political effectiveness as a result of changes in public administration and policymaking. Policies towards private enterprise and competition will also develop and foreign investment will pick up owing to the impact of reforms. These should improve the enforcement of competition policy and reduce the length of time and number of permits required to establish a new business or for a foreign company to start operating in Italy.

Weaknesses

The country's complex bureaucratic and legal procedures and inadequate infrastructure continue to deter potential foreign investors. The overall tax burden on firms is also high, and the labour market is rigid.

26

| Greece | Rank |
|--|----------|
| Overall rank | 26 (27) |
| Overall environment for private enterprise | 26 (27) |
| Financing environment | 26 (24) |
| Market opportunities | 28 (26) |
| Legal & policy environment | 25 (25) |
| Entrepreneurial environment | 22 (30) |
| Risk | 20 (n/a) |

Greece performs poorly, ranking outside the top 20 in every category, making it the worst-placed euro zone economy. It has, however, seen a slight upgrading in its entrepreneurial environment, mainly owing to improvements in government regulation on setting up new businesses.

Strengths

As a member of the euro area, Greece has greatly reduced exchange-rate risk and now enjoys much lower interest rates than in the recent past. Inflation is likely to remain above the euro area average, but prices should be lower and more stable compared with the 1990s. Greece's substantial current-account deficit, although an indication of the steady erosion of the country's competitiveness, is no longer a problem for exchange-rate stability and is also more easily financed as a result of membership of European economic and monetary union (EMU). Greece is expected to have easy access to capital markets at competitive rates, provided that it maintains effective policies on reducing the government deficit.

Weaknesses

Greece continues to attract less foreign investment than any of its EU15 partners and many of the new EU member states, such as Poland and Hungary. The main reasons for this are the limited size of the Greek market; its remoteness from north European markets; inflexible labour laws and powerful trade unions; administrative and legal delays; and a lack of transparency.

27

| Hungary | Rank |
|--|----------|
| Overall rank | 27 (22) |
| Overall environment for private enterprise | 23 (18) |
| Financing environment | 28 (27) |
| Market opportunities | 24 (24) |
| Legal & policy environment | 15 (8) |
| Entrepreneurial environment | 24 (31) |
| Risk | 32 (n/a) |

Hungary is the lowest-ranked EU country. It is also one of the biggest fallers in this year's survey, dropping five places to 27th. Much of this can be put down to the addition of the risk category, in which Hungary is rated the second-worst of the countries surveyed. It has also seen a fall in its legal and policy environment ranking—it rated eighth last time around—as some leading politicians have become vocal in their opposition to foreign investment.

Strengths

Hungarian law provides a high level of protection for private property. The administrative procedures involved in setting up and running businesses have been streamlined, although the introduction of stricter environmental regulations to meet EU requirements will impose substantial costs. With EU membership, direct incentives, offshore support and tax allowances for new ventures had to be replaced by other methods of attracting investors. This involved reducing the corporate tax rate, deducting training and R&D costs for tax, and encouraging investment in less developed areas of Hungary.

Weaknesses

The macroeconomic situation has long been the weakest area of Hungary's business environment. Preparations for joining EMU, attempts to sustain catch-up growth rates well above the EU average, and the need to deal with large fiscal and external deficits—Hungary's recurring "twin deficits" problem—will pose tough policy challenges for the authorities over the next few years. The fiscal position remains weak and is a major cause for concern.

28

| India | Rank |
|--|----------|
| Overall rank | 28 (32) |
| Overall environment for private enterprise | 31 (30) |
| Financing environment | 31 (29) |
| Market opportunities | 27 (33) |
| Legal & policy environment | 32 (26) |
| Entrepreneurial environment | 13 (28) |
| Risk | 27 (n/a) |

India is the biggest riser in this year's survey, climbing four places to 28th. This is owing to a sharp improvement in its entrepreneurial environment score, partly thanks to the ongoing liberalisation of the tax regime and partly because of the government's desire to cut back the red tape associated with starting a new business. A private equity culture has not yet blossomed, although the market is more attractive to foreign investors.

Strengths

India will become increasingly important not just for outsourcing, but as a key global market with a vibrant, aspirational middle class. Attitudes towards private enterprise vary significantly by sector. The score for policy towards private enterprise is boosted by further liberalisation in several industries, including telecoms. India's booming information technology (IT) sector is both the most liberalised sector and the most open to foreign competition. Those sectors that are more liberalised, and where links with foreign firms are more widespread, have been among the fastest-growing in recent years.

Weaknesses

India's unwieldy bureaucracy remains a hindrance to the business environment. Most foreign firms that leave India cite red tape and obstructive officials as reasons. Furthermore, it seems unlikely that there will be significant progress in opening up the economy to foreign investment for the duration of the current parliament.

29

| Mexico | Rank |
|--|----------|
| Overall rank | 29 (31) |
| Overall environment for private enterprise | 30 (31) |
| Financing environment | 30 (28) |
| Market opportunities | 32 (32) |
| Legal & policy environment | 30 (27) |
| Entrepreneurial environment | 20 (20) |
| Risk | 28 (n/a) |

Mexico sees a small improvement, rising two places to 29th. Nevertheless, it is still in the bottom ten for all categories except entrepreneurial environment. There is little familiarity with the private equity or, in particular, venture capital business models. Traditional family-based businesses abound and negative attitudes towards risk-taking are the norm.

Strengths

The country's main advantages are the large size of its market and a fiscal and monetary policy framework that underpins low inflation and a relatively stable exchange-rate environment. Its other main advantages include an open, pro-active trade policy, which has allowed integration into US manufacturing supply chains and produced a burgeoning network of free-trade agreements with the world's other major markets.

Weaknesses

The tax system is convoluted and characterised by widespread evasion; labour regulations are complex and inflexible; and private enterprise is hindered by weak competition policy, vested interests and reluctance to liberalise important areas of the economy.

30

| Brazil | Rank |
|--|----------|
| Overall rank | 30 (29) |
| Overall environment for private enterprise | 28 (29) |
| Financing environment | 32 (31) |
| Market opportunities | 33 (31) |
| Legal & policy environment | 27 (31) |
| Entrepreneurial environment | 16 (21) |
| Risk | 31 (n/a) |

Brazil ranks 30th, compared with 29th in 2005 survey. Its scores have changed little over the past year, and the addition of the risk rating has merely cemented the country's position at the lower end of the ranking.

Strengths

A large domestic market, natural resource wealth and a welcoming attitude to foreign investment have attracted foreign firms across a wide array of sectors. Competition has become more prevalent since the 1990s, as a result of the opening up of trade, privatisation and a strengthening of anti-trust and regulatory agencies. Price controls have all but disappeared, except in the pharmaceutical sector. Intellectual property rights are increasingly respected, but there are lingering concerns in certain industries, notably pharmaceuticals and software manufacturing.

Weaknesses

The overall business environment remains impaired by weak political effectiveness, which hampers efforts to reform a complex and burdensome tax system, ease distortions arising from the power of vested interests, tackle crime and address deficiencies in the labour market. These shortcomings will restrict aggregate investment to below the levels needed to generate more dynamic GDP growth rates.

31

| Russia | Rank |
|--|----------|
| Overall rank | 31 (30) |
| Overall environment for private enterprise | 33 (33) |
| Financing environment | 27 (32) |
| Market opportunities | 7 (4) |
| Legal & policy environment | 31 (32) |
| Entrepreneurial environment | 21 (23) |
| Risk | 30 (n/a) |

Russia perhaps best typifies the dilemma faced by private equity firms when considering investing in emerging markets. Although conditions are extremely challenging—it ranks bottom for the overall environment for private enterprise, has a poor legal and policy environment and a strong element of risk—there are, nevertheless, enticing market opportunities.

Strengths

The attractions of the Russian economy are strong, and include a large and fast-growing consumer market, massive oil and gas resources, a low-cost and skilled labour force, and continued macroeconomic and political stability. Surveys show that foreign investment in Russia on average yields higher returns than investment in China or India, for example. This suggests that many foreign companies have developed the skills and local knowledge necessary to navigate the Russian business environment.

Weaknesses

The government has pushed through reforms to curb bureaucracy and improve governance, but implementation will remain uneven and businesses operating in Russia will continue to be impeded by arbitrary bureaucratic interference. Competition will remain restricted on a sectoral and regional basis. Links with central and regional governments will remain at a premium in a system in which property rights are insecure and the rule of law is weak.

32

| China | Rank |
|--|----------|
| Overall rank | 32 (33) |
| Overall environment for private enterprise | 29 (32) |
| Financing environment | 33 (26) |
| Market opportunities | 31 (30) |
| Legal & policy environment | 28 (33) |
| Entrepreneurial environment | 30 (29) |
| Risk | 33 (n/a) |

Despite the clamour to invest in China, the truth is that the business operating environment remains extremely challenging. This is particularly true for private equity firms. Many funds are not allowed to borrow capital for their investments and must use their own funds only. Local governments often control small pension funds, which are currently not allowed to invest in equities of any sort. Venture capitalists, in the traditional Western sense, do not yet exist in China. A number of venture capital funds bypass listed shares entirely and seek business opportunities in unlisted companies.

Strengths

The thrust of government policy is towards open market competition between economic players, the efficient allocation of capital and material resources, and integration of the economy into the regional and global economic orders. World Trade Organisation (WTO) membership since December 2001 has continued to force the pace of market opening. Under China's WTO accession agreement, many sectors must open fully over the coming few years.

Weaknesses

Despite the recognition of the role of the private sector, the Chinese government still sees a central role in the economy for state-owned enterprises. Furthermore, local bureaucracies protect local companies, and the internal market is fragmented along regional lines. There are still serious concerns over corruption, red tape and the protection of private property rights.

33

| Turkey | Rank |
|--|----------|
| Overall rank | 33 (28) |
| Overall environment for private enterprise | 29 (28) |
| Financing environment | 33 (33) |
| Market opportunities | 31 (29) |
| Legal & policy environment | 28 (29) |
| Entrepreneurial environment | 30 (16) |
| Risk | 33 (n/a) |

Turkey falls five places and replaces China as the worst-ranked country. There are few redeeming features in Turkey's environment for private equity. It retains its rating as having the worst financing environment and can now add to this the worst risk rating. The one category in which it fared moderately last year—entrepreneurial environment—has now also seen a dramatic fall.

Strengths

The size of the potential market, with a young population projected to exceed 75m by 2010, has always been a major attraction. The business environment has also long been enhanced by the existence of a customs agreement with the EU, free foreign-exchange and capital flows, a large and lively private sector and a low risk of expropriation.

Weaknesses

Turkey's flaws include a high level of political and macroeconomic instability, a troubled financial system, high and unpredictable taxes, high labour costs (despite the low educational level of the workforce), the mixed quality of the infrastructure and practical obstacles to free competition.

Methodology

Both the individual ranking criteria and the categories are weighted neutrally in the model. Quantitative data are taken from Economist Intelligence Unit databases, with the exception of data on M&A activity and IPO activity, which are taken from Zephyr. Qualitative data were scored for this report by Economist Intelligence Unit analysts.

The scores in the ranking are z-scores. This is a statistical device used to measure the distance from the mean average. A country with a positive score is above the mean; a negative scoring country is below the mean.

Overall environment for private enterprise

- Protection of private property rights
- Freedom of existing businesses to compete
- Impact of state control on business environment
- Protection of intellectual property
- Red tape and bureaucracy
- Competition policy
- Corruption
- Strength of judicial system

Financing environment

- Financing depth: stockmarket capitalisation
- Quality and stability of overall financial regulatory system
- Availability of long-term sources of capital
- Interest rates
- Long-term bond yields
- Demand for local IPOs
- Restrictions on institutional investors investing in venture capital/private equity

Market opportunities

- GDP
- Quality of management
- Scope for consolidation
- Technical skills of workforce

Legal and policy environment

- Openness of national culture towards private equity
- Government attitudes to private equity
- Laws on private equity/venture capital fund formation and operation
- Degree of restrictiveness of labour laws on hiring and firing
- M&A and takeover regulation
- Quality of local accounting regimes
- Quality of corporate governance regimes
- Government policy towards foreign investment
- Consistency and fairness of overall tax system
- Corporate tax rates
- Tax treatment of private equity/venture capital funds and investments

Entrepreneurial environment

- Cultural attitudes towards entrepreneurs
- Personal income-tax rates
- Public financing for early-stage companies
- Capital gains tax for individuals
- Fiscal incentives for R&D
- Bankruptcy and insolvency legislation
- Government regulation on setting up new business

Risk

- Banking sector risk
- Currency risk
- Sovereign risk
- Political risk
- Economic risk

Apax Partners' international offices

GERMANY

Apax Partners
Beteiligungsberatung GmbH
Possartstrasse 11
Kopernikustrasse
81679 Munich
Germany
Telephone: +49 (0)89 998 9090

CHINA

Apax Partners Hong Kong Ltd
19th Floor
One International Finance Centre
No.1 Harbour View Street
Central Hong Kong
People's Republic of China
Tel: +852 2166 8230

ISRAEL

Apax Partners (Israel) Ltd
Museum Tower
4 Berkowitz Street
Tel Aviv 64238
Israel
Telephone: +972 3 777 4400

ITALY

Apax Partners S.r.l.
Palazzo Gallarati Scotti
Via A. Manzoni, 30
Milan 20121
Italy
Telephone: +39 02 762 1191

INDIA

Apax Partners India Advisers Private
Limited
Hilton Towers
Room Nos. 1433-35
Nariman Point
Mumbai - 400021
India
Telephone: +91 22 6630 8715

SPAIN

Apax Partners España, S.A.
Velázquez 10-5º
28001 Madrid
Spain
Telephone: +34 91 423 1000

SWEDEN

Est2004 Advisors AB
Birger Jarlsgatan 5, 1st Floor
SE-111 45 Stockholm
Sweden
Telephone: +46 8 5450 7400

UK

Apax Partners Ltd
15 Portland Place
London W1B 1PT
United Kingdom
Telephone: +44 (0)20 7872 6300

USA

Apax Partners, L.P.
53rd Floor
153 East 53rd Street
New York, NY 10022
Telephone: +1 212 753 6300

www.apax.com