IMPACT STUDY:

Venture capital and private equity investors' impact on corporate growth

in 2010–2020

Key observations in the impact study:

- Businesses owned by venture capital and buyout investors, which together are referred to as private equity (PE) investors, are among the fastest growing companies in Finland
- Turnover of PE-backed businesses has grown on average nine times faster than at the peer companies
- The number of personnel in companies owned by PE investors has increased on average five times faster than at the peer companies
- Developing business operations and enabling growth require investments – Companies owned by buyout investors have been able to grow and improve their profitability simultaneously
- The study results indicate that PE-backed companies performed significantly better than peer companies during the Covid-19 pandemic

Introduction

Private equity has great significance as an accelerator of economic growth and as an employer in Finland. The aggregate revenue of Finnish portfolio companies owned by both domestic and foreign private equity investors is over €25 billion, representing over 5% of the total revenue generated by companies in Finland. In terms of export the revenue generated by Finnish portfolio companies was over €1 billion in 2020, which amounts to approximately 2% of total Finnish export. The amount of export share of Finnish portfolio companies' revenue grew by approximately 10 percentage points between 2018 to 2020, increasing from roughly 30% export of total revenue in 2018 to 40% in 2020. The total employee count in the portfolio companies in Finland is approximately 73 000, which is over 5% of the total amount of personnel in all Finnish companies. In addition, part of the employees – approximately 10 000 – of the Finnish private equity investors' portfolio companies work abroad.

The purpose of this report is to provide an overview of the impact of private equity investments, including venture capital, on Finnish business activities. The material in the report consists of companies that received an initial investment from a Finnish private equity investor between 2010-2020. The analysis was implemented by KPMG Oy Ab in corporation with the Finnish Venture Capital Association.

Private equity investment means corporate financing outside the stock exchange, which is often done in the form of equity financing and typically channeled to the marketplace through PE investment funds. Private equity investors manage funds whose largest investors include e.g., pension funds and other institutional investors. Investments are, in principle, made for the medium or long term and characterized by active ownership. Active ownership means that the main shareholder engages in close cooperation with the company's management in order to develop its business operations further.

In this report, private equity investment is divided into two categories: Venture Capital (hereinafter "VC", including seed companies) and Buyout (hereinafter "BO", including growth companies). VC investments are targeted at early-stage companies that need funding and experts to develop and grow the company. In this context, a VC company refers to a company that has received a VC investment. BO investments are often directed at medium-sized companies and are, in terms of their profile, less risky than investments made in VC companies.

Private equity investment provides many benefits, for example, by strengthening the financial standing of the company and by enhancing the company's balance sheet, which enables the company to make new investments or find debt financing for growth.

In addition to capital, PE investors provide companies with strategic expertise, develop the reporting and management systems, create modern incentive and commitment models, and make their own contact networks available to the company for rapid development of the operations. PE investors enable companies to access new markets through their extensive networks, both at national and international levels.

This report focuses on the impact of private equity investors on three different subject areas in corporate operations: growth of companies, increase in personnel, and profitability.

Methodology, framework, and constraints of the study

The premise for this study is annual data provided by Finnish venture capital and private equity investors of their investments in 2010-2020. The sample in the 2010-2020 period comprised 744 target companies, of which 605 could be included in the study based on the availability of their financial figures. Of these 605 companies, 287 were in the BO category and 318 in the VC category.

In our study, we wanted to find a group of companies that could be compared with target companies that received an investment. Thus, a peer group was created for every combination of investment type and initial investment year, in accordance with the following criteria:

- The peer database includes 81,010 businesses with a turnover of more than €100 thousand in 2017.
- For every combination of investment type and initial investment year, all compa nies are selected from the database in the same industries with turnover between the turnover of the smallest and largest company receiving a PE investment.
- Deleted from the peers are the 0.5% fastest growing companies and 0.5% of the most decreased companies, due to potentially incomparable financial details.
- A weighted average is calculated of the turnover growth rates, by industry, in the same proportion as the target companies’ turnover is divided among the industries.

COMPANY PROFILES

The companies included in our study ranged in size from very small startups to large and mature businesses, stemming from different industries and geographic locations. To gain a better understanding of their makeup, the companies have been categorized into different size categories and industries. Graph 1 presents the split in turnover size for the BO and VC companies based on the 2020 figures. As earlier stated, the VC category mostly consists of early-stage companies and are consequently smaller than their BO counterparts. The BO companies represent a more varied group, ranging from very small, to companies with over €100 million in turnover.

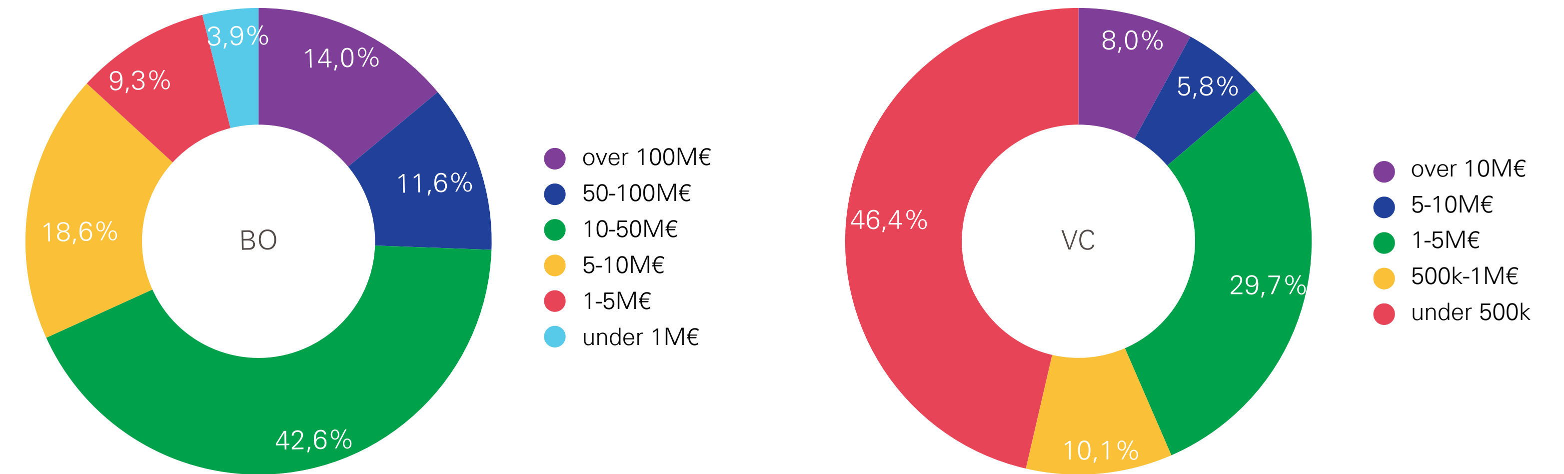
In terms of geographic presence, the studied PE companies were mostly from Uusimaa, with most of them concentrated in the capital region. Helsinki was by far the most represented city, with 277 of the companies of the total 605 being based there. Other important centers for PE investments include Espoo with 68 companies, Oulu with 63 companies and Tampere with 42 companies. Overall, PE companies are located across the nation and the quality of the company is the main factor for the PE investors to make an investment, not the geographical location.

The companies selected by PE investors were active in variety of industries. This can be seen in graph 2, which presents a percentual split of BO and VC companies' initial investments between 2010-2020 per industry segment. The most favored industries for VC investors were information and communications, industrial manufacturing, and professional and technical services, while most BO investments were in industrial manufacturing and professional and technical services. Historically, information and communication as well as professional and technical services remained as the largest investment segments over the years, while wholesale and retail investments moderately decreased during the last years.

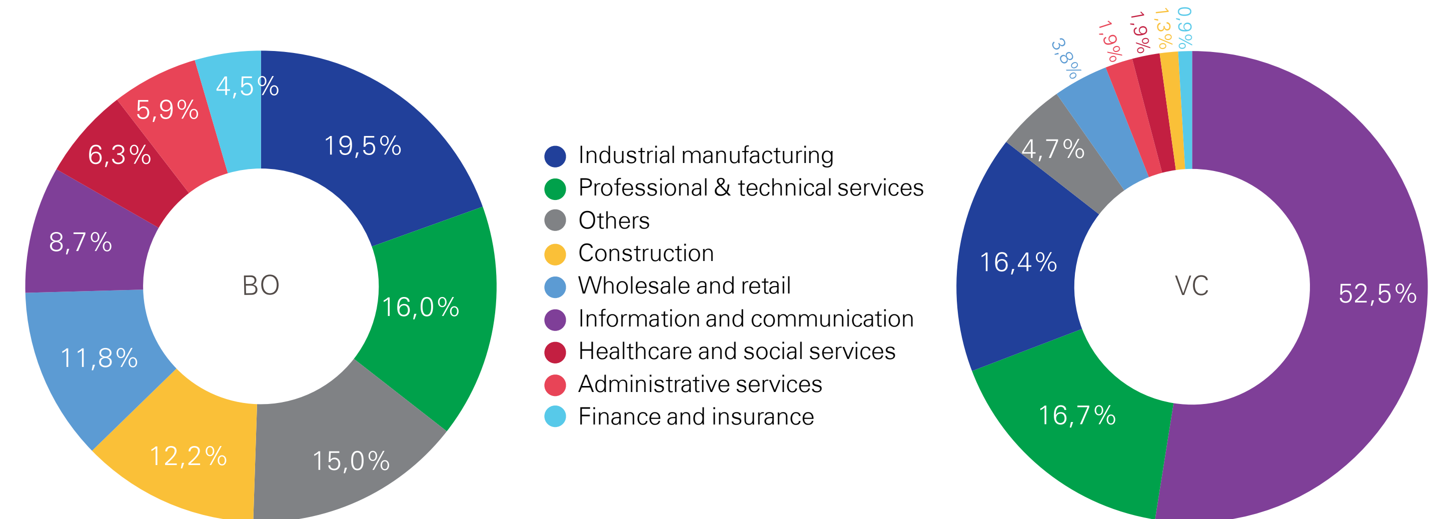
GROWTH:

Businesses owned by venture capital and private equity investors are among the fastest growing companies in Finland

The goal of private equity investors is to generate rapid growth for their target companies by means of development of business operations and through both organic growth and acquisitions. Some of the growth in turnover at such companies comes with acquisitions, but much of the change takes place organically as the companies grow.



Graph 1. BO and VC companies split by turnover (2020 revenue)



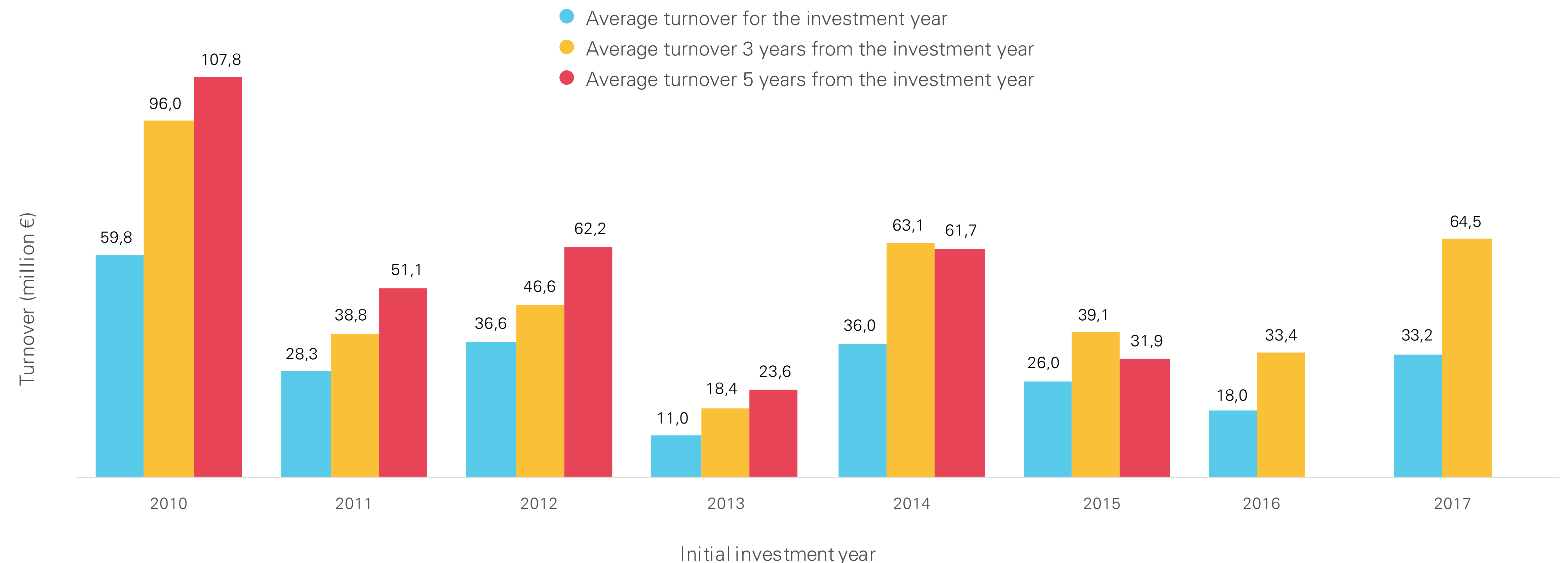
Graph 2. BO and VC companies' initial investments by industry (2010-2020)

Result of the study:

We studied the development of companies that received their initial investment between 2010 and 2017 over a three- and five-year period, e.g., for companies receiving an investment in 2010, the three-year review extends until 2013 and the five year period extends to 2015. During the 2010 to 2017 period, there were 240 BO companies and 272 VC companies that received their initial investment from private equity companies.

The average turnover of BO companies, shown in graph 3, increased in all the review periods included in our study. During the three-year period after the initial PE investment, the average company grew by 64%. After five years the average growth had reached 81%, demonstrating the significant value added that investments by buyout investors can generate.

In absolute terms, the combined turnover for the BO companies during their initial years of investment between 2010 and 2017 was approximately €6,8 billion. After the three-year periods, this number had grown to approximately €9,5 billion. For the five-year periods of 2010 to 2015 the combined turnovers grew from approximately €5,1 billion to €6,3 billion. During the review periods several companies were exited, which affect the combined turnover and explains why relative growth per company is even larger than the growth in total turnover.



Graph 3. Buyout companies' average turnover for the investment year as well as 3 and 5 years from the investment

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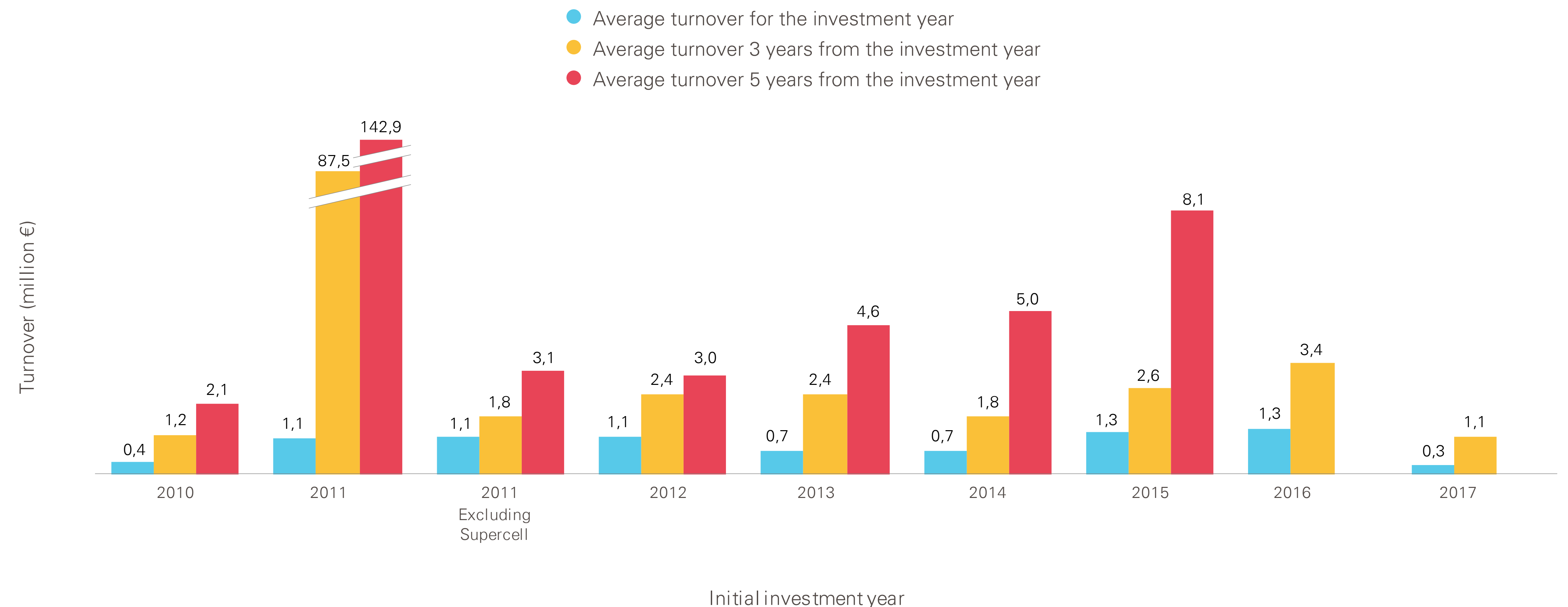
For VC companies, growth has been significant and most of it was generated organically. Graph 4 presents the average turnovers from the reported VC companies between 2010-2017. During this period the three-year growth per company amounts to an average of 170%, excluding the exponential growth of Supercell. During the five-year review periods of 2010-2015 the average growth per company was approximately 425%, again excluding Supercell. The five-year growth has been reaching higher year after year, which reflects the development of the start-up field in Finland.

In absolute terms, the combined turnover for VC companies grew from approximately €265 million during their initial investment years to €430 million after the three-year periods between 2010-2017. During the five-year periods of 2010 to 2015, the combined turnover grew from €203 million to €440 million. However, these totals do not take into account the companies that were exited during the review periods, meaning that the average turnover growth per company is even higher.

While being an extreme outlier and thus excluded from the analysis, Supercell still demonstrates the importance of private equity investors as enablers of corporate growth. Where competition intensifies and companies see an increasing need for growth, PE investors act as strategic and financial partners. Although VC investors aim at the highest profits possible by carefully selecting which startups to invest in, an estimated one-half of the companies that receive a VC investment fail to execute their business plan and cease operations within a few years. Still, the highly positive outcomes of successful startups outweigh the risks, making VC investing profitable.



Graph 4. Venture capital companies' average turnover for the investment year as well as 3 and 5 years from the investment

When compared to the peer group, both VC and BO companies performed significantly better in terms of turnover growth. With a sampling of all the VC companies, the three and five-year turnover CAGR was 77,8% and 47,6%. In comparison, the peer groups' figures for the same time periods were 8,7% and 6,9%, indicating that turnover for VC companies had on average grown over nine times faster than their peers.

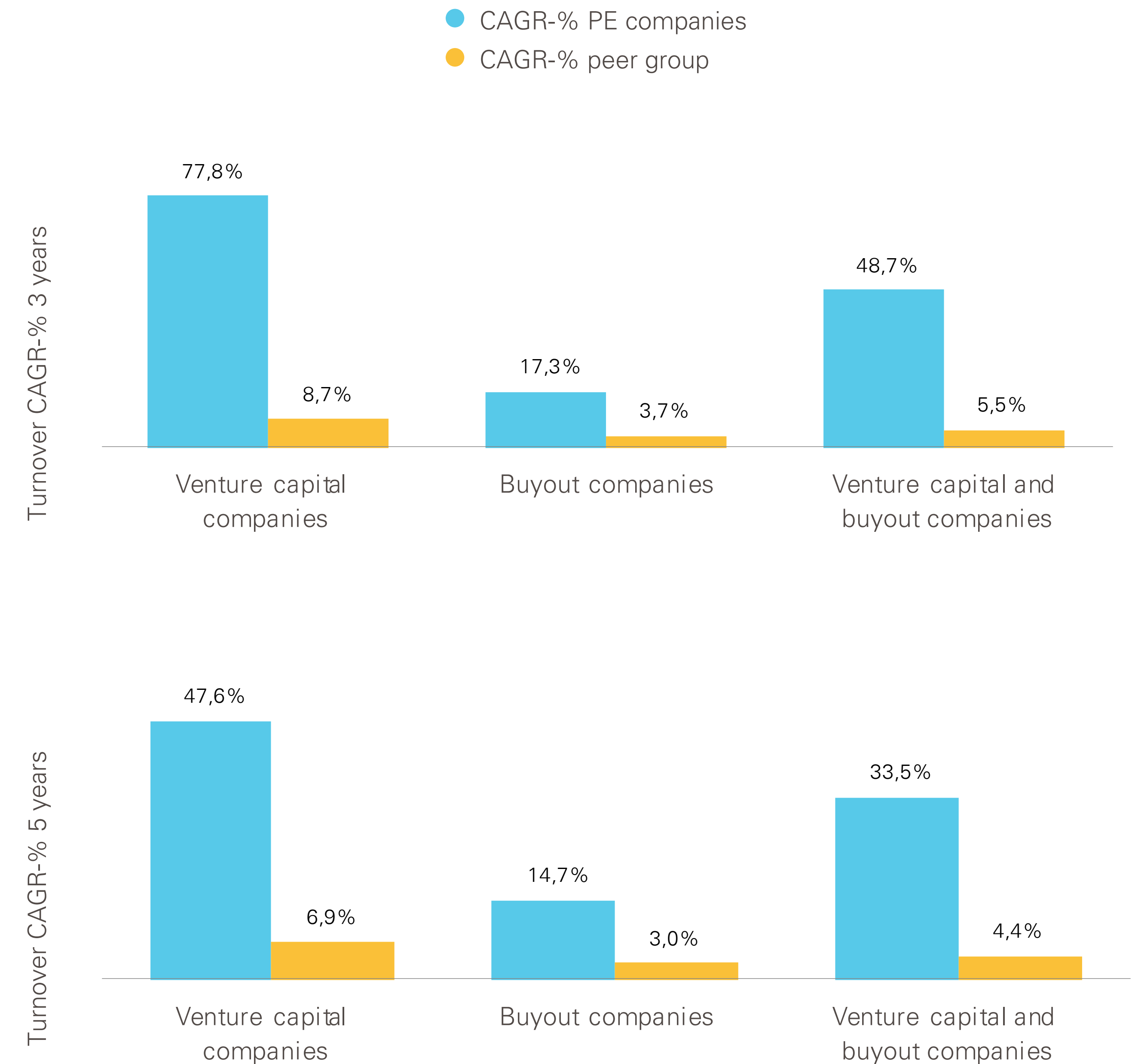
Respectively, the average turnover CAGR figures of BO companies were reported as 17,3% and 14,7%. While not growing as fast as the VC companies, BO companies still managed to outperform their peers by a large margin, growing approximately five times faster during the studied time period. When combined, the average turnover CAGR of VC and BO companies amounted to 48,7% and 33,5% compared to 5,5% and 4,4% for the peer group. Similarly, BO and VC companies outperformed peer companies significantly during the 2017 three-year review period with an average CAGR of 23,4% compared to 1,1% for the peer group. The result indicates that private equity companies performed significantly better than peer companies during the Covid-19 pandemic.

In conclusion, PE companies massively outperform their peers in terms of turnover growth, growing approximately nine times faster on a three-year horizon and seven times faster on a five-year horizon. While VC companies show larger relative growth, it should be remembered that the absolute CAGR figures of both types are not comparable, due to the difference in the companies' size.

PERSONNEL:

The number of personnel in companies owned by PE investors has increased on average five times faster than at peer companies, indicating faster employment growth than other companies in Finland

Companies that are funded by private equity can hire more employees to enable growth. On the other hand, rapid growth also requires hiring new employees to enable growth in the long-term. This is seen as a positive factor for both the companies and the Finnish economy. Some of the increases in personnel comes with acquisitions, but much of the change takes place organically by hiring new employees as the company grows.

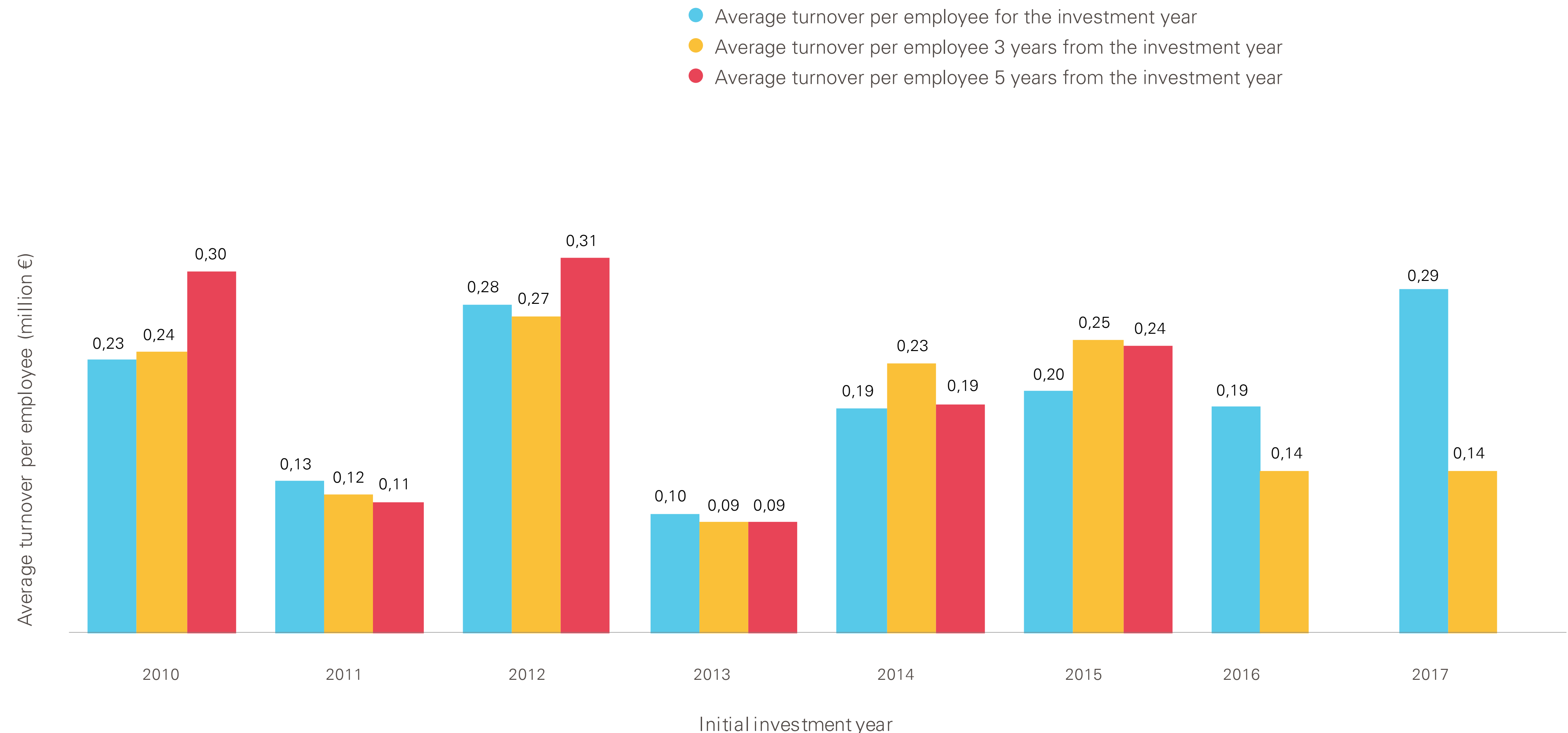


Graph 5. Venture capital and buyout companies' 3 and 5-year average turnover CAGR-% compared to peer group

Result of the study:

The combined number of employees at BO companies that received their initial investments between 2010-2017 was approximately 32 800. After the three-year period, this number had increased to 53 800, indicating 64% growth in personnel. After the five-year periods of 2010-2015 the number of employees increased from 22 000 to 33 000, indicating a growth of just under 50%. However, these totals do not take into account the companies that were exited during the review periods, meaning that the average personnel growth per company is even higher.

Another indicator that describes the development of a company in relation to staff is the company's average turnover per employee. This relation is also reviewed over a three-, and five-year period from the year of the initial investment. Graph 6 reveals that that the average turnover per employee for BO companies three years after the investment did not increase significantly from the initial year with the two most recent years included in our study showing a notable decrease, which may partially be explained by the Covid-19 pandemic, as the turnover of some companies have declined significantly in 2019 and 2020, but the employee count has not decreased proportionately. The figures for the five-year period show only a modest increase, indicating that the number of personnel has increased in line with the turnover growth of the companies. BO investments are more often directed to labor-intensive companies, where growth is often created by hiring more employees, thus creating new jobs.

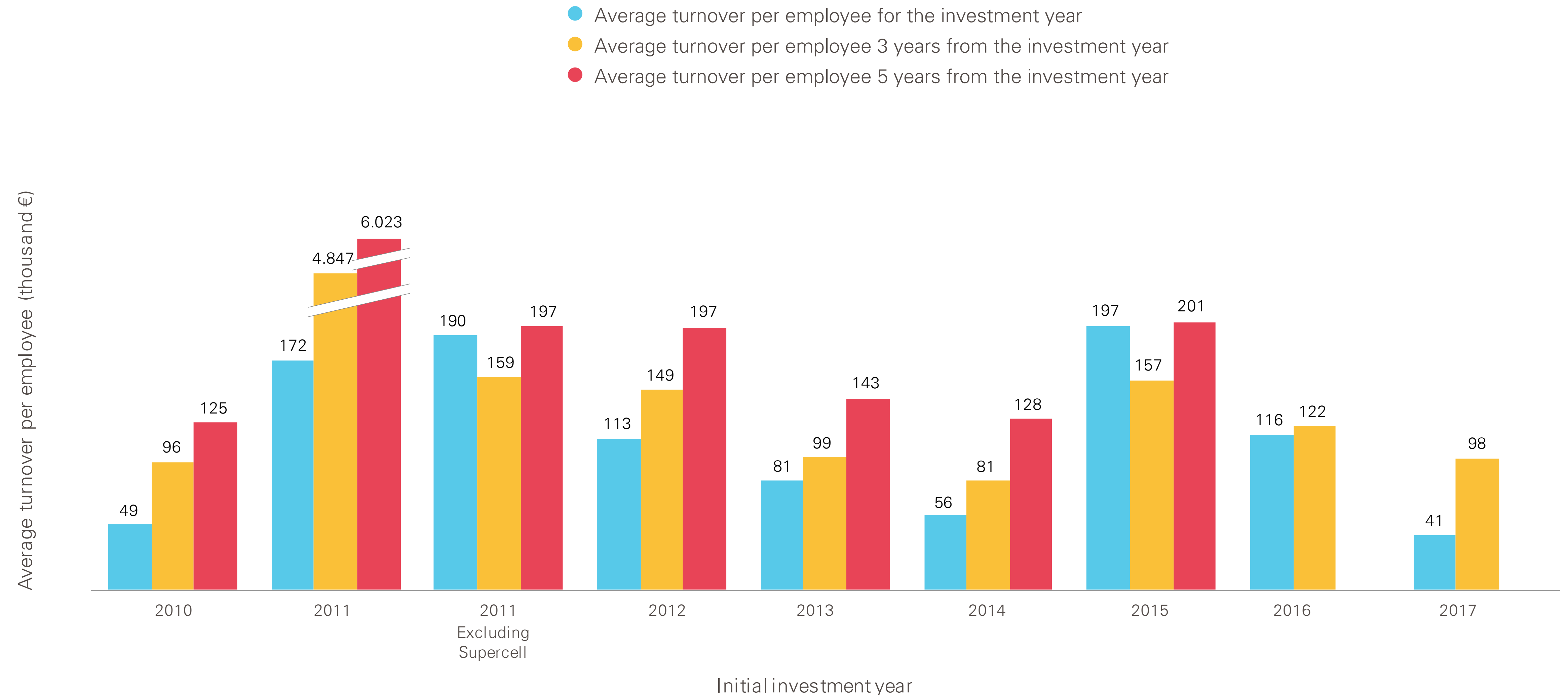


Graph 6. Buyout companies' average turnover per employee – for the investment year and 3 years as well as 5 years from the investment

For VC companies, the combined number of employees at the initial years of investment between 2010-2017 was 2 167. After the three-year period, the number of personnel had increased to 4 120, indicating a growth of over 90%. The five-year periods of 2010-2015 also show rapid growth, with the number of employees increasing from 1 706 to 3 098, indicating a growth of over 80%.

Graph 7 shows us that VC companies' average turnover per employee on both a three- and a five-year period is growing on a continuous basis compared to the initial investment year. This indicates that turnover growth for VC companies does not correlate as strongly to the hiring of more employees as the BO companies. Instead, VC companies increase their efficiency and productivity over time.

The majority of VC investments are based on a scalable business model, meaning that the resources within the invested companies can produce services for growing number of customers. VC companies often have a very low turnover at the time of investment but can grow faster and more spontaneously in comparison with larger BO companies. A good example of this is Supercell, which grew exponentially during 2011-2015.



Graph 7. Venture capital companies' average turnover per employee – for the investment year as well as 3 years and 5 years from the investment

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Graph 8 reveals that the average CAGR personnel growth of BO and VC companies' is much higher in comparison to the peer groups. BO companies' annual growth rate on a three- and a five-year period was 16,6% and 8,0% whereas the respective numbers for the peer group were 4,5% and 2,5%. The rate of personnel growth was fastest in the first three years after the investment and steadily decelerated after that. Similarly, the personnel CAGR also slowed down among peer companies', keeping the ratio compared to the PE companies mostly unchanged over the years.

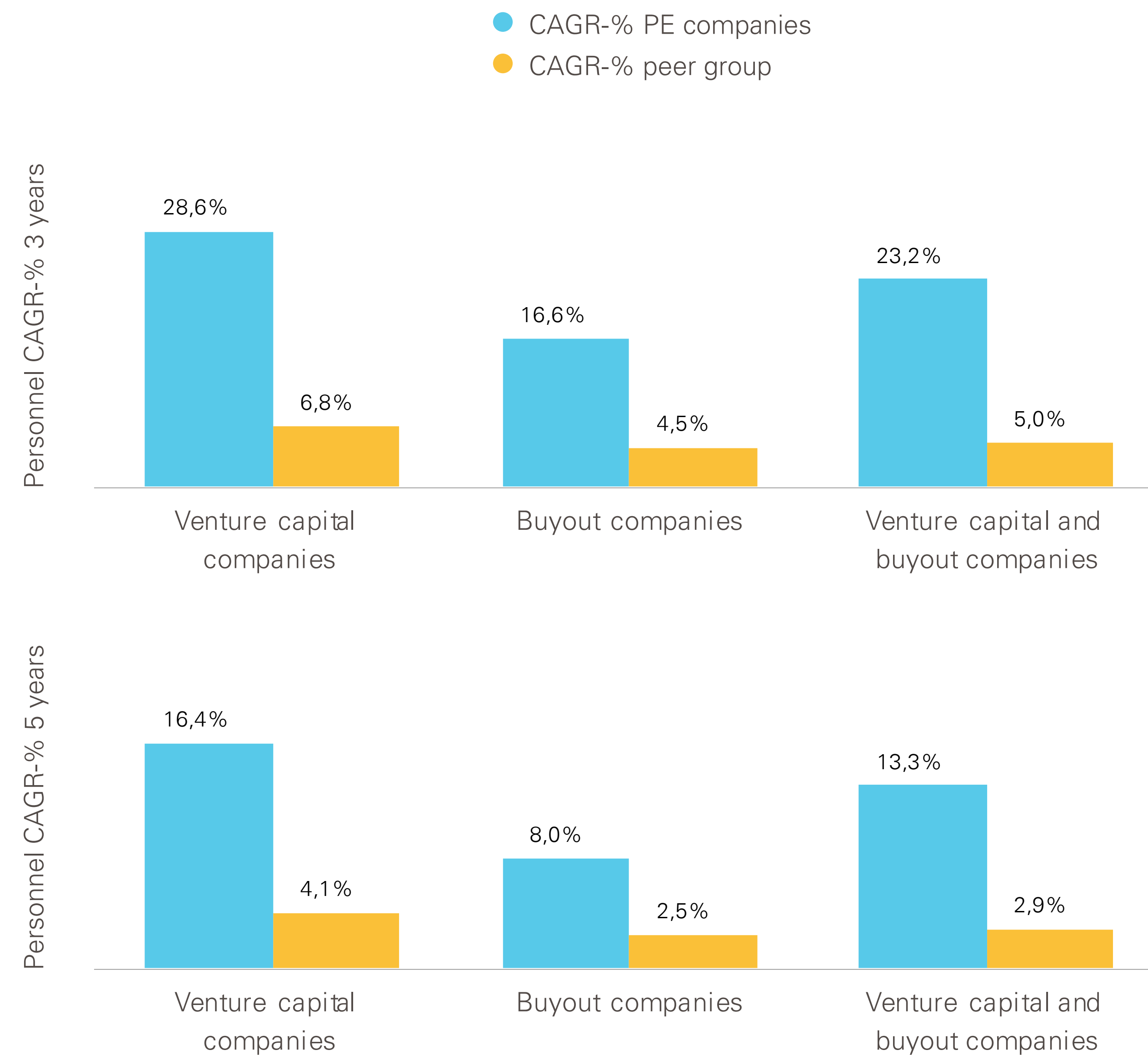
VC companies also significantly outperformed their peers, with growth even exceeding the BO companies. The VC companies reported personnel growth within the three and five-year periods of 28,6% and 16,4%. The peer group, in contrast, only grew by 6,8% and 4,1%. The difference in personnel growth between BO and VC companies is to be expected, given that VC companies tend to be relatively small, rapidly growing companies, while BO companies tend to be larger and more mature businesses.

The combined average three- and five-year personnel CAGR of BO as well as VC companies was 23,2%, and 13,3%, whereas the peer group's corresponding figures were 5,0% and 2,9%, indicating that personnel in PE companies grew approximately five times faster in comparison to their peers throughout all of the calculated periods.

PROFITABILITY:

Developing business operations and enabling growth require investments – Buyout companies have been able to grow and improve their profitability simultaneously

A company can have many motives for seeking external capital, but the main reasons are often the same: the company either seeks growth or needs revitalization or a similar change. Growing a company, revitalizing, and developing its business operations are often expensive; although BO companies have sought rapid growth through investments, they have still managed to improve their profitability throughout the review period. VC companies in contrast, are typically less profitable in the early days of business due to large focus on growth and prioritization of value investments over savings.

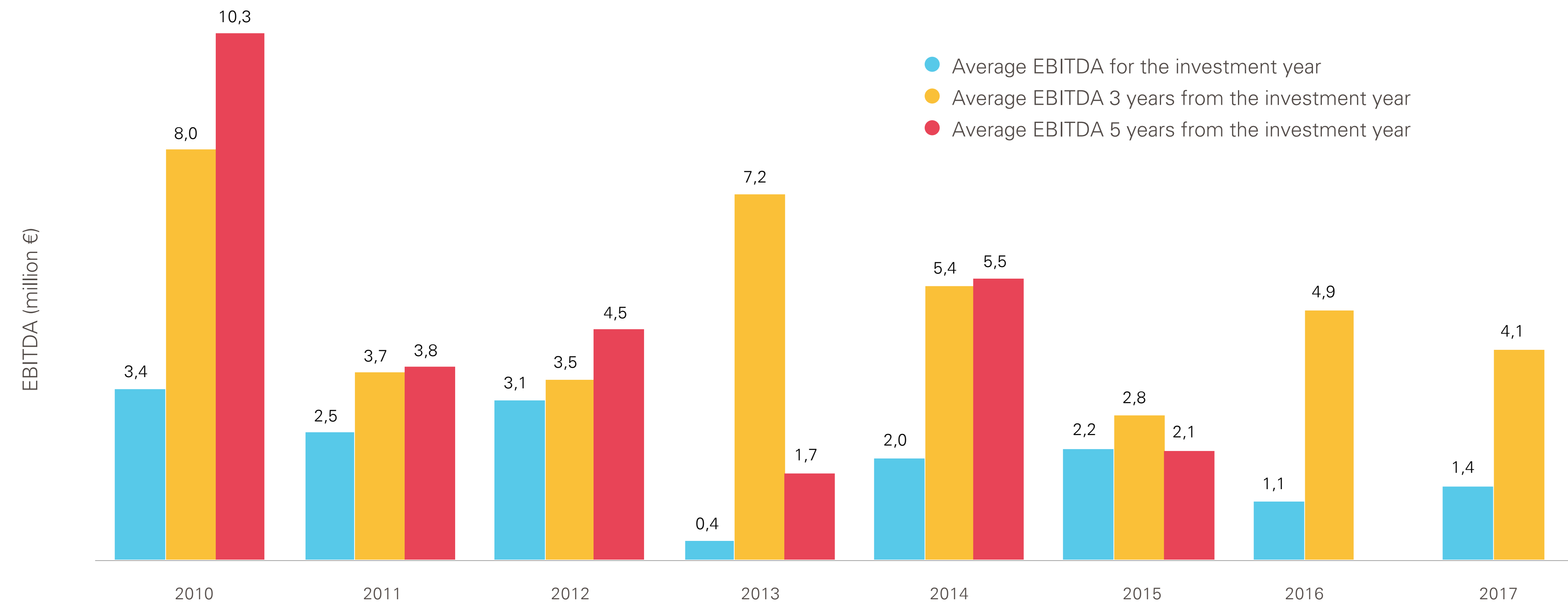


Graph 8. Venture capital and buyout companies' 3 and 5-year average personnel CAGR-% compared to peer group

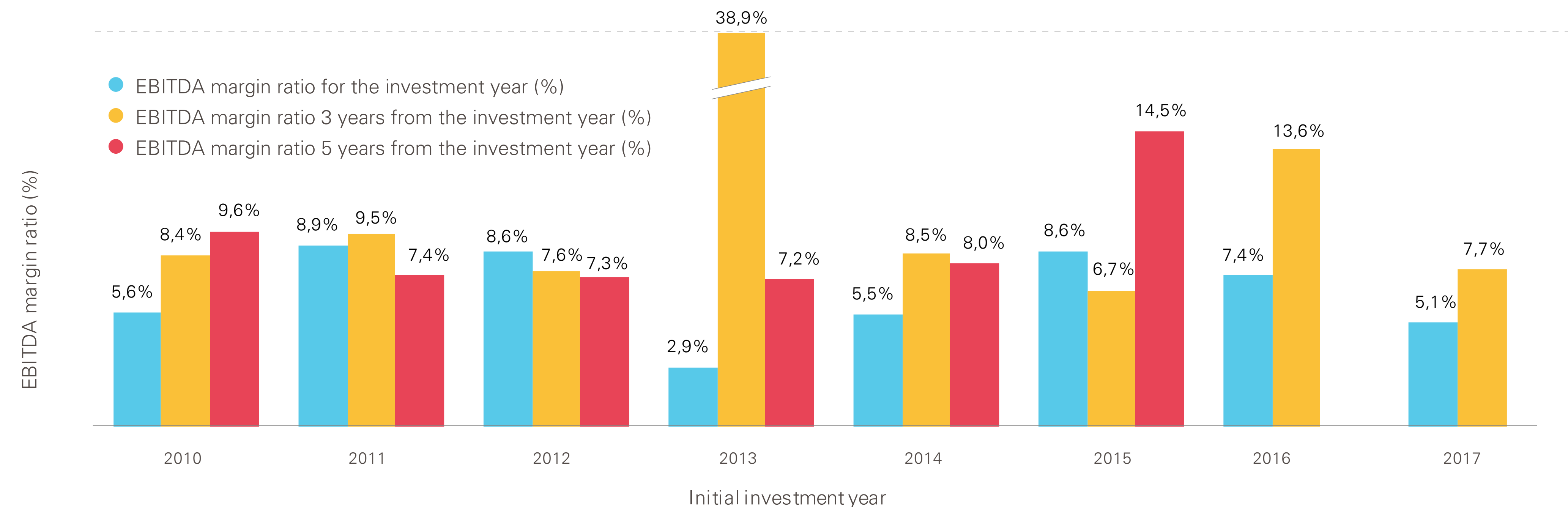
Result of the study:

In our study, we used EBITDA as an indicator of the company's profitability. Graph 9 shows the average EBITDA of the BO companies for the investment year, as well as after three and five years. In comparison to the initial year, the average EBITDA had increased after the three-year period in all the years included in the study. The figures from five years after the initial investment also show a significant increase, with an average growth of 238% from the initial year, more than tripling the average EBITDA. The dramatic difference in the year 2013 can mostly be attributed to the sale of subsidiaries or business operations of a few companies.

The average EBITDA growth in graph 9 is tremendous but should be compared to the turnover. Therefore, the EBITDA margin ratio, calculated as EBITDA in relation to turnover, is presented in graph 10. When comparing the graphs, it is evident that the development in profitability has not entirely followed the same path as the average EBITDA. While the development in EBITDA margin ratio has overall been positive, the relative growth is smaller and more volatile on an aggregated level compared to the average EBITDA. However, maintaining a stable profitability level simultaneously while growing rapidly can only be an indicator of the high quality which BO companies establish. Furthermore, it should be noted that long-term profitability cannot be determined by analyzing individual years, rather, a longer time horizon is needed in order to get a complete picture.



Graph 9. Buyout companies' average EBITDA for the investment year and 3 and 5 years from the investment

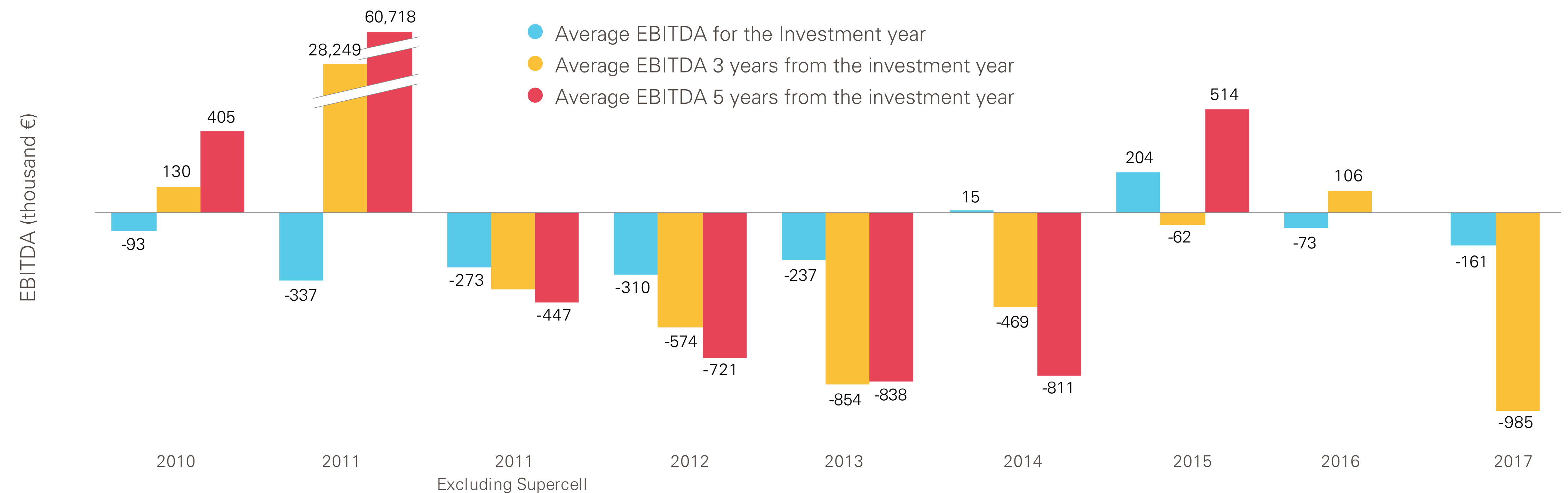


Graph 10. Buyout companies' EBITDA margin ratio for the investment year and 3 and 5 years from the investment

In graph 11, the average EBITDA for the VC companies for the investment year, as well as 3 and 5 years from the investment, is presented. The combined average EBITDA for the VC companies during the initial investment years was approximately €1,3 million negative. Three and five years after the first investments the average combined VC EBITDA stood at roughly €3,1 million and €1,9 million negative, excluding Supercell. This indicates that most VC companies had not turned profitable five years after their initial investments. However, there are some notable exceptions, like the years 2010, 2011 including Supercell and 2015.

The negative EBITDA during the initial years after the investment is to be expected to a certain extent, as VC companies tend to prioritize growth over profit and hence value investments over savings in the early years of business. However, the figures presented also indicate the volatility of VC companies in terms of profit, with some able to generate large profits after a few years while many others had not become profitable.

Despite the negative EBITDA, the majority of the companies' turnovers increased during the studied years. As explained earlier, VC investments targets tend to be startups which rely on funding to enable their continued growth and to cover their initial operating deficits. These companies typically focus on specific market segments and innovative solutions that generate value for society. Therefore, the development of targeted companies by VC investors should not directly be compared against positive profitability levels, but rather against other indicators such as, level of innovation. For example, small companies often look for growth by hiring more employees, using marketing efforts, developing sustainability and new technological productions, etc. These factors are expenses that have a direct impact on profitability, as can be seen in graph 11.



Graph 11. Venture capital companies' average EBITDA for the investment year and 3 and 5 years from the investment

Adapting to a new digitalized way of working – lessons learned from Covid-19, and case examples from two buyout portfolio companies

SECTOAUTOMOTIVE

Industry	*Car leasing*
Description	*Leasing of cars to private and corporate customers as well as sales of used cars*
Revenue (2020)	*268 M€*
Personnel (2021)	*91*

TIETOKESKUS

Industry	*Information and communication technology*
Description	*Sales of basic information technology services, solutions and equipment*
Revenue (2020)	*99 M€*
Personnel (2021)	*276*

The Covid-19 pandemic suddenly, and without time to react, transformed the normal business environment and created a myriad of new challenges. This required several changes in both strategic and operational procedures. Companies were forced to adapt and modify their operations to better fit the digital environment, which has become a new normal for many. Some organizations were more digitally mature and were ready to react more promptly to the changing environment, while other companies were faced with a harsh business meltdown and were forced to radically change their way of working. This section gives brief examples of the key challenges that occurred at the beginning of the pandemic, the solutions employed by Secto Automotive and Tietokeskus in tackling the issues, as well as examples of how private equity investments generate value in fast-changing environments.

Three areas were identified where the case companies' performance and rapid change of modus operandi played a large role:

- **Sales strategy and customer behavior:** Although the covid-19 pandemic changed the business model, companies still needed to interact with their customers and partners. Sales strategies and processes became largely digital across most industries, forcing many companies to modify their sales processes accordingly. For example, the car leasing industry, which had previously employed very traditional sales processes, including face-to-face sales, shifted to largely digitally focused sales. According to Secto Automotive, roughly every second order after the beginning of the pandemic came through digital channels, indicating a sharp decline in the importance of physical car dealerships, and conversely a sharp increase in the importance of digital sales channels and services. Similarly, Tietokeskus saw a change in customer preferences at the beginning of the pandemic as more equipment related to working from home (e.g., headphones, cameras, laptops) was procured by customers. To cope with the increasing demand, the company focused on boosting the efficiency of sales by partly outsourcing early-stage sales activities such as first-party certification to third parties. Furthermore, Tietokeskus emphasized the importance of continuously monitoring drivers and "silent" signals in the market to enable agile changes in the sales process, reflecting changes in market and customer behavior.

- **People management and leadership:** The sudden transition from traditional ways of working to a situation where most employees were working from home raised various challenges related to people management and leadership. Finding the right answers to questions of how to maintain employee satisfaction and wellbeing, encourage independent work, and instill employee self-management became the new reality for most companies. Both Tietokeskus and Secto Automotive reacted quickly at the beginning of the pandemic by adapting their leadership. More agile leadership methods were implemented, with more frequent but shorter meetings to enable continuous oversight of operational and people performance. The new leadership structure meant that more time was spent on managing employees, but enabled companies to keep employees up to date concerning what was working and what was not. This resulted in better self-management and faster reaction times as employees gained a better overall view of the sales backlog and CRM system in a fast-changing environment.

- **Forecasting and supply chain:** Supply chain shortages became normal among many industries at the beginning of the pandemic. Forecasting cyclicality became more complex, and predicting the realization of an estimate became even harder in terms of both sales and the required resources, assets and workforce. Many companies, including Tietokeskus and Secto Automotive, suffered component shortages due to worldwide logistical problems. In order to quickly adapt to the new environment, greater attention was placed on increasing the collaboration between wholesalers/suppliers and company representatives, sharing information forecasts (which brought the main partners even closer together) and creating systematic collaboration between the main stakeholders and the company. This streamlined process of micromanaging the supply chain helped companies to anticipate delays in logistics and to meet customer demands more accurately and without facing equipment shortages.

Private equity investments involve not only funding, but also the sharing of experience and knowledge

As briefly explained above, fast changing environments and unexpected circumstances require experienced leadership that is capable of fast decision making. Private equity investors are typically highly experienced people with a broad knowledge of multiple industries, and are capable of managing and providing guidance in complex situations. In addition to funding, private equity investors generate value by guiding companies in the right direction, thus supporting their growth and organizational stability in fast changing environments.

Summary of the report

The findings indicate that private equity investors have a positive impact on their portfolio companies. The turnover and number of personnel at companies owned by PE investors have grown much more than is the case in the peer group. Furthermore, the profitability of BO companies has increased significantly. VC companies require significant investments to enable growth, and profit is seldom generated in the initial years following the investment. However, due often to their scalable business models, VC companies can grow quickly and exponentially when successful.

Private equity investors contribute managed risk-taking and competence in developing business operations for their companies. This cooperation results in startup companies that succeed in the global marketplace as well as strong domestic and international small and medium-sized companies. This enhances economic growth and employment in Finland.

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