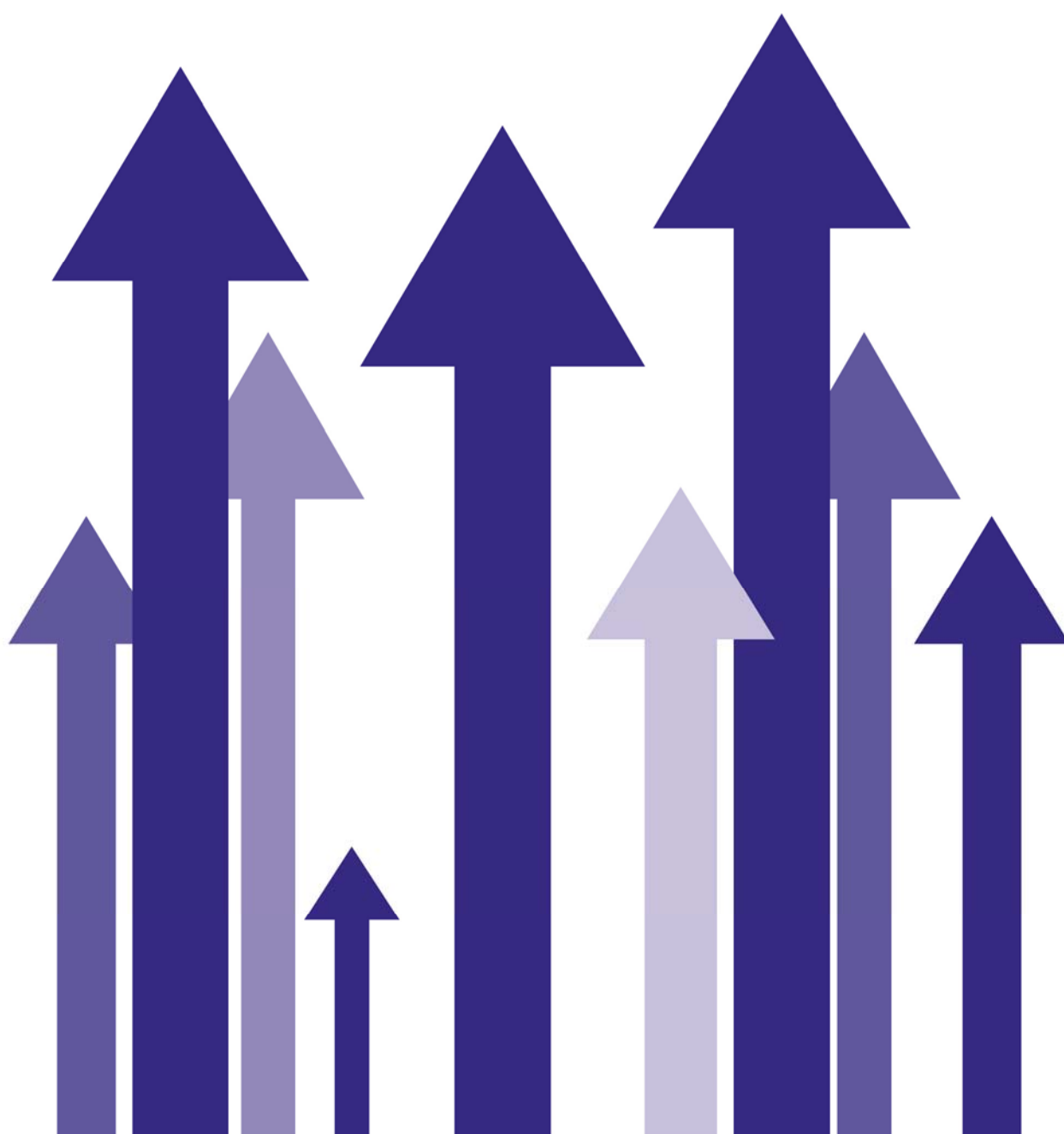


A business confidence survey amongst  
3i backed companies across Europe  
Number 25, Quarter 3 2005



## 3i European Enterprise Barometer



The European economic recovery lost momentum in 2004. After the temporary improvement in Q1 2005, GDP is predicted to achieve a modest growth of 0.2% by Q2, and to gradually strengthen in Q3 (0.3%) and in Q4 (0.4%). However in the wake of rising oil prices and increasingly divergent economies for individual European countries, the economic confidence has taken a downward turn. Recovery was predicted for the latter part of this year (expected GDP rise 0.4% during 2005) but increasing European pessimism could impact upon the final outlook for 2005.

# Executive Summary

The 3i European Enterprise Barometer Index has dropped to its lowest level since Q3 2003, with many 3i companies expecting mixed fortunes.

- **Optimism has diminished amongst 3i companies regarding their own position**
- **There is considerably less certainty this quarter, regarding the climate for either starting a new business or expanding existing business**
- **The main positive driver of the European Enterprise Barometer remains the perception of a favourable climate for 'growth by acquisition'**

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.

**The perception that the favourable climate remains for 'growth by acquisition' is sustained, and continues to be the main positive driver of the European Index.**

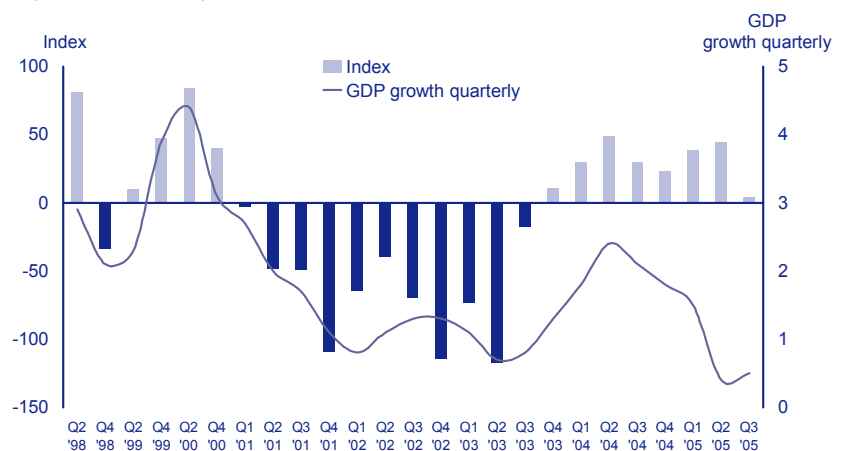
Post Q4 2003, the outlook among 3i backed companies has been generally optimistic despite some fluctuations in the Index. Up to Q2 2004, this reflected the improving levels of quarterly GDP growth.

In Q2 2005 the Index received its fourth highest rating since the Barometer was launched in 1998. However in comparison, Q3 2005 has seen a sharp downturn in European economic confidence which has effectively followed a decrease in GDP quarterly growth. The Index has declined from +44 (Q2) to +4 (Q3) (see Chart 1).

"Current Economic climate - flat, unexciting and needs a quick regenerative boost with a 0.5% interest cut (not a 0.25% cut) to install some growth and confidence"

3i backed company, UK

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



Germany (+53) and the Nordic countries (+46) still hold the highest Index scores, albeit with substantial decreases in confidence. Italy (-64) and the UK (-46) have the lowest Index scores of all the countries in the survey. Spain is the only country to see a rise in the Index this quarter (+16 to +28). (see Chart 2).

"It all revolves around price. The impact of gas/oil is important to our business and its increase is not well received."

3i backed company, France

### Q3 sees an increasing concern regarding the climate for setting up new businesses.

Concerns are growing amongst 3i backed companies across Europe, about the general business and political environment. Growth by acquisition is considered, on balance to be the only area where perceptions remain favourable (see Chart 3).

"Increasing uncertainties."

3i backed company, Spain

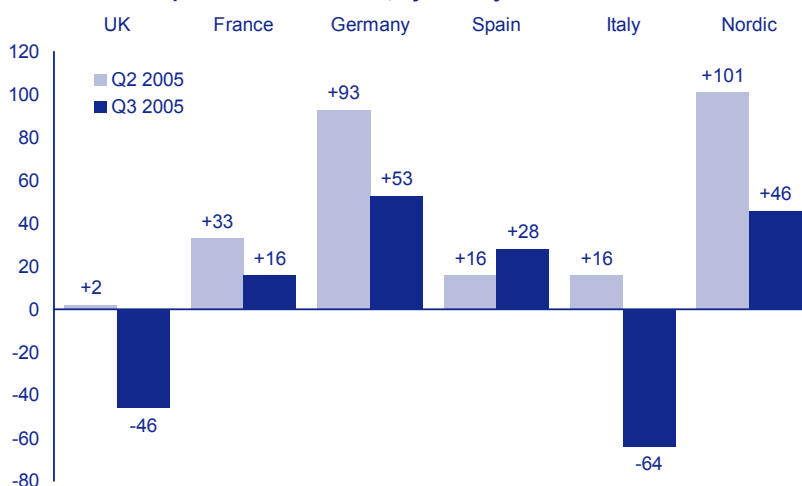
**Despite diminishing optimism, on balance, 3i backed companies remain positive regarding their own position; although expectations regarding increasing profitability and turnover continue to decline.**

The number of organisations expecting to see an increase in turnover is down on the previous quarter but at a similar level to the same period last year (Q3 2004).

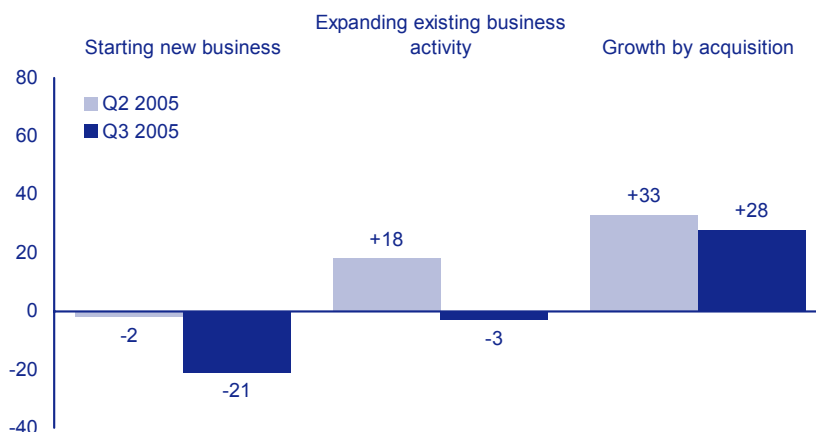
The balance of companies expecting to see an increase in profitability has continued its downward trend since Q4 2004. In comparison the balance expecting an increase in investment remains relatively stable.

Despite these downturns, looking forward to the next calendar year, one in three 3i backed companies expect to increase their labour force. This figure is slightly under the previous quarter (+38), but still marks a continuing high level of optimism in employment. The current run is the highest since Q2 2002 (see Chart 4).

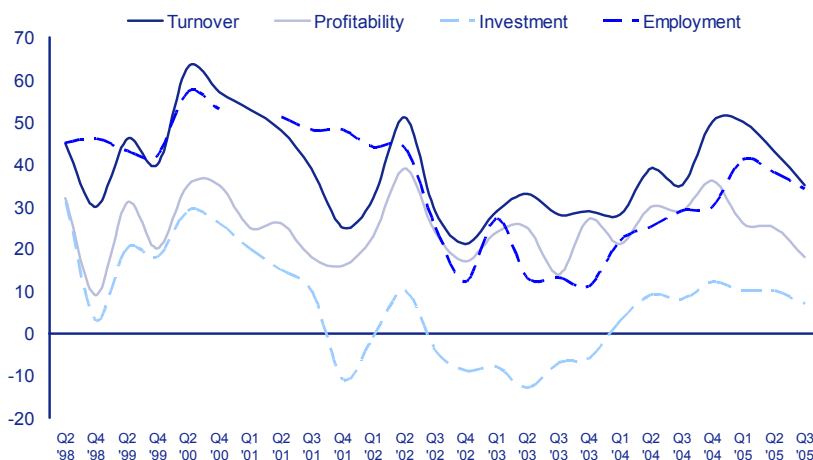
**Chart 2: 3i European Barometer Index, by country**



**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 and house prices 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 fell and the latest results show are the lowest since Q2 2003. The SG Global Economic Outlook says: "As we head into the second half of the year, the UK economy seems to be losing steam. The recent manufacturing and retail sales data have been disappointing and the rate of house price inflation still seems to be falling. Such data are taken as signs of a steady weakening of the economy that will soon require policy action to correct."

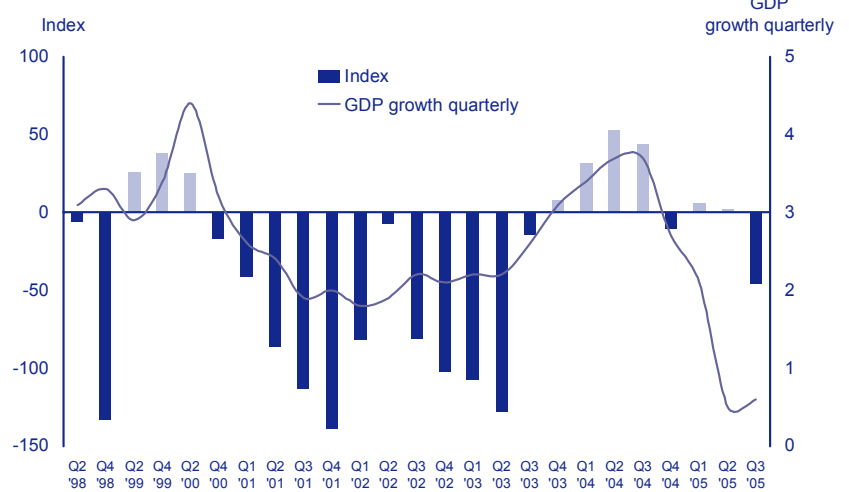
Latest results from the 3i European Enterprise Barometer shows on balance, an increasing pessimism amongst UK based 3i backed companies about the general business and political climate for both starting new business and expanding existing business activity. The outlook for growth by acquisition has also fallen to just above the benchmark level (+1), the lowest in Europe (see Chart 6).

On balance, expectations regarding profitability and investment are at their lowest levels in the UK since the survey began in 1988. 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 (+21 vs +42). This rather gloomy outlook extends to expectations regarding employment over the coming year, also down on the first quarter of 2005 (+10 vs +39). (See Chart 7).

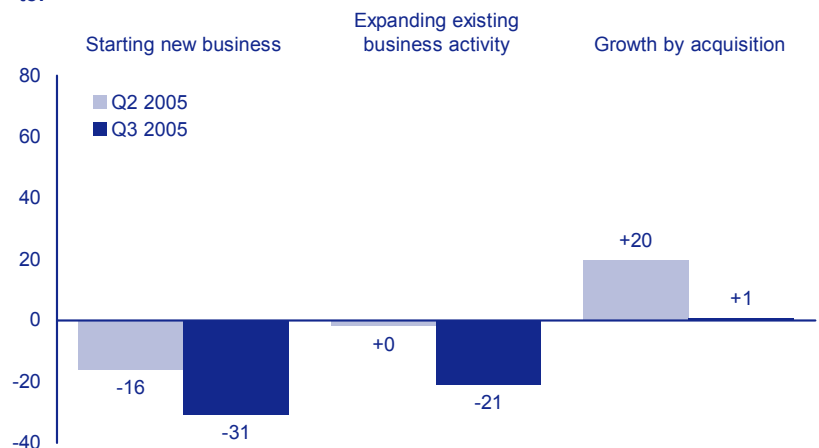
"Expectations have been over-optimistic. Expect some softening in UK interest rates with little scope for significant cuts in ECB rates. Anticipating sterling to weaken to the benefit of UK exports to Eurozone. Meanwhile, further job losses are likely in high volume UK manufacturing."

3i backed company, UK

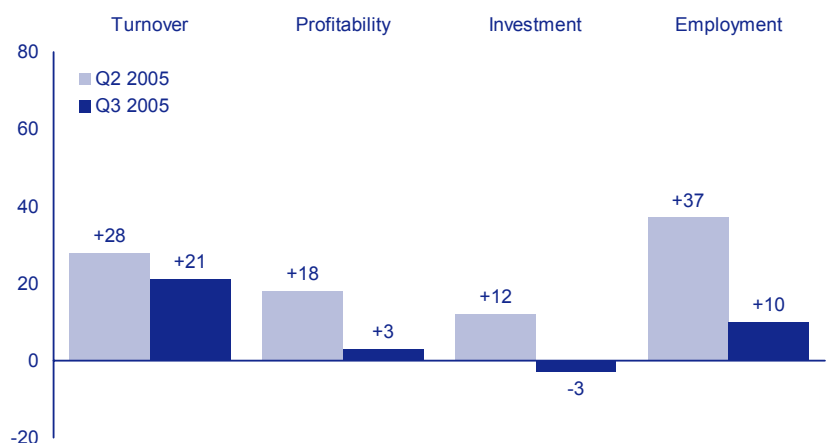
**Chart 5: UK Barometer Index**



**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

**Despite a downturn in the German economy over recent years, 3i backed companies in Germany are the most confident in Europe.**

The SG Global Economic Outlook says: "For the first time in four years, the German economy should this year, be able to begin reaping the benefits domestically of the recovery in exports. After several bleak years, employment has finally stabilised and leading employment indicators have been encouraging, so have leading indicators on the consumption side. Orders for domestic consumer goods appear to have taken up the running from the export side."

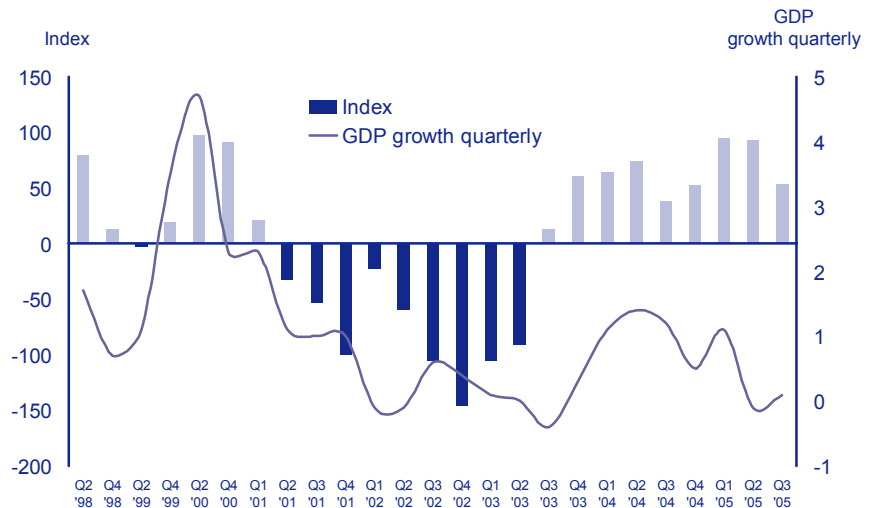
Although the German index is down from Q1 this year, confidence is greater than in other individual countries surveyed. The positive outlook is mainly driven by optimism regarding the climate for expanding existing business activity and growth by acquisition. Whilst on balance, the business and political environment is still perceived to be favourable to starting a new business, it is less so than in previous quarters this year (see Chart 9).

Despite the overall positive outlook regarding the local economy, 3i backed companies, on balance, are less optimistic about their own fortunes this quarter. Fewer predict an increase in profitability and turnover this quarter. They are also less positive about employment levels over the coming year. This pull back suggests a degree of caution in an otherwise comparatively optimistic German economy (see Chart 10).

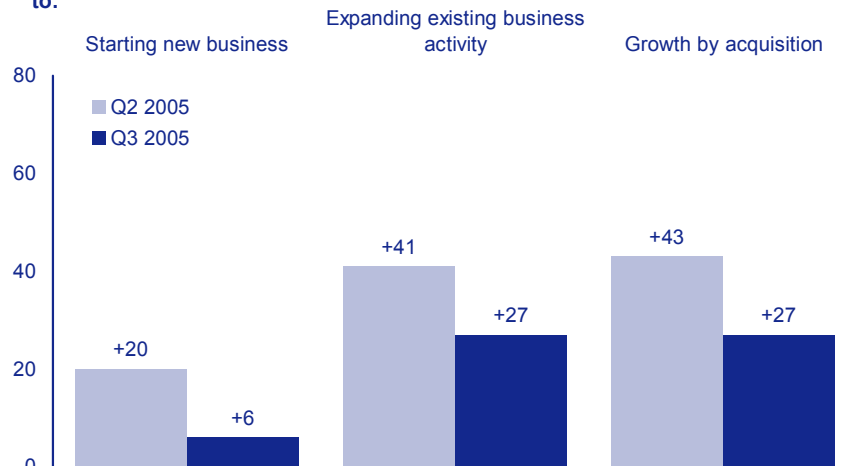
"Expecting positive 'psychological' changes following the election."

3i backed company, Germany

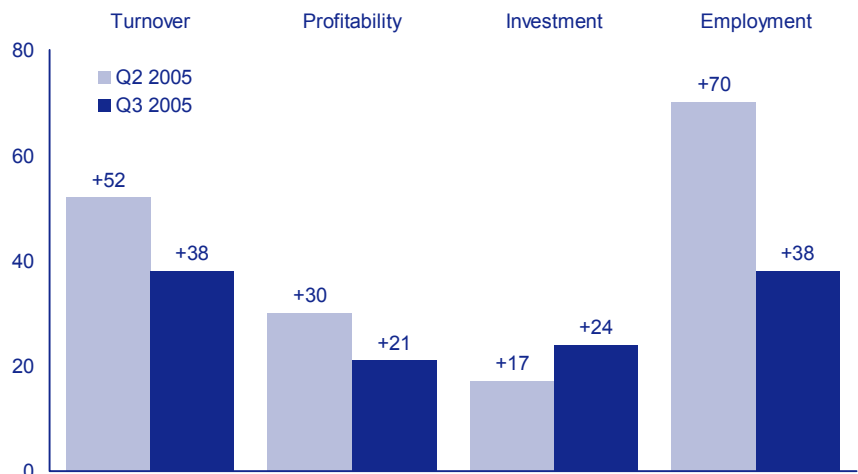
**Chart 8: Germany Barometer Index**



**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

Despite a slight downturn in optimism regarding the business and political climate, the Nordic region continues to maintain a strong level of business confidence compared to the other European countries (see Appendix: Barometer Index).

The latest results from Q3 suggest that the Nordic markets remain ready for expansion of existing business activities. However, the outlook for business start ups is less promising, dropping to a score of -6, the lowest in the Nordic region since Q2 2003 (see Chart 12).

Whilst the Nordic regions are optimistic about increasing levels of turnover over the current quarter, expectations for profitability are down slightly from the Q2 level (see Chart 13).

On balance, investment is expected to remain stable. But, there is less optimism about employment levels in the coming year.

“We have reached a peak and demand will decrease. The order income for our mechanical industry sector has dropped a little and we do not see that there will be any change in that situation for the rest of the year.”

3i backed company, Nordic

Chart 11: Nordic Barometer Index

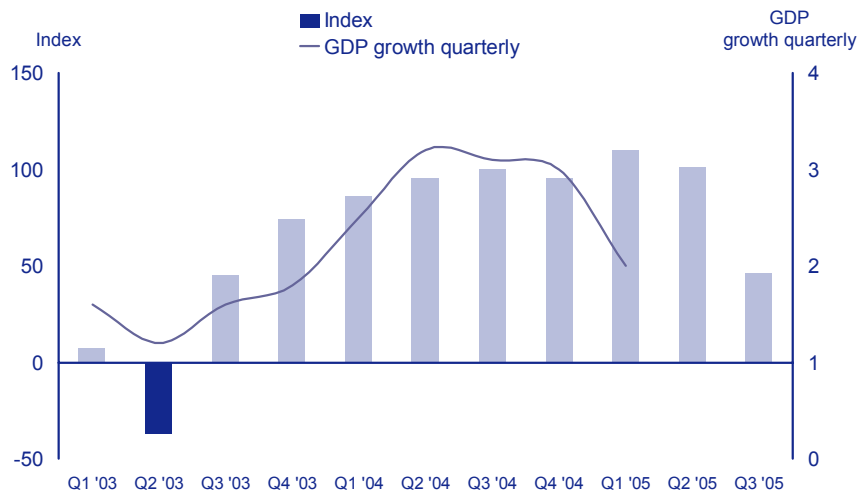


Chart 12: Components of Barometer Index – balance of all Nordic respondents (weighted by GDP) considering business and political climate more favourable to:

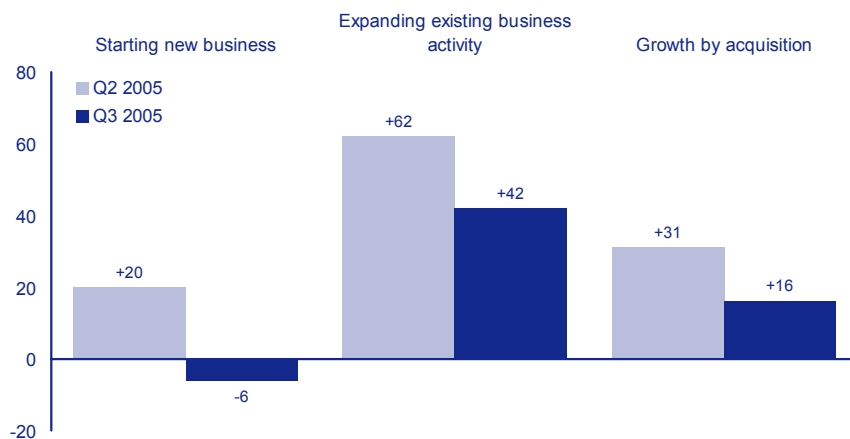
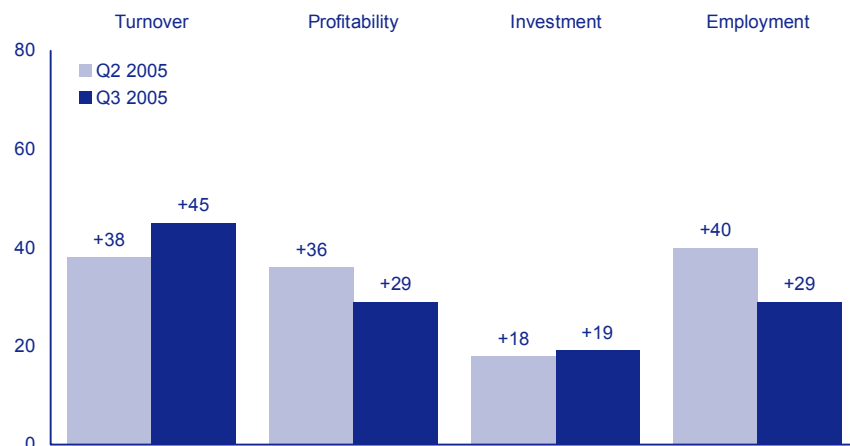


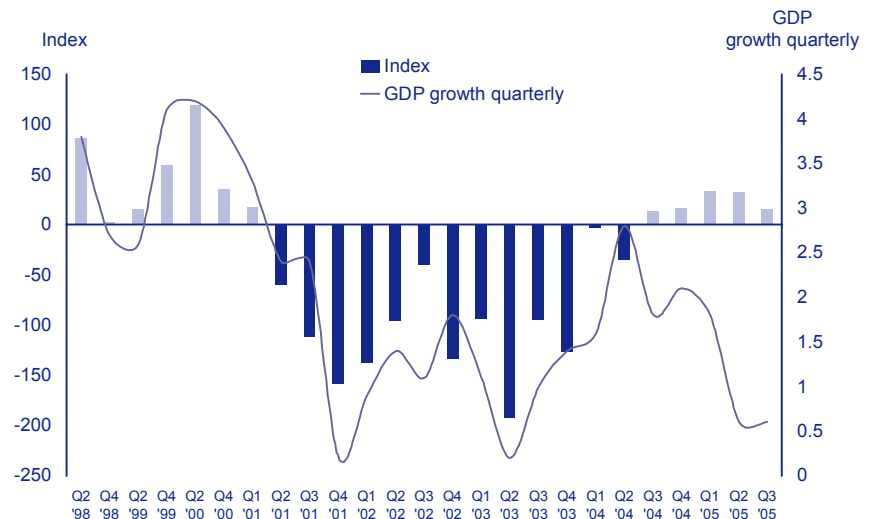
Chart 13: Balance of all Nordic respondents (weighted by GDP) expecting an increase over current quarter in:



# France, Spain and Italy

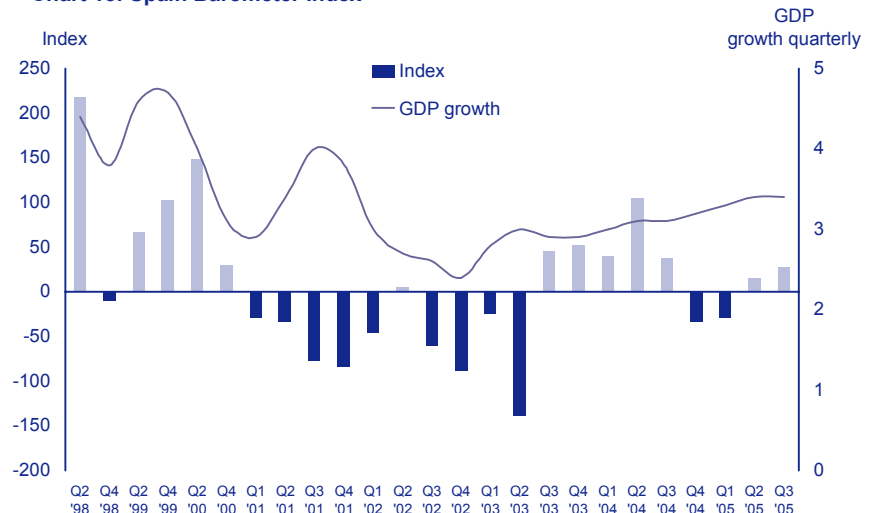
Q3 has seen a downturn in optimism regarding the business and political climate in France. This has been largely driven by an increasingly pessimistic outlook for new business start ups and expansion. However, 3i backed companies remain confident about the current climate for growth by acquisition (+64 in Q3). After initial optimism in Q1 2005 about turnover, the Q3 outlook shows French confidence to have stabilized at a lower level on a par with Q2. By contrast, the outlook for profitability and investment this quarter show signs of growth. (see Chart 14).

Chart 14: French Barometer Index



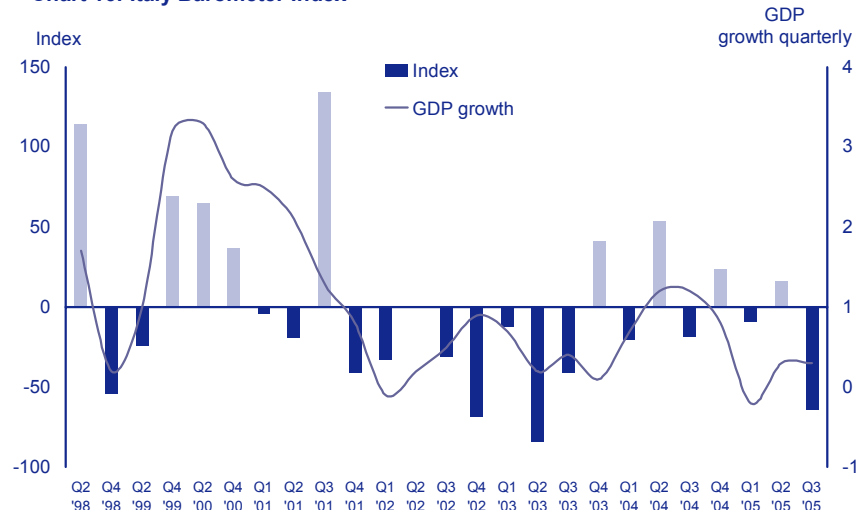
Q3 sees continued growth in optimism amongst Spanish 3i backed companies, making Spain the only country in the EEB with an improved Index score this quarter. The main drivers of improved business confidence are an increasingly optimistic outlook for expanding existing business activities combined with a less pessimistic outlook for new company start ups. Expectations regarding turnover, investment and profitability are higher this quarter compared to earlier this year, whilst predicted employment remains stable (see Chart 15).

Chart 15: Spain Barometer Index



In the past few years, the Index in Italy has fluctuated between positive and negative. The latest results indicate that the outlook in Italy is now more pessimistic than it has been for the past two years. The business and political climate for starting a new business or expanding existing holdings is considered to be unfavourable on balance. But, similar to other European countries covered in the scope of European Enterprise Barometer, the outlook for 'growth by acquisition' is the only area where businesses are truly optimistic. On balance, the index continues to see fluctuations in terms of turnover, profitability and investment; with Q3 showing a negative swing amongst 3i backed Italian companies (see Chart 16).

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 20<sup>th</sup> July 2005. By 5<sup>th</sup> August, 245 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 and France, should be borne in mind when assessing the results.

## Barometer Index

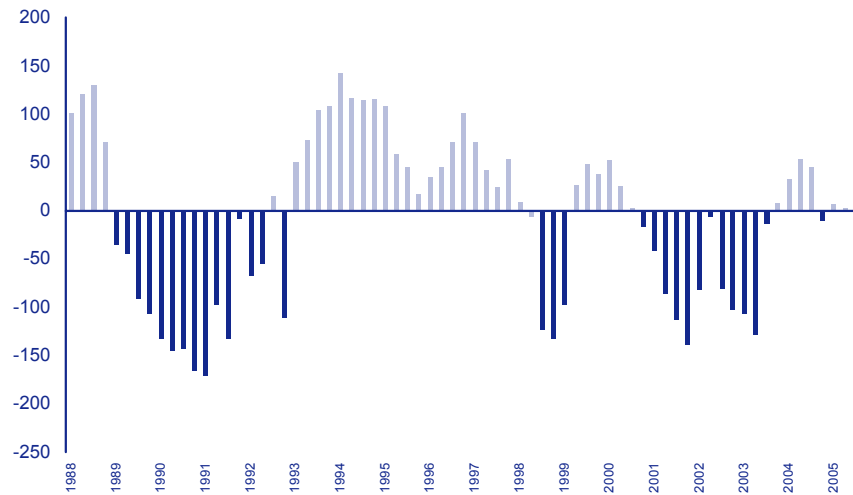
	Weighted	UK	France	Germany	Spain	Italy	Nordic
Q2 98	81	-6	86	79	218	114	
Q4 98	-34	-133	3	12	-10	-54	
Q2 99	10	26	16	-3	67	-24	
Q4 99	47	38	59	19	102	69	
Q2 00	84	25	120	98	148	65	
Q4 00	40	-17	35	91	30	37	
Q1 01	-3	-41	18	21	-29	-4	
Q2 01	-48	-86	-60	-33	-34	-19	
Q3 01	-49	-113	-112	-53	-76	134	
Q4 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	-108	-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
Q3 05	4	-46	16	53	28	-64	46

## Response Rates

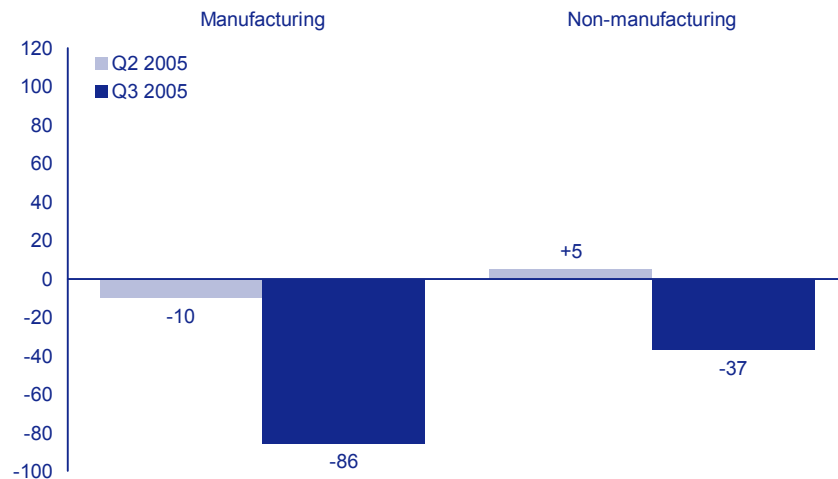
	All (unweighted)	UK	France	Germany	Spain	Italy	Nordic
Despatched	1103	792	51	123	52	20	65
Returned	245	143	11	34	19	7	31
Response rate	22.2%	18.1%	21.6%	27.6%	36.5%	35.0%	47.7%



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



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



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

