Norway: Prosperity and opportunity

Norway is one of the richest countries in the world, and significantly more prosperous than its Nordic neighbours. Does the high level of wealth and the structure of the economy signal a profitable climate for future venture capital (VC) and private equity (PE) investments? We find good reason to claim just that. Our arguments are presented below.

More than petroleum and cyclical sectors

In 2006, GDP per capita in Norway was more than 60% higher than in Germany, and almost 40% higher than in Sweden. As opposed to the public impression, the high income level is not solely a result of oil and gas production and access to natural resources. It also relates to a highly educated population and a growing ability to shift from a raw material-based economy to an economy focusing more strongly on high-tech products and high-skill services. This pattern is well illustrated in Figure 1 where we show that the GDP per capita level, excluding oil and shipping, is not far below the overall GDP per capita level in the other Nordic countries. In other words, there is a large business sector in Norway which is not petroleum related. Figure 2 provides additional support to this pattern. Here, we present an industry decomposition of the economy in selected countries. Graphically, it looks as if the manufacturing, retail trade and business services sectors are significantly smaller in Norway, but if you look at the actual numbers listed in the graph, the sectors do not differ much in size from what you find in Finland and Denmark. Thus, we may conclude that the Norwegian business sector is significant and varied, even when the large petroleum sector and shipping sectors are left out of the picture.

For VC and PE investors, this observation is important, since the competencies of VC and PE investors rarely fit strongly cyclical sectors, where valuation is heavily dependent on considerable price variations. This is typically the case in oil extraction and exploration, shipping and fish breeding and harvesting. (Notice though, that the large group of petroleum related service and equipment providers are less exposed to these cyclical patterns.) In realizing that there are a large number of firms outside these sectors in Norway, the prospects for value-enhancing VC and PE ownership in Norway becomes more clear.

Norway: A young and untouched PE market

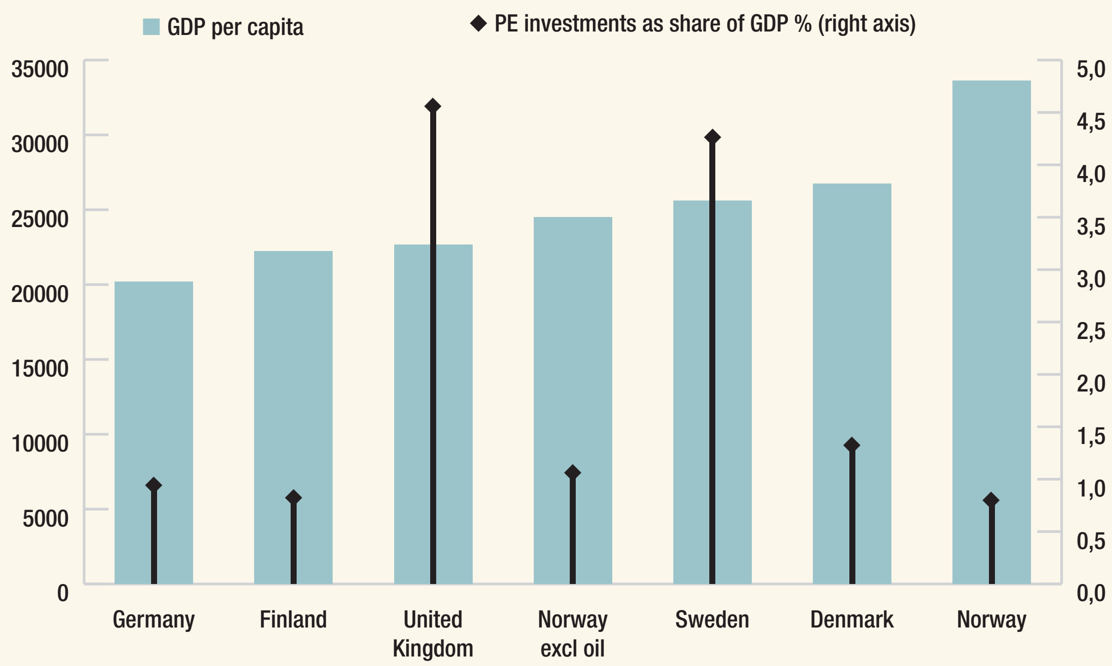
The fact that the number and variety of potential VC and PE investment cases is larger than most financial players believe should also be considered in light of the fact that the present level of VC and PE investments is rather low in Norway. Thus, the potential for identifying profitable cases is large. In Figure 1, we show that the VC and PE investment activity level in Norway is low, especially when

Table 1: Company universe in Norway and Sweden (2006)

Turnover categories	Norway: EBITDA-margin>20%	Norway: Total	Sweden: EBITDA-margin>20%	Sweden: Total
Mini cap: EUR 1–5mill	5038	21392	4335	27814
Small cap: EUR 5–25mill	1307	6402	1067	7932
Mid cap: EUR 25–100mill	298	1218	270	1753
Large cap: EUR 100–1000mill	108	402	90	527
Mega cap: EUR 1bn +	17	28	11	48

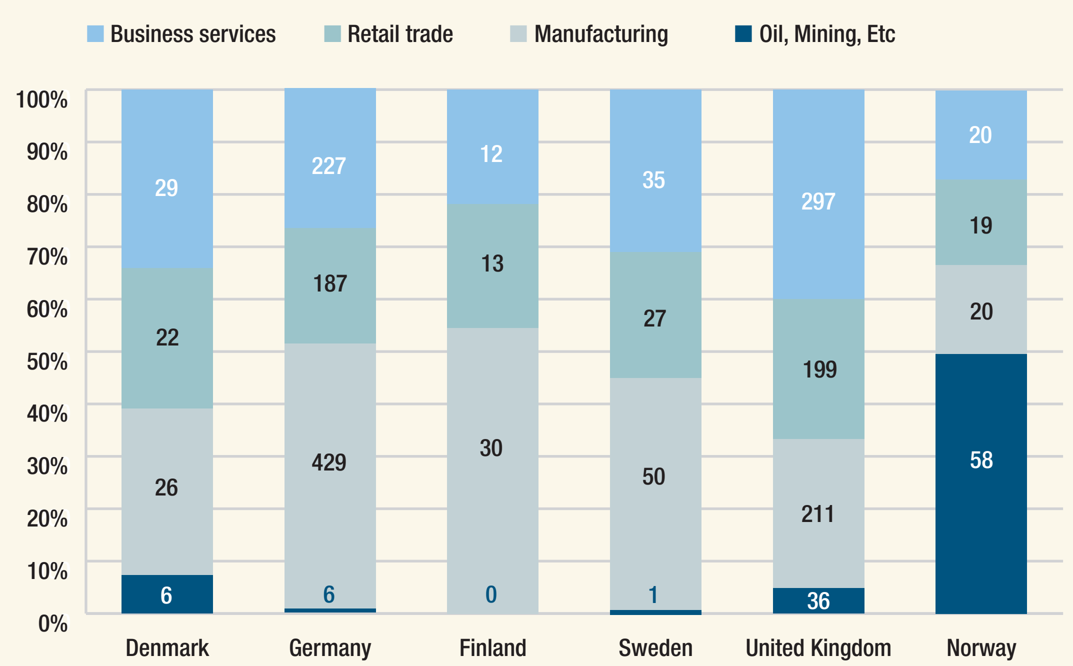
Source: MENON Business Economics/Norsk Venture (NVCA). The distribution covers organizational units. Large companies often consist of several units.

Figure 1: Prosperity and the role of VC and PE investments (2006)



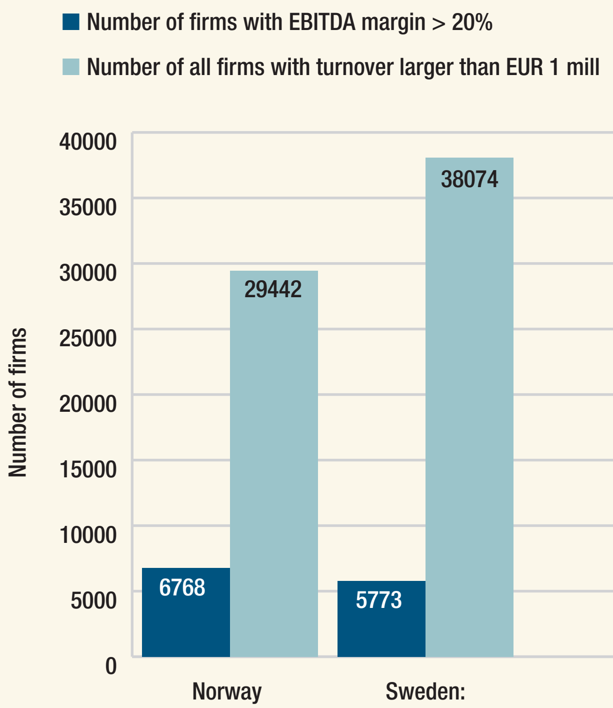
Source: MENON Business Economics/Norsk Venture (NVCA) and World Bank

Figure 2: Industrial composition of the economy, 2005 (figures are value added in bn EUR)



Source: Eurostat

Figure 3: The company universe in Norway and Sweden (2006)



Source: MENON Business Economics/Norsk Venture (NVCA)

compared with countries like Sweden, Denmark and the UK. The blue diamonds in Figure 1 display the investment activity in 2006, but figures for total capital under management show the same picture. Funds located in Norway managed a total of EUR 5.5bn at the end of 2007. In Sweden, the figures are approximately 7 times larger.[1]

One would thus expect that the company universe looks completely different in Norway and Sweden, but that is not really true. In Figure 3 and Table 1, we describe the number of firms according to size and EBITDA-margin in Norway and Sweden. Although there are more firms in Sweden, the number of highly profitable firms is actually systematically lower. Nevertheless, the number of VC and PE portfolio companies is more than twice as large in Sweden compared to Norway (approximately 500), and the difference is especially large in the expansion and buyout segments.

An active market for entry and exit

These comparisons indicate that the Norwegian PE market is younger and more untouched than many other markets, with a potentially larger universe of good investment cases. This is probably the reason why a growing number of large foreign private equity houses are now establishing Norwegian subsidiaries. Yet, a large number of potential investment cases does not alone guarantee a high return on investments. More specifically, the market should also provide an active arena for changes in corporate control and sound exit opportunities. Healthy market capitalization growth also supports a higher expected return on investments in the VC and PE industry. In this respect, the Oslo Stock Exchange (OSE) has shown a remarkable performance over the last 5 years. At year-end 2007, the OSE market capitalization was 5 times larger than in 2002 (see Figure 4). Stock markets like OMX, Deutsche Börs and the London SE came nowhere near such figures. The growth was partly driven by climbing oil prices, but the number of IPOs (both oil and non-oil related) has been impressively high on the OSE, contributing to the market cap growth. In Figure 5, we show that only the London SE has been able to compete with respect to the intensity of new listings on the OSE. Note also that in recent years, as many as 1/3 of the IPOs on the OSE have been PE-related, indicating a strong vitalization of the market for VC and PE exits during the last few years.

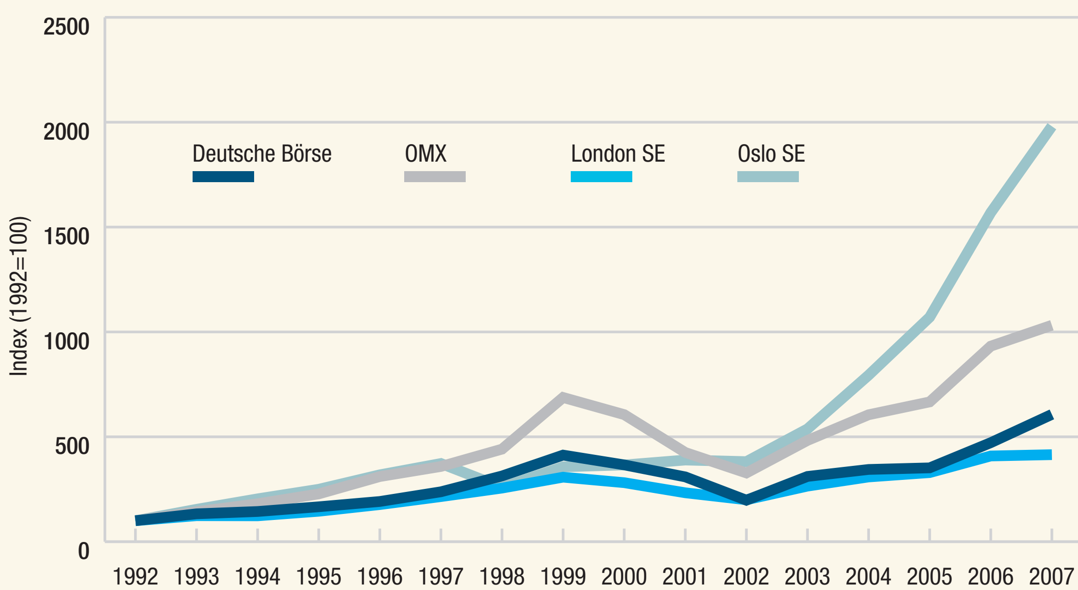
Old Norwegians create investment opportunities

In Norway as in most European countries, an aging population represents a major challenge for the economy as the number of workers per retired declines rapidly, putting an increasing tax burden on future generations. Yet for VC and PE investors, this demographic shift represents a large future investment opportunity. As an increasing number of existing owners of businesses in Norway grow old, the number of firms seeking new owners will mushroom. In Figure 6, we illustrate this development by describing how private ownership in Norway is distributed according to the owners' age.

Approximately 1/3 of the business sector in Norway (in terms of estimated market value in 2003) is owned by private Norwegian persons. The rest is either owned by foreigners, the government or foundations and cooperatives. In 2003, there were 76,000 firms where a person was the majority owner. Moreover, more than 50% of all strategic private ownership shares

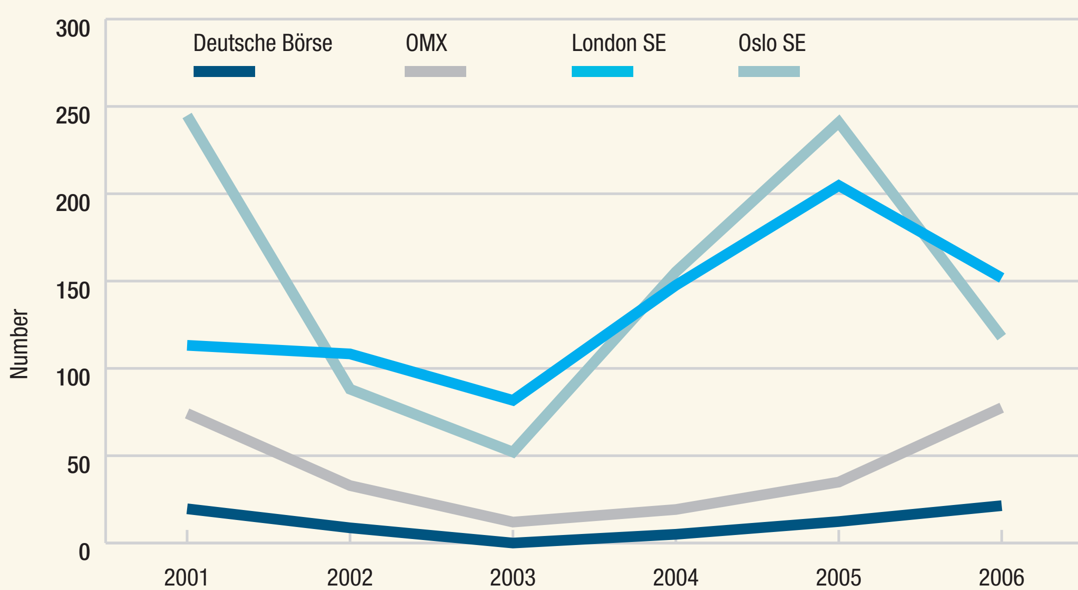
1) Note, however, that Swedish funds operate to a larger extent as overseas investors. More than half of the revenues generated by the portfolio companies in Swedish funds come from foreign portfolio firms.

Figure 4: Market capitalization



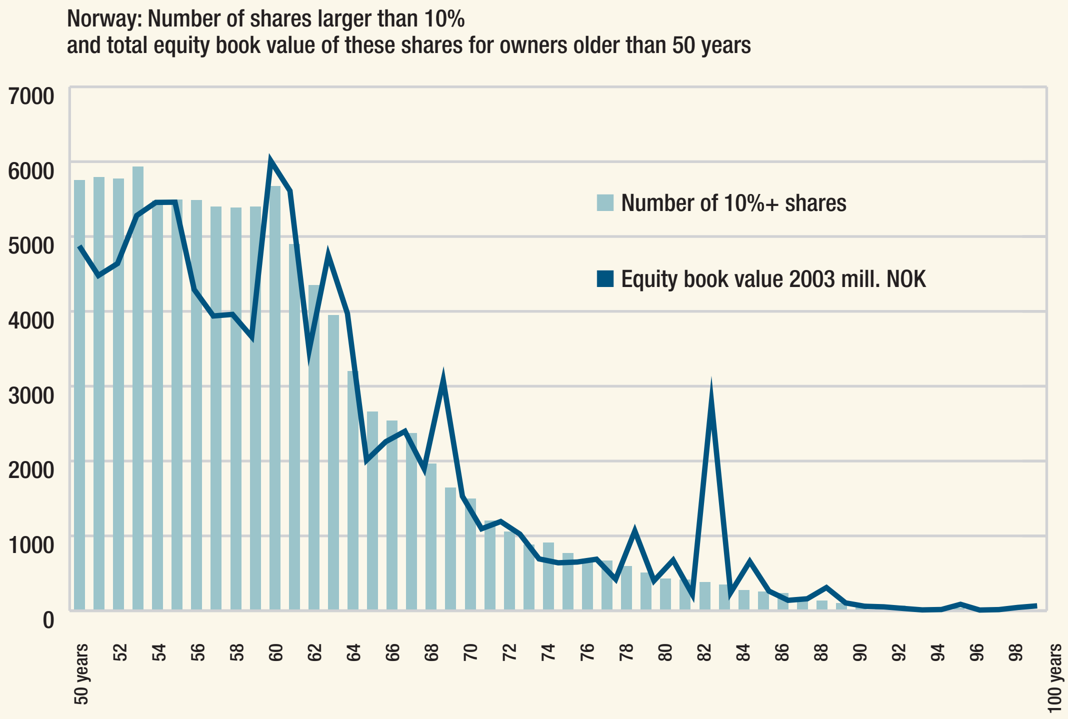
Source: World Federation of Exchanges

Figure 5: Number of new listings per bn USD in market capitalization



Source: World Federation of Exchanges

Figure 6: Composition of ownership in Norway by owner age



Source: MENON Business Economics/Norsk Venture (NVCA)

(shares larger than 10%) in Norway are owned by people older than 50 years. As shown in Figure 6, the number of such shares fall dramatically for age groups older than 60. Those who are 60 hold more than 5500 strategic shares, while those who are 70 hold less than 1,500. If we assume that this pattern is maintained over the next 10 years, 27,000 strategic shares will have to change owners as existing owners move from the 50-60 years cohort to the 60-70 years cohort. More than 11,000 of them are majority shares. In other words more than 11,000 companies will search for new majority owners over the next 10 years due to aging. Many of them will be handed over to younger family members, but as the population grows older, the number of younger family member is reduced, increasing the opportunity for out-of-family ownership change. For VC and PE investors, this means higher deal flows and potentially lower deal prices, especially among more mature firms. ■