



■ Background

The private equity and venture capital industry in Switzerland is small in absolute and relative terms compared to its immediate neighbours. However, lower inflation, interest and corporate and personal taxation rates than the European average, high levels of innovation and the presence of major multi-national corporations suggest that Switzerland is a good place to invest. This apparent contradiction stems from the perception that there is a lack of entrepreneurship and experienced business professionals in the Swiss workforce reducing the attractiveness of a large number of potential innovative projects for potential investors.

In 2002, Switzerland was included for the first time in the Global Entrepreneurship Monitor (GEM) project. The report supports the perception that Switzerland develops well-educated individuals more suitable to being employees than entrepreneurs and that government policy does not intervene to support the development of new companies. Changes in these areas are being proposed and introduced, which can only have a positive impact in the number of new opportunities for investment.

As predicted last year, new funds were difficult to raise in 2002, with only CHF 307 million being raised, an amount lower than 1998 levels. With the global economic difficulties continuing and a significant curtailment of corporate capital expenditure, many portfolio companies have had their growth potential impaired and their values reduced. Negative publicity surrounding the negative cycle has made efforts to raise new funds harder, especially from the corporate and insurance/pension fund industries.

The cycle of restructuring and writing down existing portfolio investments as well as identifying alternative exit strategies continued in 2002, keeping new investment activity lower than recent history. Although the criteria for making new investments have been raised, Swiss private equity and venture capital firms increased the total amount invested in 2002 compared to 2001 and continued to focus their investment on domestic companies, favouring the biotechnology and medical/health related sectors. The average investment per company of CHF 5.3 million was only marginally less than that achieved in 2001 of CHF 5.5 million. The majority of total amount invested was initial investment and in the start-up expansion stage, suggesting an undercurrent of optimism that the venture capital market will show some signs of recovery within the next year.

■ Sources of Capital

Total funds raised in 2002 amounted to CHF 307 million, a decrease of CHF 701 million or 70 per cent compared to the CHF 1008 million achieved in 2001. This decrease comes on top of the 34 per cent reduction recorded between 2000 and 2001. A quick review of sources of funds reveals that the 2000 to 2001 decrease was principally due to lower realised capital gains, while the 2001 to 2002 decrease was almost totally due to a reduction in the amounts raised by independent funds. In 2002, funds raised by captives reached CHF 49 million, a strong rebound from the very low 2001 value of CHF 2 million. With the fall in independent fundraising, money from captives represented 16 per cent of total funds raised.

In contrast to fundraising in most other countries where insurance companies, pension funds and large corporations contribute a substantial proportion of total funds raised, private individuals contributed 55 per cent of the new funds raised in Switzerland in 2002, representing a significant increase in absolute and relative terms from 2001. This is in stark contrast to all other investors who reduced their contribution in 2002. Funds from corporate investors who were the primary source in 2001 with CHF 254 million, only provided CHF 19 million in 2002. Traditionally pension funds tended to provide more funds than insurance companies, this was reversed in 2002 with insurance companies providing a third more than pension funds. No money was raised from funds of funds, academic institutions or capital markets. These sources provided CHF 234 million in 2001.

Virtually all of the funds raised came from within Switzerland, which is probably linked to the change in type of investor.

Consistent with 2001, approximately three quarters of the funds raised were allocated to high-tech investment. However there has been a shift in allocation from early-stage to expansion/development. This may translate into new companies finding it harder to attract the first round of financing especially if they are not classified as high-tech. Only CHF 0.4 million of total funds raised was earmarked for allocation to non high-tech investment.

■ Investment Patterns

Investment made in 2002 stood at CHF 458 million, an increase of CHF 90 million or 25 per cent on 2001. For the first time in five years, the amount invested exceeded the funds raised during the same year. A review of new funds raised against investments made, for the period since 1998 suggests there remains over CHF 1 billion still to be invested.

Of the amount raised in 2002, 72 per cent was for initial investment, a reversal of the situation seen in 2001. Notwithstanding the fact that there were a small number of very large initial investments, the average initial investment has risen from that seen in 2001 with a corresponding shift away from seed to more start-up and expansion stage companies.

The fall in new funds raised and the increase in initial investment confirms other studies that show private equity and venture capital practitioners are concentrating on finding and developing investments rather than raising new funds.

As in 2000 and 2001, 2002 showed that the majority of the total amount invested continued to be made by independent private equity managers. There was a significant swing towards syndication with only 3 per cent being invested unsyndicated, compared to 62 per cent in the previous year. There was a significant increase in domestic syndication, which accounted for CHF 205 million of total amount invested compared to CHF 8 million in 2001. As in 2001, domestic investment made up the majority of total amount invested. But for the first time in recent years, investments outside Europe were more than those made in other European countries (23 percent and 12 percent respectively of the total amount invested).

Just over 50 percent of the investments made in 2002 were in the biotechnology and medical/health related sectors. This field is considered to be one of Switzerland's growing strengths and three 'hotspots' of activity centred around Geneva/Lausanne, Basel and Zurich are developing. There exist a number of venture capital firms with connections to the established pharmaceutical industry, specialising in the life sciences sector. It is not surprising that three of the four largest deals in Switzerland were biotechnology companies and involved Swiss investors.

Similar levels of investment in percentage terms were made 2002 and 2001 in the other electronics related, consumer related and industrial products and services sectors i.e. 31 per cent of the total amount invested. Computer related investment amounted to CHF 61 million representing a 24 per cent decrease compared to 2001. There was a more dramatic fall in investment made in communications, other manufacturing and other services from a total of CHF 133 million in 2001 to CHF 26 million in 2002.

■ Legal and Fiscal Environment

Since the creation of SECA, the Swiss Private Equity and Venture Capital Association and *Le Réseau*, a lobbying organisation to facilitate high technology investment, a variety of successes in the improvement of the fiscal and legal environment for venture investment in Switzerland have been achieved. Changes include; modification of Swiss pension scheme rules to allow investment in venture capital funds, company law changes permitting shares to be issued at CHF 0.01 nominal value, creation of Swiss University technology transfer offices and the introduction of a University entrepreneurship course financed by the state.

The federal law adopted in 1999 allowing the foundation of 'risk capital' (private equity and venture capital) companies that would benefit from special tax advantages has not had its desired impact with few such enterprises applying for registration. An evaluation of the effectiveness of the law commissioned by the State Secretariat for Economic Affairs (SECO) was completed in January 2003. Many recommendations were made by this commission to revise areas of the law relating to private equity investing, including; redefinition of the term 'new company' to allow more investee companies to receive financing from private equity and venture capital companies; reduction of the 50 per cent limit to allow more risk capital company funds to be invested outside Switzerland, grant tax relief for business angels on private equity equal to that applied on loans and removal of the condition that requires a business angel to invest alongside a risk capital company.

Amendments to other Swiss laws are considered necessary to further improve the legal and fiscal environment and are currently being drafted or debated by the parliament;

- Discussion on the introduction of new legislation allowing effective and efficient limited partnership structures in Switzerland have been initiated by the Federal Government and supported amongst others by SECA and *Le Réseau*. Most venture capital financing raised in Switzerland continues to be managed via offshore domiciled limited partnerships.
- During April 2003 the Federal Council opened a consultation process to discuss taxation of employee stock options. As a general rule, options will be taxed at the date of irrevocable acquisition (grant or vesting date), unless certain conditions are fulfilled whereby they will be subject to income tax at 50 per cent of the economic benefit at exercise. It should be noted that a recent court decision has resulted in the canton of Zurich taxing 'genuine' options at date of grant and 'non-genuine' options at date of vesting. This opens up the possibility of different tax treatments on stock options under federal and cantonal/communal tax laws.
- The law governing the required minimum number of Swiss resident members of Board of Directors was debated in Parliament in March 2003 and the current proposal removes the requirement for the majority of members to be Swiss citizens and would allow more members to be domiciled outside of Switzerland. Finalisation is not expected until after 2003.
- The laws surrounding limited liability companies 'Sàrl' are subject to a complete revision, and are likely to be debated in 2004.

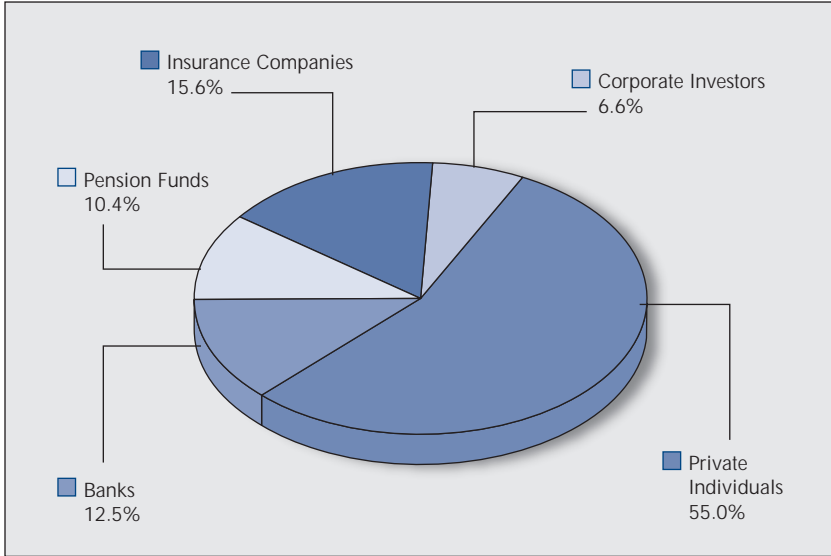
■ Exiting

Total divestments at cost reached CHF 139 million, 11 per cent lower than the CHF 157 million recorded in 2001. With the closure of the new market on the Swiss stock exchange and the global economic downturn it is not surprising that divestments by flotation were not favoured although selling of quoted investments did occur.

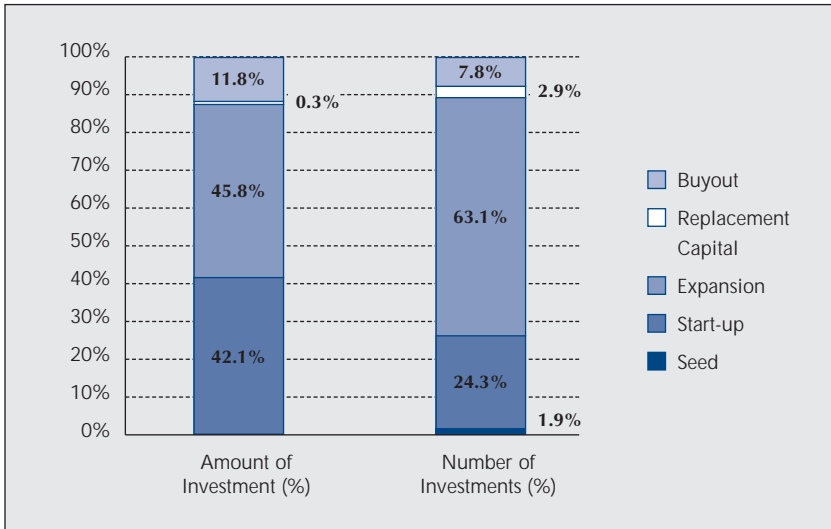
Divestment by trade sale, of CHF 13 million or 9 per cent of the total, was less than half of that reported in 2001. However the number of divestments and number of companies involved fell only slightly between the two periods (2002; 9 and 9, 2001; 10 and 10 respectively).

With the effective closure of the capital markets and reduced trade sale opportunities, by far the most common method of divestment was by write-off, CHF 118 million in 2002 representing 85 per cent of the total compared to CHF 73 million or 47 per cent in 2001. It should be noted that fewer investments and number of companies were divested by write-off (2002; 9 and 7, 2001 24 and 21 respectively) but the cost per company divested in this manner increased from CHF 3.5 million in 2001 to CHF 16.9 million in 2002.

PRIVATE EQUITY RAISED BY TYPE OF INVESTOR IN 2002



STAGE DISTRIBUTION OF INVESTMENTS IN 2002



■ Funds Raised

Funds (in CHF x 1,000)	2001		2002	
PRIVATE EQUITY RAISED BY SOURCE				
	Amount	%	Amount	%
Independent Funds Raised in Year	941,996	93.4	246,865	80.5
Amount Raised by Captives	2,441	0.2	48,541	15.8
Subtotal New Funds Raised	944,437	93.7	295,406	96.4
Realised Capital Gains	63,656	6.3	11,141	3.6
Total Funds Raised	1,008,094	100.0	306,546	100.0
PRIVATE EQUITY RAISED BY TYPE OF INVESTOR				
Corporate Investors	253,970	26.9	19,375	6.6
Private Individuals	30,664	3.2	162,341	55.0
Government Agencies	0	0.0	0	0.0
Banks	186,811	19.8	36,865	12.5
Pension Funds	100,328	10.6	30,730	10.4
Insurance Companies	74,566	7.9	46,095	15.6
Fund of Funds	77,265	8.2	0	0.0
Academic Institutions	25,755	2.7	0	0.0
Capital Markets	130,690	13.8	0	0.0
Not Available	64,388	6.8	0	0.0
Subtotal New Funds Raised	944,437	100.0	295,406	100.0
Realised Capital Gains	63,656	-	11,141	-
Total Funds Raised	1,008,094	-	306,546	-
GEOGRAPHICAL BREAKDOWN OF PRIVATE EQUITY RAISED				
Domestic	591,568	58.7	304,279	99.3
Other European Countries	205,169	20.4	2,267	0.7
Non-European Countries	211,357	21.0	0	0.0
Total Funds Raised	1,008,094	100.0	306,546	100.0
EXPECTED ALLOCATION OF FUNDS RAISED				
High-Tech Early-Stage	501,516	49.7	76,598	25.0
Non High-Tech Early-Stage	11,126	1.1	180	0.1
High-Tech Expansion/Development	242,840	24.1	152,746	49.8
Non High-Tech Expansion/Development	89,841	8.9	202	0.1
Venture Capital	845,323	83.9	229,727	74.9
Buyout	21,890	2.2	76,819	25.1
Other	140,881	14.0	0	0.0
Total Funds Raised	1,008,094	100.0	306,546	100.0

Investments

	2001						2002					
	Amount of Investment	%	Number of Investments	%	Number of Companies	%	Amount of Investment	%	Number of Investments	%	Number of Companies	
Initial Investment	106,581	29.0	63	34.0	53	39.6	331,239	72.3	36	35.0	34	39.1
Follow-on Investment	261,089	71.0	121	66.0	80	60.4	127,064	27.7	67	65.0	53	60.9
Total Investment in Year	367,671	100.0	184	100.0	133	100.0	458,303	100.0	103	100.0	87	100.0
DISTRIBUTION OF INVESTMENTS BY INVESTOR TYPE												
Independent	352,694	95.9	170	92.7	120	90.4	346,844	75.7	82	79.6	67	77.0
Captive	2,623	0.7	10	5.2	9	6.6	58,661	12.8	13	12.6	13	14.9
Semi- Captive	12,355	3.4	4	2.3	4	2.9	52,677	11.5	6	5.8	5	5.7
Public Sector	0	0.0	0	0.0	0	0.0	121	0.0	2	1.9	2	2.3
Total Investment	367,671	100.0	184	100.0	133	100.0	458,303	100.0	103	100.0	87	100.0
STAGE DISTRIBUTION OF INVESTMENTS IN YEAR												
Seed	39,616	10.8	37	20.4	22	16.3	123	0.0	2	1.9	2	2.3
Start-up	73,327	19.9	58	31.4	41	31.1	193,001	42.1	25	24.3	23	26.4
Expansion	129,294	35.2	75	40.6	57	43.0	209,765	45.8	65	63.1	53	60.9
Replacement Capital	7,553	2.1	1	0.6	1	0.7	1,289	0.3	3	2.9	3	3.4
Buyout	117,882	32.1	13	6.9	12	8.9	54,125	11.8	8	7.8	6	6.9
Total Investment	367,671	100.0	184	100.0	133	100.0	458,303	100.0	103	100.0	87	100.0
SYNDICATION OF INVESTMENTS IN YEAR												
No Syndication	228,297	62.1	136	74.0	85	63.9	15,046	3.3	21	20.4	17	19.5
National Syndication	7,873	2.1	15	8.0	15	11.1	204,926	44.7	51	49.5	44	50.6
Transnational Syndication	131,500	35.8	33	18.0	33	25.0	238,331	52.0	31	30.1	26	29.9
Total Investment	367,671	100.0	184	100.0	133	100.0	458,303	100.0	103	100.0	87	100.0
GEOGRAPHICAL DISTRIBUTION OF INVESTMENTS IN YEAR												
Domestic	210,612	57.3	115	62.5	90	67.6	297,663	64.9	66	64.1	49	56.3
Other European Countries	100,315	27.3	41	22.2	20	15.2	56,851	12.4	15	14.6	15	17.2
Non-European Countries	56,744	15.4	28	15.3	23	17.1	103,789	22.6	23	22.3	23	26.4
Total Investment	367,671	100.0	184	100.0	133	100.0	458,303	100.0	103	100.0	87	100.0
SECTORAL DISTRIBUTION OF INVESTMENTS IN YEAR												
Communications	35,766	9.7	35	18.5	18	13.1	18,193	4.0	17	16.5	15	17.2
Computer Related	79,383	21.6	57	30.8	35	26.2	60,557	13.2	31	30.1	20	23.0
Other Electronics Related	31,682	8.6	12	6.2	11	8.4	47,156	10.3	15	14.6	15	17.2
Biotechnology	2,193	0.6	5	2.7	4	2.8	104,819	22.9	19	18.4	19	21.8
Medical/Health Related	18,782	5.1	17	9.6	15	11.2	126,359	27.6	6	5.8	6	6.9
Energy	609	0.2	1	0.7	1	0.9	0	0.0	0	0.0	0	0.0
Consumer Related	45,141	12.3	6	3.4	6	4.7	46,068	10.1	2	1.9	2	2.3
Industrial Products and Services	35,618	9.7	8	4.1	5	3.7	47,625	10.4	6	5.8	3	3.4
Chemicals and Materials	1,218	0.3	1	0.7	1	0.9	0	0.0	0	0.0	0	0.0
Industrial Automation	4,075	1.1	3	1.4	2	1.9	124	0.0	2	1.9	2	2.3
Other Manufacturing	73,770	20.1	13	6.8	12	9.3	2,075	0.5	3	2.9	3	3.4
Transportation	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Financial Services	7,730	2.1	9	5.5	6	3.7	0	0.0	0	0.0	0	0.0
Other Services	23,293	6.3	6	3.4	6	4.7	5,328	1.2	2	1.9	2	2.3
Agriculture	1,827	0.5	1	0.7	1	0.9	0	0.0	0	0.0	0	0.0
Construction	1,218	0.3	1	0.7	1	0.9	0	0.0	0	0.0	0	0.0
Other	5,363	1.5	9	4.8	9	6.5	0	0.0	0	0.0	0	0.0
Total Investment	367,671	100.0	184	100.0	133	100.0	458,303	100.0	103	100.0	87	100.0
Subtotal High-Tech	136,620	37.2	93	50.5	63	47.4	171,918	37.5	53	51.5	45	51.7

■ Divestments

	2001				2002							
	Amount of Divestment	%	Number of Divestments	%	Number of Companies	%	Amount of Divestment	%	Number of Divestments	%	Number of Companies	
Divestment by Trade Sale	33,046	21.1	10	14.7	10	15.9	12,633	9.1	9	36.8	9	40.0
Divestment by Public Offering	16,433	10.5	21	30.9	21	33.4	3,041	2.2	3	10.5	3	13.3
Divestment by Flotation (IPO)	1,000		1		1		0		0		0	
Sale of Quoted Equity	15,433		20		20		3,041		3		3	
Divestment by Write-Off	73,011	46.5	24	35.3	21	33.1	118,498	85.2	9	36.8	7	33.3
Repayment of Principal Loans	4,850	3.1	4	5.9	4	6.4	1,829	1.3	3	10.5	1	6.7
Sale to Another Venture Capitalist	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Sale to Financial Institution	64	0.0	1	1.5	1	1.6	0	0.0	0	0.0	0	0.0
Sale to Management (Buy-back)							0	0.0	0	0.0	0	0.0
Divestment by Other Means	29,522	18.8	8	11.8	6	9.6	3,130	2.2	1	5.3	1	6.7
Total Divestment in Year	156,926	100.0	68	100.0	63	100.0	139,130	100.0	25	100.0	21	100.0

■ Portfolio at Cost

	2001			2002		
	Amount	Number of Investments/ Divestments	Number of Companies	Amount	Number of Investments/ Divestments	Number of Companies
Portfolio at Cost 1st Jan	1,979,883			2,190,627		
Total Investment in Year	367,671	184	133	458,303	103	87
Total Divestment in Year	(156,926)	68	63	(139,130)	25	21
Portfolio at Cost 31st Dec	2,190,627			2,509,800		

■ Geographical Flows of Private Equity

Amount (in CHF x 1,000)	2001	2002
FUNDS		
	Amount	Amount
Funds raised by local P.E. houses	1,008,094	306,546
INVESTMENT		
Investment by local P.E. houses	367,671	458,303
(-) Foreign investment by local P.E. houses	(157,058)	(160,640)
Local investment by foreign P.E. houses	180,706	866,870
Total Investment in Country	391,319	1,485,812

■ Macro Economic Indicators

	2001	2002
Number of Private Equity Executives	132	168
Private Equity Investment as % of GDP	0.089%	0.110%
GDP (Local currency billions)	414.8	416.8
Private Consumption	203.9	205.7
Public Consumption	53.7	54.7
Consumer Prices (1995=100)	104.8	105.5
Producer Prices (1995=100)	96.7	96.3
Interest Rates (3-year)	2.8%	1.1%
Interest Rates (10-year)	3.4%	3.2%
Share Prices (1995=100)	240.7	196.4
Retail Sales (1995=100)	103	102
Unemployment Rate	2.5%	2.9%

Source: OECD. When n/a Economist Intelligence Unit