

## **BURKHARD BALZ**

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“German Private Equity and Venture Capital Funds 2011 – An attractive investment opportunity”,  
Opening Statement: “Germany – the Economic Powerhouse of Europe”

Ladies and Gentlemen,

first of all, I would like to thank Mr. Ostheimer and *Mr/Mrs ... (Representative of Hong Kong Trade Development Council)* for their warm words of welcome. It is my great pleasure to speak to such a distinguished audience today. It has been my first visit at the Asian Financial Forum and I daresay, I was very impressed by the excellent selection of speakers and the various networking opportunities. Given my professional background as banker, having primarily worked with institutional clients, I naturally still feel associated with the developments in the investment business.

Tonight, I would like to address you as Member of European Parliament, who is represented in the Committee on Economic and Monetary Affairs as well as in the Special Committee on the Financial, Economic and Social Crisis. My special bond to Asia and China becomes apparent through my substitute membership in the EU-China Delegation of the European Parliament.

At the beginning of my opening statement, I would like to underline the traditionally excellent economic relations between the European Union and China. This statement can be easily emphasized by impressive figures. From 2000 to 2009 the trade volume between both trade giants tripled. From the European perspective exports rose from 26 billion to 82 billion Euro and imports increased from 75 billion to 248 billion in 2008, followed by only a slight decrease in 2009. Direct EU foreign investments amounted to 5,3 billion Euro in 2009. Thereby, Germany is accountable for a large amount of the European trade with China. German companies keep the biggest share of the European trade volume to China with 47% of its exports and 23% of its imports.

Why is the German economy the driving force in Europe?

After the introduction of the Euro in 1999, Germany was called the “sick man of Europe” in sharp contrast to the fast growing countries at the peripherals of the European Union. Meanwhile, the former favourites of foreign investors – Ireland, Greece and Spain – face serious economic difficulties. The tide has turned to the benefit of Germany and its sustainable economic and budgetary politics. The German economy is the largest in Europe and the fifth-largest in the world. The recent economic growth began to outperform other economies in Europe and is likely to continue through 2011. Searching for an explanation for the current German strength, we have to go back to history.

At the beginning of the 90s domestic and foreign companies considered Germany’s reunification as a chance to grow. It opened the door for massive investment, mostly in former East Germany. In general, the modernization and integration of the eastern economy had been a costly long-term process, with total transfers from West to East amounting to 2 trillion or even up to 3 trillion so far. The introduction of the Euro forced companies to cut costs and to increase productivity in order to remain competitive in foreign markets. A substantial reform package in the labour market followed. All in all, “the worker productivity per Euro spent” raised remarkably. According to figures published by the European Central Bank, Germany became around 13% more competitive compared to its neighbours.

With a global economy showing slight signs of recovery, Germany was ready for a new take-off. At the moment the German economy is growing faster than the US-American and has a lower unemployment rate. While the United States are running the danger of deflation, current European interest rates may already be too low for the German economic boom. The secret of the German success are not only the well-known global champions like BMW and Siemens, but also small and medium-sized companies, often family owned, with less than 500 employees and annual sales of less than 50 million Euros. They employ 70% of German workers and contribute to 50% of the country’s Growth Domestic Product.

In order to back up the short-term achievements by a foresighted, prudential policy, the German government presented a four-year fiscal consolidation package worth 80 billion Euros in order to reduce the structural budget deficit. The austerity package will largely focus on labour and social security budgets. Additionally, revenues are increased, for example by requiring the banking sector to pay a bank levy related to a bank’s size, business sector, interconnectedness and volume of derivative trades.

In 2010, Germany's deficit amounted to roughly 4% of its GDP. That is significantly less than previously forecasted. The European Union has given German government until 2013 to get its consolidated budget deficit below 3% of GDP, the target set by Stability and Growth Pact. Besides, a new constitutional amendment limits the federal government to structural deficits of no more than 0,35% of GDP per year as of 2016. It is likely that Germany will be able to meet both requirements ahead of schedule.

The economic upturn during the past months largely depended on the growth of exports - a phenomenon, which is not completely new for my country. In fact, between 2004 and 2007 exports accounted for two-thirds of the economic growth. After a sharp recession in 2009, when the GDP contracted by nearly 5%, the German industry now substantially recovered from the doldrums, even though figures are still 17% below their historical peak. However, for the upcoming years research institutes expect the German economic upswing to continue. Growth rates between 3% and 2% of GDP are forecasted. The positive outlook is also strengthened by a significant increase in domestic demand. Within the European Union Germany is likely to remain in the pole position. For whole Europe the growth expectations range around 1,4% of GDP. Besides, Germany is far less limited by household debt than its neighbours. Given the arguments before, the country seems to be in a good starting position to further benefit from the boom in emerging markets - and to become more and more attractive for foreign investors.

Why should we not develop a more intense relationship in the field of private equity and venture capital? A strong private equity industry provides an alternative source of funding for capital-rationed companies. It can re-energise tumbling companies. It injects better management, when better management is required. And finally it also offers investment opportunities for institutional investors capable to deal with the associated risks.

The worldwide private equity markets partly recovered from a dramatic cutback of activities in 2009, which had been the result of the liquidity crisis in the US sub-prime market in 2008 and the following economic downturn worldwide. Indicators for the first half of 2010 announced that investment activity is slightly up compared with the first six months in 2009, with private equity firms focusing on investments in small and medium sized companies. According to research reports full year figures for 2010 will result in a moderate increase compared to the previous year.

The financial crisis, its global economic damage and the enormous efforts to stabilize financial markets forced governments and regulators to review the regulatory and supervisory architecture. In November 2010, the European Parliament adopted a new Directive on Alternative Investment Fund Managers, the so-called AIFM-Directive, which will be transposed into national law until 2013. It is worth to mention three key areas, in which the Parliament had a strong say, while negotiating the text with the European Commission and the Council.

- Private equity funds: The AIFM Directive contains provisions, which should protect portfolio companies from asset stripping. A special safeguard clause is foreseen for the first two years, after a company has been taken over by a private equity investor. Besides, private equity investors have to comply with detailed information and disclosure requirements. However, this is no rule without proportionality: Private equity investments in small and medium-sized companies are exempted from these provisions.
- Selection and liability of depositary: The new Directive clarifies, who can be selected as depositary and who remains liable, when depositary tasks are delegated.
- Marketing passport: From 2015 onwards investment fund managers and funds from outside the EU will be able to obtain a marketing passport for the whole Union area, subject to certain conditions (as, for example, a cooperation agreement between the supervisory authorities involved).

From the German perspective, the Directive is an appreciated complement to already existing national regulation. For the first time, there will be a pan-European regulatory regime for alternative investment fund managers, creating a level playing field and strengthening the legal predictability for investors. The European Parliament made huge efforts in order to include a passport option in the new legislation, which will hopefully attract foreign investors – why not from China?

China still successfully withstands the downturn in global economy. The private equity market in China is growing rapidly in number, size and variety of deals. More than half of China's exports are currently produced by foreign-invested enterprises. Companies in China's neighbour countries Japan and South Korea play a major role in this process. The role of European enterprises is certainly extendable, as the majority of consumer goods is already exported to the European Union.

So far, China-focused funds have accounted for more than 9% of the global fund raising – an enormous increase compared to 1% in 2007. The private equity sector fills a gap in China's financial system, where capital is primarily channelled through state-controlled banks. Especially start-up-companies benefit from fund raising actions by venture capital funds. A further relaxation of capital-

raising-rules caused another boom. The restriction on registered insurance companies placing money in private equity firms was partly lifted. They can invest up to 5% of their assets this way. The recent developments are naturally most welcomed by representatives from Europe, who are open for a more intense bilateral cooperation. A good example is the following: According to recent figures by Asia Private Equity Research there are 167 foreign private equity managers registered in China – an increase of nearly 100% in comparison to the situation only ten years ago.

Switching to German private equity markets: The PE industry already bottomed out in 2009, when the consequences of the global financial crisis were still pretty obvious. Current figures underline a positive trend. In the third quarter of 2010 the investments in German companies increased by one-third compared to the second quarter. After nine months the investments already outnumbered the year-end-result in 2009. So far, the buyout investments already tripled compared to 2009. It is more than likely that the German economic uptrend will further enlighten business expectations and result in an increasing number of buyouts.

In the foreseeable future the private equity and venture capital industry will be for many good reasons an integral part of the European economic landscape. The regulatory environment will preserve stable conditions in this specific business sector. It would be too easy to say that Germany has solved all of Europe's economic problems, as a balanced German economy will probably not be enough to save all Eurozone countries from their current difficulties. However, the structure of the German industry is healthy - good products, well-known brands and a solid mixture of innovative, globally recognized companies. As Europe's driving economic force Germany will be an excellent starting point for investors interested in sustainable business opportunities. The country is now collecting the dividend for political and legislative changes, which have been envisaged several years ago and are continuously implemented. Thus, our companies were able to preserve their competitiveness on world markets, initiating a remarkably fast comeback on the path of sustainable growth.

To remain successful in a world economy, in which competition is increasingly intense, politicians and business must continuously look out for improvements – why not in spirit of mutual cooperation and trust?

Thank you very much for your attention.