



## 3i European Enterprise Barometer



The economic recovery in Europe lost momentum in 2004. After a strong increase during the first half, real GDP rose at an annual rate of less than one percent in the following two quarters. In the wake of renewed weakness, labour market conditions did not improve. Inflation accelerated at the end of year because of the surge in oil prices and it is likely that this, coupled with the strength of the Euro, has dampened economic expansion. Recovery is expected in the latter part of the year (expectation is that GDP will rise by 1.4% during 2005) but unemployment is expected to remain high whilst inflation remains stable at around 2%. All in all, the outlook for 2005 is for a low speed recovery.

# Executive Summary

The 3i European Enterprise Barometer Index rises for a second quarter and many 3i companies expect to see a rise in their own fortunes in the coming quarter

- **Perceptions of a more favourable climate for 'growth by acquisition' drive the European Index upwards for the second quarter in a row**
- **3i companies remain optimistic about their own position**
- **In the UK, business confidence remains fragile; concerns about interest rates continue to dampen optimism.**
- **"The worst is over say German firms" Despite declines in foreign demand and appreciation of the Euro dampening export growth, chronic unemployment and a languishing stock market, business confidence in Germany is high.**

The European Enterprise barometer provides a quarterly measure of business confidence among 3i-backed companies in the UK, France, Germany, Italy, Spain and the Nordic Region. Since its conception in 1988, the Index produced from the Barometer has tended to follow a similar pattern to the GDP growth rate of the European Union and provides a useful insight into the political and economic climate in each market. It also shows the outlook for turnover, investment and profitability among 3i backed companies in the months ahead.

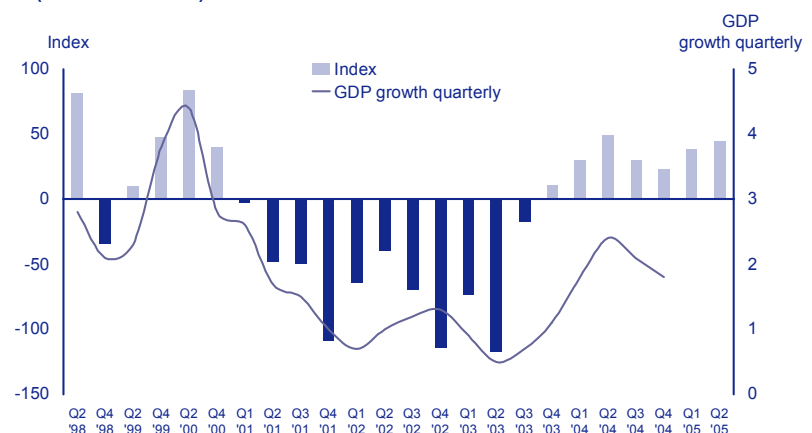
## Perceptions of a more favourable climate for 'growth by acquisition' drive the European Index upwards for the second quarter in a row

Post Q4 2003, the outlook among 3i backed companies has been more optimistic and whilst the Index has fluctuated in the last year and a half, it has remained positive signalling a period of greater certainty and improved business confidence.

For the last two quarters the overall trend has been upwards; however due to a slight downturn in confidence in the middle of 2004, the latest figures for Q2 2005 are virtually on par with the same period last year (see Chart 1).

The UK holds the lowest Index figure (+2) of all the countries in the survey with the Nordic countries still holding the highest (+101). In Spain the Index has continued to recover some of the ground lost six months ago, moving from -28 to +16.

**Chart 1: 3i European Barometer Index\*, historical series (weighted by GDP) compared with EU15 real GDP annual growth rate for equivalent quarter (source: Eurostat)**



The Index in Italy is also somewhat higher than the previous quarter (-9 to +16) but still continues to fluctuate between positive and negative. In Germany the Index has remained near the level achieved last quarter (+95 to +93).

There are still some concerns about the general business and political environment for start up businesses and perceptions of the climate for the expansion of existing business is at a similar level to Q2 2004. The outlook for growth by acquisition is considered, on balance to be more favourable (see Chart 3).

"There are two key factors that are going to affect all businesses negatively in the coming months and years...energy prices, these are on a sharply upward trend...combining this with rapidly growing demand from the developing economies and inelastic demand in OECD economies we may have only seen the start of energy driven inflation.

The second key trigger for a slowdown will be the debt bubble that now has UK consumer debt in excess of one trillion pounds"

3i backed company, UK

### 3i companies remain optimistic about their own position

3i backed companies remain relatively optimistic about their turnover, profitability and investment potential for the period January to March 2005.

On balance, whilst the number of organisations expecting to see an increase in turnover is slightly down on the previous quarter it is on par with the same period last year.

The balance of companies expecting to see an increase in profitability and investment remains relatively stable.

Longer term i.e. during the next calendar year, 41% of 3i backed companies expect to increase their labour force. This figure is consistent with the previous quarter and marks the highest level of optimism in the area of employment since Q2 2002

Chart 2: 3i European Barometer Index, by country

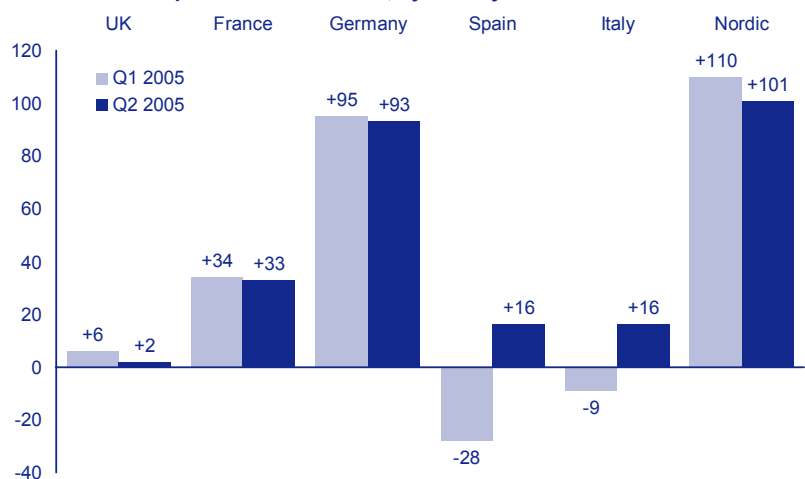


Chart 3: Components of Barometer Index – balance of all European respondents (weighted by GDP) considering business and political climate more favourable to:

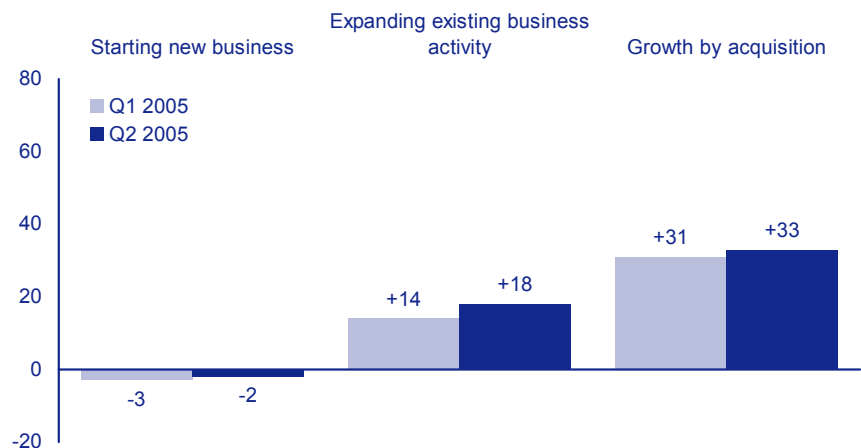
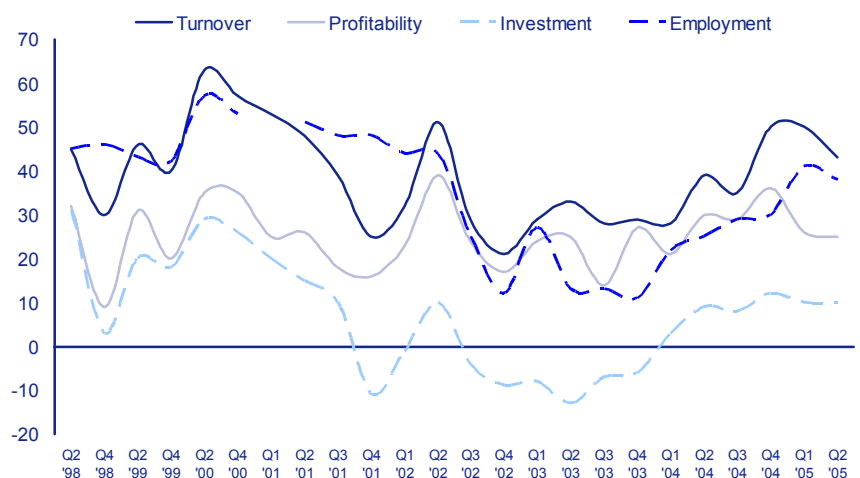


Chart 4: Balance of all European respondents (weighted by GDP) expecting an increase over current quarter in:



# United Kingdom

**In the UK, business confidence remains fragile; concerns about interest rates continue to dampen optimism.**

In the early part of 2004, business confidence improved and the Index rose to its highest point since the survey began in 1988. This recovery was however fairly short lived, at the end of 2004 confidence crashed and the last two quarters have shown a positive but fairly weak outlook for the months ahead. The La Caixa forecast says "...the British economy is progressively moving into a stage of lower growth, although the fund of resistance provided by consumption will avoid an excessive slowdown".

Latest results from the 3i European Enterprise Barometer shows that on balance, UK based 3i backed companies remain pessimistic about the general business and political climate for both starting new business and expanding existing business activity. Whilst the outlook is more positive for growth by acquisition (+20), compared to other European countries the outlook is still relatively weak in this area (see Chart 6)

"..Venture Capital is still extremely difficult and hampering both start ups and growth".

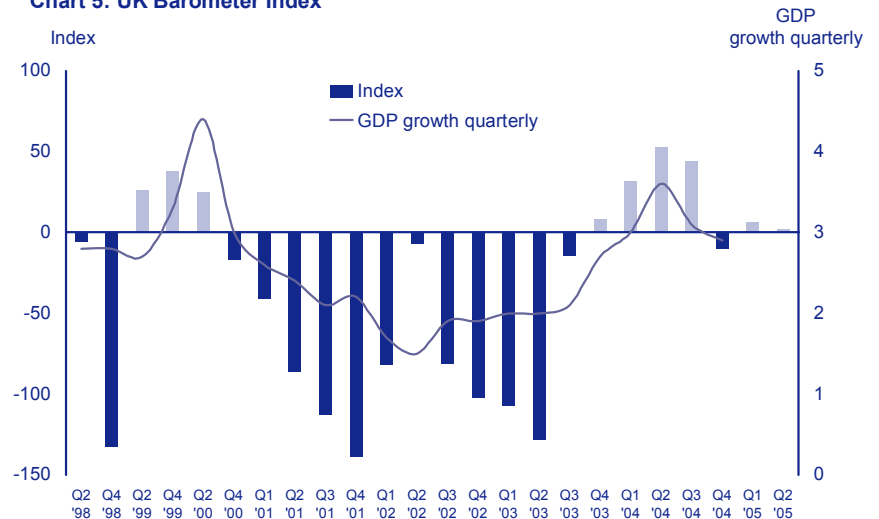
3i backed company, UK

On balance, levels of optimism about profitability are at their lowest levels in the UK since Q1 2003. The balance of 3i backed companies expecting an increase in turnover in the coming quarter is also considerably lower than that seen in the first quarter of this year (+28 vs +42). This said, investment outlook remains stable and positive as do expectations regarding increases in employment over the coming year.

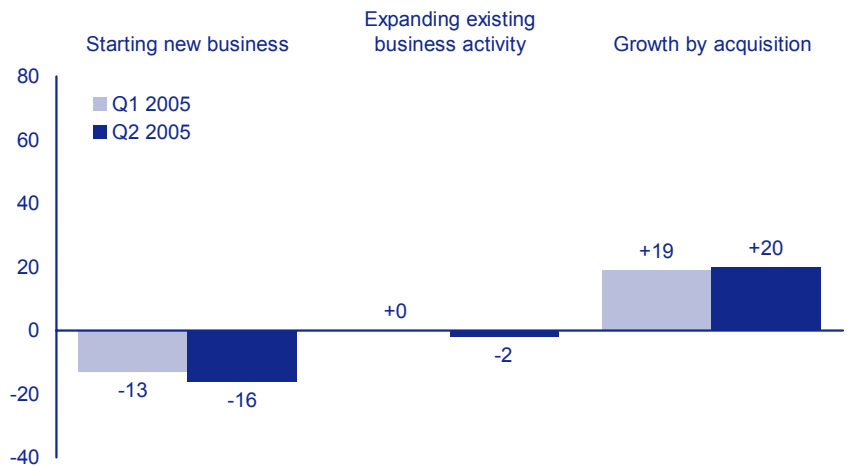
"There seems to be a lack of confidence creeping back in, leading to a pause in orders...perhaps due to the impending election"

3i backed company, UK

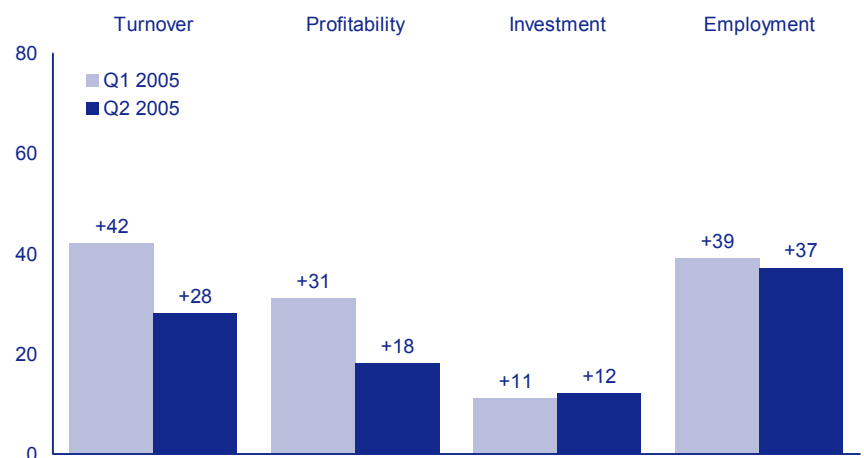
**Chart 5: UK Barometer Index**



**Chart 6: Components of Barometer Index – balance of all UK respondents (weighted by GDP) considering business and political climate more favourable to:**



**Chart 7: Balance of all UK respondents (weighted by GDP) expecting an increase over current quarter in:**



# Germany

**“The worst is over say German firms”**  
Despite declines in foreign demand and appreciation of the Euro dampening export growth, chronic unemployment and a languishing stock market, business confidence in Germany is high.

The German index remains at one of its highest levels in over four years despite a fragile economy. The positive outlook is driven by optimism on all three measures that combine to make the overall index.

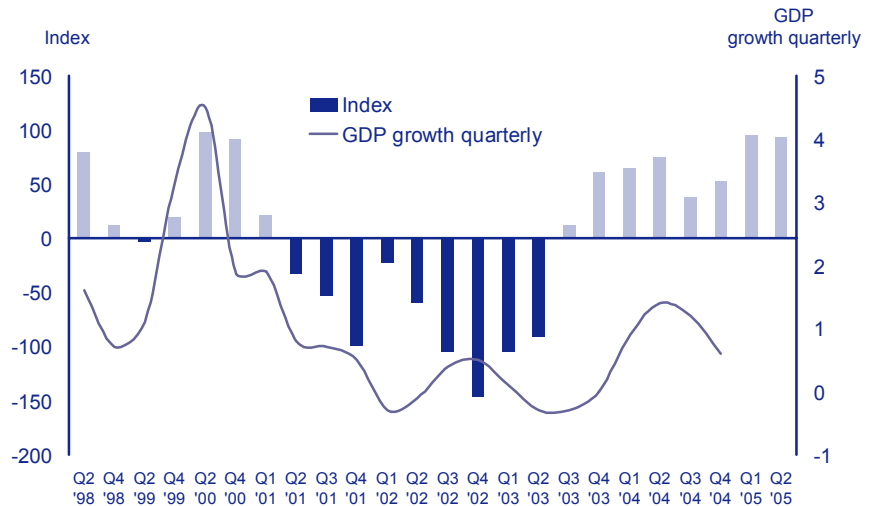
On balance, the business and political environment is perceived to be favourable to starting a new business, expanding existing business and growth by acquisition. The climate for start ups is perceived to have remained stable since Q1 2005, there has been a slight upturn in optimism relating to expanding existing business activity and a slight downturn in optimism related to growth by acquisition.

Despite this positive outlook, 3i backed companies, on balance, are less likely to predict an increase in profitability this quarter. The balance expecting to see an increase in turnover or investment over the current quarter remains stable (+52 and +17 respectively). There is clearly still an element of wariness despite the generally rosy picture painted by these latest results.

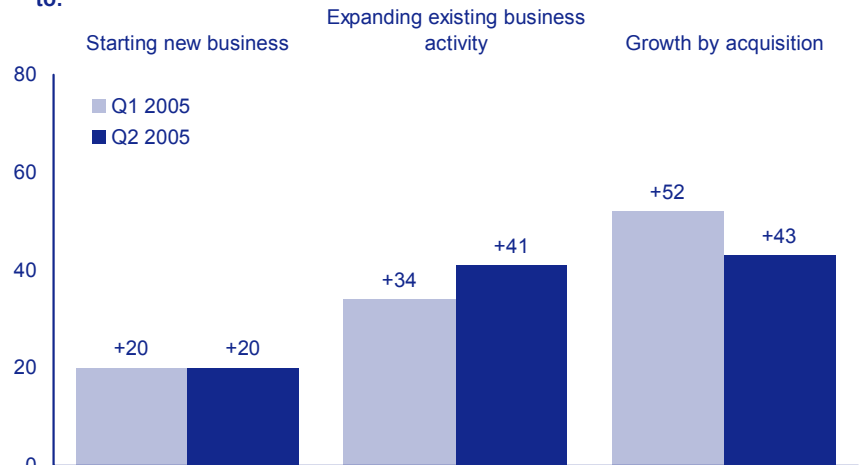
“The business climate in Germany continues to be overshadowed by a general pessimism and conservatism...further reforms are of the highest significance just because of the signal they are sending out...that includes --- but is not limited to --- a comprehensive tax reform”.

3i backed company, Germany

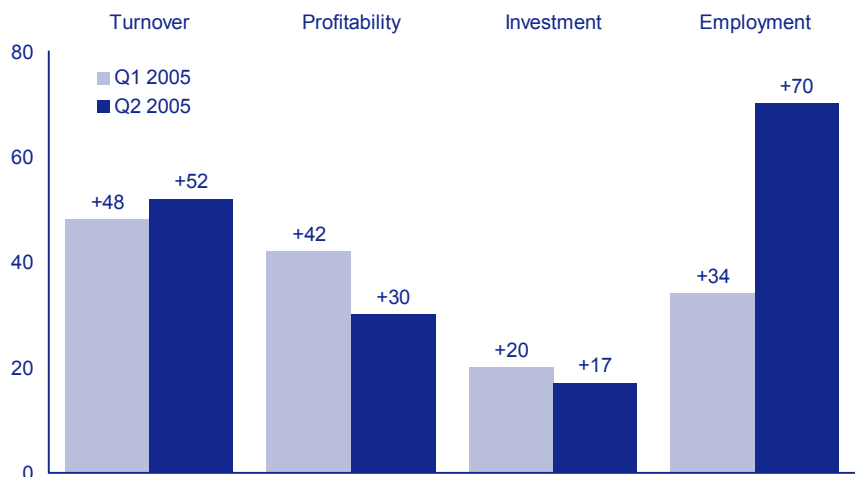
**Chart 8: Germany Barometer Index**



**Chart 9: Components of Barometer Index – balance of all German respondents (weighted by GDP) considering business and political climate more favourable to:**



**Chart 10: Balance of all German respondents (weighted by GDP) expecting an increase over current quarter in:**



# Nordic regions

Business confidence in the Nordic regions surpasses that of any other European country participating in the European Enterprise Barometer. Since measurement started in 2003, the Index has been positive and relatively stable.

Latest results suggest the Nordic markets are ripe for expanding existing business activity. On balance, 62% of 3i backed companies based in this region feel the business and political environment is more favourable for this type of activity than it was last year; this figure of +62 is the highest recorded to date for the Nordic region. The outlook for business start ups and growth by acquisition is, on balance, less favourable than last quarter but remains positive.

Whilst the Nordic regions are optimistic about their own profitability over the current quarter, expectations for turnover movements remain stable and we see a marked downturn in those expecting to see an increase in investment and employment (+18 and +40 respectively, down from highs of +40 and +66 in Q1 2005).

"The order income has slowed down in Sweden and exports have also slowed...no need to employ"

3i backed company, Sweden

Chart 11: Nordic Barometer Index

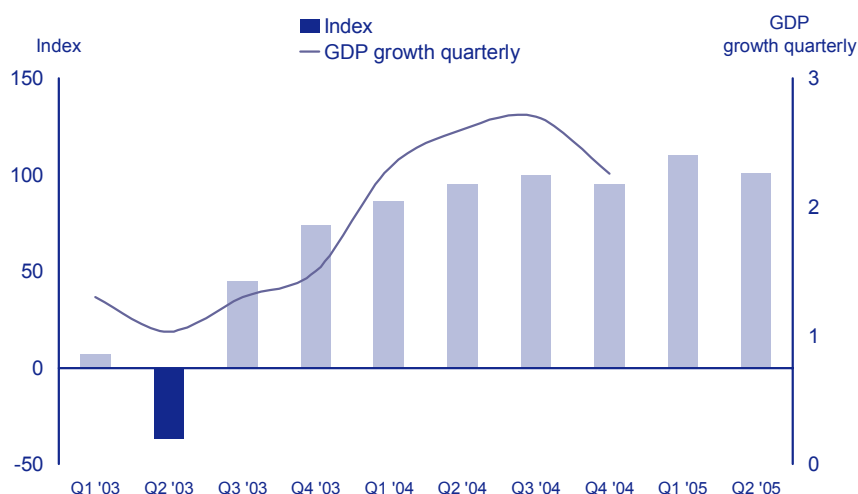


Chart 12: Components of Barometer Index – balance of all Nordic respondents (weighted by GDP) considering business and political climate more favourable to:

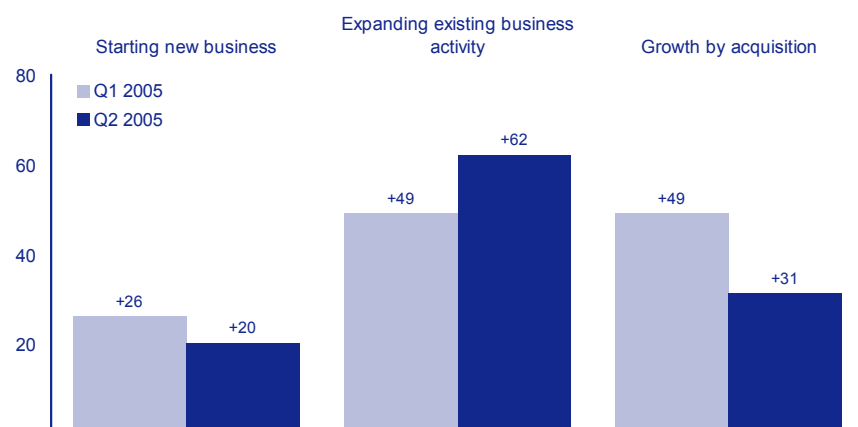
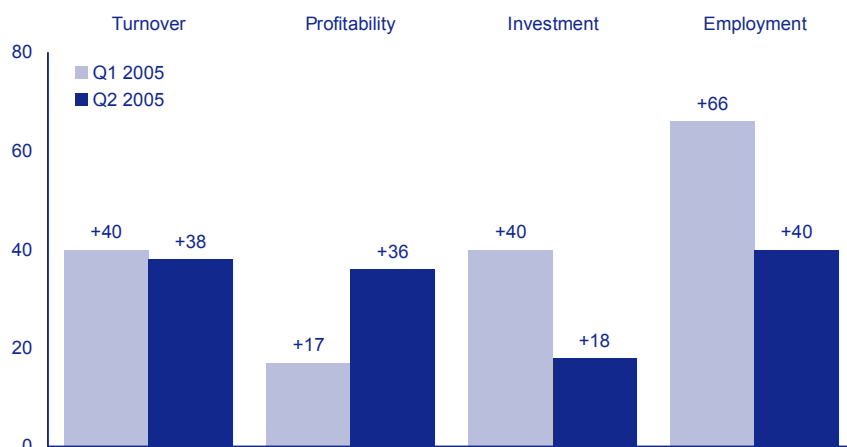


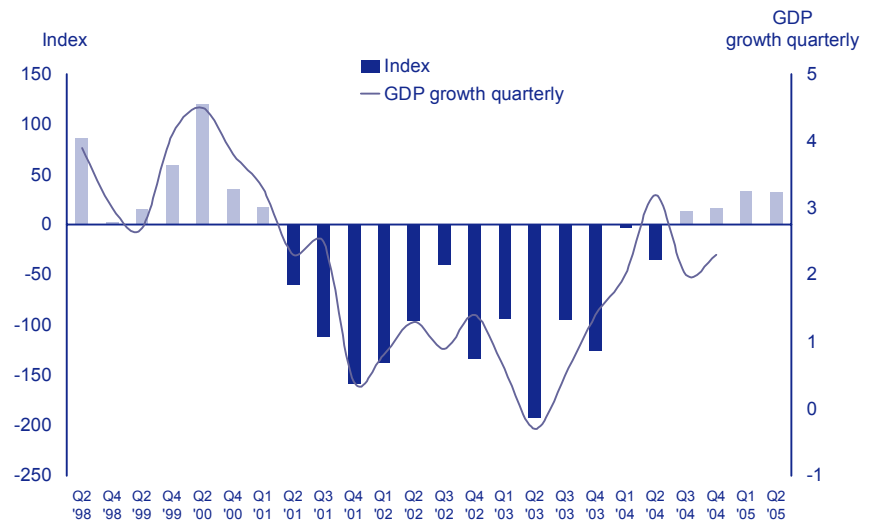
Chart 13: Balance of all Nordic respondents (weighted by GDP) expecting an increase over current quarter in:



# France, Spain and Italy

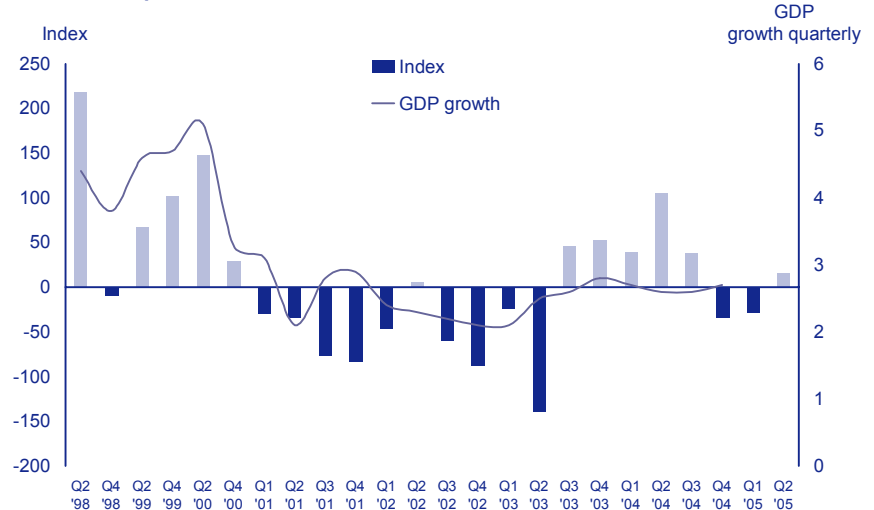
The 3i French Barometer Index has remained stable since last quarter. The optimism about turnover increases seen in Q1 2005 has faded but the current outlook is on a par with the same period last year. The outlook for profitability was at a record high last quarter, and remains stable this quarter but is still more modest than in other countries. Investment expectations remain on a par with the previous quarter.

Chart 14: French Barometer Index



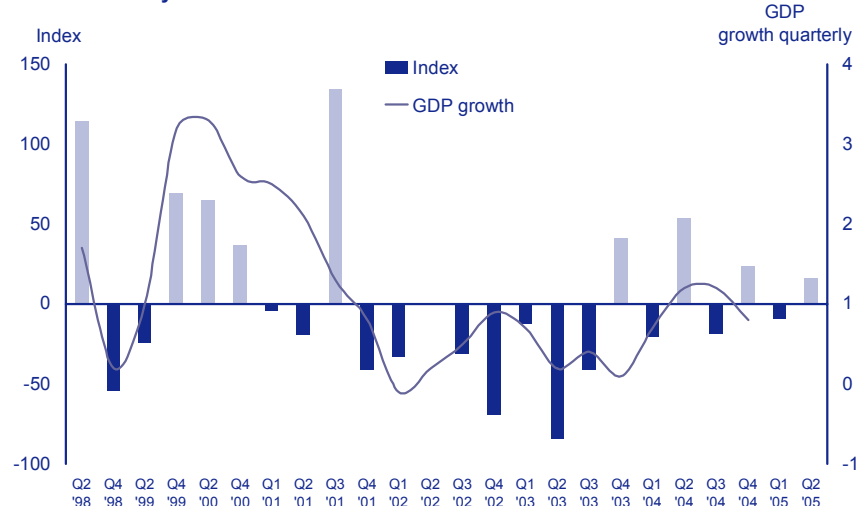
In the last survey Spain had the most negative outlook of all countries evaluated. This quarter sees an improvement in business confidence driven largely by a more optimistic outlook in terms of the potential to grow existing business and growth by acquisition. The market is still not felt to be conducive to new business start ups. Investment and turnover outlooks are more pessimistic this quarter but expectations re: profitability are up considerably on Q1 2005.

Chart 15: Spain Barometer Index



The Index in Italy has fluctuated between positive and negative over the past 8 surveys; this is most likely a reflection of the small sample base rather than a reflection of the economic situation per se. This said, the latest results indicate that the outlook in Italy is more optimistic than three months ago. The business and political climate for starting a new business is still, on balance, not seen to be particularly favourable. As in other European countries, the outlook for 'growth by acquisition' is the only area where business is truly optimistic. Companies are increasingly optimistic about improving their own turnover. On balance, we continue to see fluctuations in terms of expectations regarding investment.

Chart 16: Italy Barometer Index



# Appendix

3i offices in the UK, France, Germany, Italy, Denmark and Sweden supplied lists of names of contacts, generally Managing Directors, in companies in which they had made investments.

Questionnaires were e-mailed in the relevant languages from 15<sup>th</sup> March 2005. By 5<sup>th</sup> April, 313 completed questionnaires had been returned.

A summary statistic, the 'balance' is used to report the answers to most questions. For a question where the options are 'up', 'same' and 'down', the balance is the percentage reporting 'up', minus the percentage reporting 'down'.

Overall figures have been weighted by national CDP in each of the countries (responses from Denmark, Finland and Sweden are grouped together and treated as a 'Nordic' region).

3i-backed companies in Europe taking part are split fairly evenly between those with under and those with over 100 employees. More 3i-backed companies in Germany than elsewhere have fewer than 100 employees. More of those in Spain than elsewhere employ over 250 people.

The small sample sizes for some aspects of the analysis, particularly the country results for Italy, should be borne in mind when assessing the results.

## Barometer Index

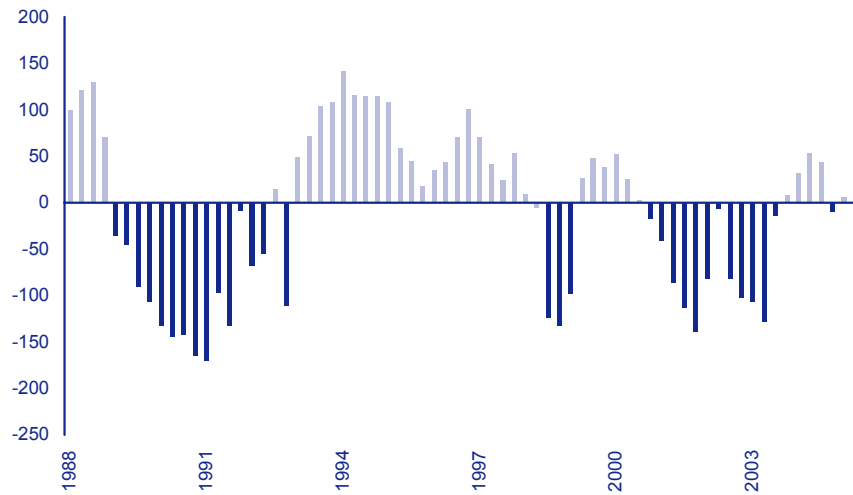
	Weighted	UK	France	Germany	Spain	Italy	Nordic
Q2 98	81	-6	86	79	218	114	
Q4 98	-34	-133	3	12	-10	-54	
Q2 99	10	26	16	-3	67	-24	
Q4 99	47	38	59	19	102	69	
Q2 00	84	25	120	98	148	65	
Q4 00	40	-17	35	91	30	37	
Q1 01	-3	-41	18	21	-29	-4	
Q2 01	-48	-86	-60	-33	-34	-19	
Q3 01	-49	-113	-112	-53	-76	134	
Q4 01	-109	-139	-158	-100	-83	-41	
Q1 02	-64	-82	-138	-23	-46	-33	
Q2 02	-39	-7	-96	-60	6		
Q3 02	-69	-81	-40	-105	-60	-31	
Q4 02	-114	-102	-133	-146	-88	-69	
Q1 03	-73	-107	-94	-105	-24	-12	7
Q2 03	-117	-128	-192	-91	-139	-84	-37
Q3 03	-17	-14	-95	12	46	-41	45
Q4 03	11	8	-126	61	52	41	74
Q1 04	30	32	-3	64	40	-20	86
Q2 04	49	53	-35	74	105	54	95
Q3 04	30	44	13	38	38	-18	100
Q4 04	23	-10	17	52	-34	24	95
Q1 05	38	6	34	95	-28	-9	110
Q2 05	44	2	33	93	16	16	101

## Response Rates

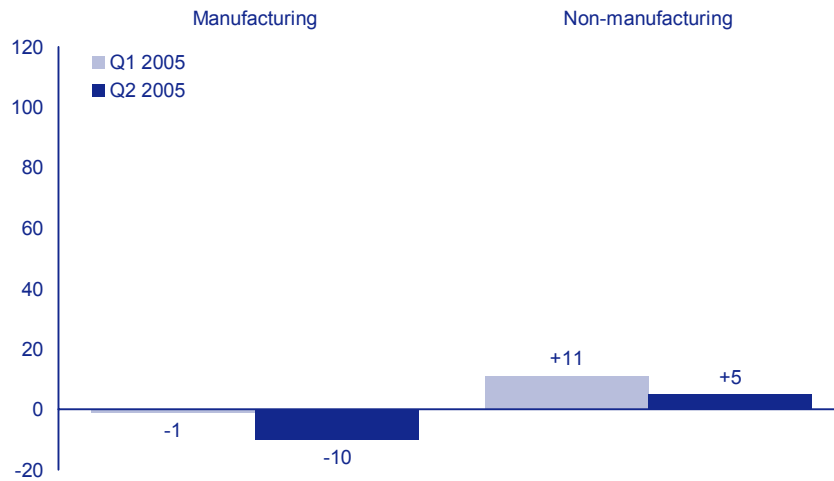
	All (unweighted)	UK	France	Germany	Spain	Italy	Nordic
Despatched	1194	858	56	130	63	22	65
Returned	313	165	19	46	27	11	45
Response rate	26%	19%	34%	35%	43%	50%	69%



**Chart 17: UK Barometer Index, historical series**



**Chart 18: UK Barometer Index, by sector**



**Chart 19: UK Barometer Index, by region**

