Europe: King Canute Trying to Halt Tide of Private Equity Investment

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Just as King Canute reputedly tried to halt the onslaught of the tides, and the Luddhites smashed machinery to retard the progress of the Industrial Revolution, Europe is again experiencing a similar conflict. Forces of normal and rational economic progress confront traditional economic nationalism and other obstacles standing in the way. This article will discuss the conflict in Europe between various constituencies promoting continued private equity investment and those resisting these dynamic market forces.

The boom in merger and acquisition activity in Europe is well documented. In 2006, $1.59 trillion of merger and acquisition transactions occurred, overtaking that activity in the US for the first time. Five of the top ten deals around the world were European in 2006. The UK accounted for $367 billion, leading Spain with $190 billion and France with $174 billion. The total value of such activity in Europe has almost tripled since 2004. Similar trends are also present in 2007. This dramatic rise in the changing hands of ownership of local businesses has exacerbated this normal tension.

In one corner of the ring, some government politicians, as well as some trade unions, have vocally and demonstrably attempted to politicize and oppose the inexorable trend of private equity investment in Europe. In France, the President, Nicolas Sarkozy, criticized corporate raiders. In the UK, a large trade union has blasted the attempted takeover of Salisbury, a venerable grocery chain, by a private equity consortium. Legislation in the Danish Parliament would impose a form of excise tax on excessive leverage. The French and Spanish governments have blocked, or voiced strong opposition to takeovers by foreigners of local companies deemed to be in the national interest. The French government went so far as to dissuade Pepsi from making a bid for Dannone, a leading French yogurt manufacturer. Edmund Phelps, a 2006 Nobel Laureate for Economics, has often railed against European sensitivity to economic progress.

Despite these vocal headwinds denouncing the onslaught of investment, tectonic shifts have recently occurred facilitating structural change. A recent survey by the European Venture Capital Association (“EVCA”) found that over the past three years tax policies and legal codes have become more favorable to venture capital and private equity capital in most European countries. The survey found that countries like Spain, which were once considered openly hostile to these activities, are now considered favorable. Some countries' tax and business codes have made it easier for pension funds and insurance companies (which combined constitute nearly fifty percent of private equity investment in Europe) more than twenty percent) to invest in private equity deals. The EVCA has tabbed Ireland as the country with the most appealing tax and legal framework. Ireland has recently adopted pension fund and insurance legislation to promote investment, offered attractive research and development credits, and boasts the lowest corporate tax rate on the continent. The EVCA survey surprisingly found France to have made "remarkable improvement" in its treatment of private equity investment and conferred on it second place status. In France, pension funds and insurance companies are now permitted to invest in private equity without restriction, fund management fees are now exempt from value added tax, and France has provided tax breaks to domestic citizens, discriminating against foreign ones, in industries which it considers to be "innovative."

The implications of this conflict are huge. The free flow of capital is critical to economic progress and world harmony. Political and social intransigence and conflict will impede progress, interfere with political, social and economic relations, make less efficient and therefore more costly the production and delivery of goods and services, and inevitably restrict world trade and growth.

The tipping point will likely evolve as politicians and the public recognize that while demagoguery may be cathartic, and economic dislocations in certain industries and geographic regions may be inevitable, world history has demonstrated that in the long run progress and cooperation maximizes efficiency, improves overall wealth and living standards, and is therefore unavoidable.

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