German funds need incentives for private equity – minister

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GERMANY – The reluctance of large domestic investors to go into private equity and venture capital is discouraging foreign investors from investing in German start-ups, according to a study commissioned by the German federal economy ministry.

Pensionsfonds and Pensionskassen only play a minor role as investors in venture capital compared to their European counterparts, according to the study, which was conducted by the private equity consultants Fleischhauer, Hoyer & Partner (FHP). Only 6% of investments originated from German Pensionskassen

"We have to at least double our investments in this area to stay competitive on an international level," Michael Glos, the German economy minister, said at the presentation of the study .

"Germany needs an internationally competitive tax framework to make German risk capital attractive for institutional investors. Risk capital is a very important instrument to finance start-ups and growth by young, innovative companies."

Findings from the study will be considered in current negotiations on changes to the legislation on equity participation andrisk management part of which is the 'acting in concert' bill, the minister added (see earlier IPE-article: German Cabinet passes 'acting in concert' bill) .

However, one of the main obstacles to investing in venture capital identified by FHP is lack of knowledge on the asset class.

"Soft and not entirely rational reasons are prevalent among the reasons for not investing," noted the authors of the study, in which 132 institutional investors and funds of funds were interviewed. Some 18% of these were retirement vehicles.

"Private equity engagement is seen as highly risky and incompatible with a conservative asset allocation. Legal reasons for not investing were not named but many said they shunned the organisational complexity connected to those investments."

Apart from "improving the image of the asset class" through political commitment, FHP urged the government to create regulated, German private equity investment vehicles.

"The licensing of vehicles similar to Luxemburg structures like the FCP could facilitate access to private equity for smaller investors and save them the detour via foreign funds," explained the consultants. They suggested taking German Spezialfonds, devised specifically for institutional investors, as a model.

Size was another obstacle identified by FCP. "Many smaller investors do not have enough assets under management to make any allocation to alternatives," they noted.

However, considering the growth potential in the funded retirement sector the authors expect considerable increase in allocations to private equity over the short-term.

"The potential of institutional investors is enormous. The institutions we interviewed that are not yet invested in private equity have combined assets under management of €400bn, which means an investment potential for venture capital of €1bn ."

In 2006, assets in German Pensionsfonds, grew 680% to €8.3bn. Unfunded corporate book reserves amounted to €250bn, some of which may flow into other vehciles.

FHP noted especially for very immature retirement vehicles private equity was a very good asset class because of the long investment horizon.

The study cited European Venture Capital Association (EVCA) figures, which states that 24% of money in European private equity funds comes from pension funds.

If you have any comments you would like to add to this or any other story, contact Carolyn Bandel on +44 (0)20 7261 4622 or email carolyn.bandel@ipe.com

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