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Institutional Investors in Private Equity Funds in Europe

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Abstract:

Purpose: *The aim of the review study is to analyze and assess the structure of institutional investors in private equity funds in Europe.*
Design/Approach: *The research concerning the structure of institutional investors in private equity funds on European market in 2018- 2022 was conducted on the basis of secondary data from statistical data mainly included in research conducted by Invest Europe.*
Findings: *The aim of private equity (PE) is to provide a high return to investors on those assets, assigning expert management teams to manage the companies and assets outside of the glare of public markets. PE has grown rapidly over the last three decades. Over the last decades investing in PE and real assets has gained considerable momentum. Achieving high exposure to PE is a challenge faced by institutional investors who in recent years have been building sizable allocations to this alternative investment vehicle. Successfully acquiring, managing, and exiting these investments directly demands strong expertise and incentives that most institutional investors are lacking. The vast majority of private equity funds are organized as limited partnerships responsible for fundraising investment decisions, and development of the portfolio companies.*
Practical implication: *The research conducted on a role of institutional investors in PE activities may provide a rationale for expanding research in this area in another countries and regions and assessing the vulnerability of financing relationships to unexpected external difficulties.*
Originality/Value: *Study, in the form of a scientific contribution with a high degree of applicability, takes the form of a review using literature and published statistics and was geared towards analyzing and assessing changes in the investments and numbers of institutional investors in European PE funds market.*
Keywords: *private equity, funds, limited partnerships, institutional investors, Europe.*

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1. Introduction

Private Equity (PE) markets have exploded in the past three decades. PE assets under management (AUM) have multiplied more than tenfold since 2004 reaching $8 trillion in 2022. European countries have been very active in PE investments. Their roles in PE fundraising is reflected by almost 50% share in global scale before North America (24,5%) and Australia and Asia (22%) (Investing, 2023).

Investing in PE has gained considerable drive as described by Gilligan, Wright (2020) and Cumming *et al.* (2022). High exposure to PE has become a challenge faced by institutional investors like insurers, pension funds, banks, endowments, and sovereign wealth funds who in recent years have been building considerable allocations to this vehicle. PE also represents an increasing proportion of most institutional investor portfolios.

These investors dominate the demand side of the market and spend considerable time and resources making PE investment decisions, probably as a result of the large commitment and multi-year nature of such investments (Tamayo *et al.*, 2023). Generally institutional investors invest indirectly through limited partnerships funds as so-called limited partners (LPs) in which they commit a sizeable amounts of capital for a given period of time (Kieffer *et al.*, 2023).

Institutional investors are becoming more and more active in providing capital. A common explanation for the increase in institutional investor demand for the investment is that it is a new asset class with attractive features such as low sensitivity to business cycle fluctuations, low correlation with equity markets and protection against long-term inflation. The aim of the study is to analyze and assess the structure of institutional investors in fundraising PE funds in Europe.

2. Literature Review

Special types of financial investors, which predominantly invest in various sectors primarily guided by the aspects of risk and financial return, are institutional investors. The term institutional investor has been assigned to private financing through investment funds. Without the risk of making a major mistake, it can be said that financing from private sources in many cases fastens the financing structure of specific investments. \

However, for institutional investors themselves, the motivation is the diversification of investments and the expected, certain in the long term, stream of income, or the allocation of capital in order to match long-term liabilities with long-lived assets (Serebrisky *et al.,* 2015; OECD, 2014; Haran *et al.,* 2021; Fuchs, 2017).

There is no compact definition of an institutional investor. The closest one with common characteristic is that institutional investors are not physical persons. They are organized as legal entities. Institutional investors may act independently or be part of a larger company group or conglomerate. More and more often, institutional investors are treated as intermediary investors as an institution that manages and invests other people's money (Grima and Thalassinos, 2020).

The primary objective of institutional investors' asset allocation is to achieve the most optimal trade off of risk and return (Cumming *et al.*, 2022). Institutional investors that can provide long-term financing, in particular pension funds, insurance companies and mutual funds, are important players in financial markets (Serebrisky *et al.*, 2015; OECD 2014). Most institutional investors represent a conservative investment style, trying to combine the highest return with the lowest level of risk in their investment portfolio (Thalassinos and Thalassinos, 2018).

Based on three criteria important in the aspect of investment choice – motivation, risk profile and regulatory status – Bielenberg (Bielenberg *et al.*, 2016) distinguished 8 groups of institutional investors: banks, investment companies, insurance companies and private pensions, public pensions and superannuation plans, sovereign-wealth funds, operators and developers, private-equity funds and endowments and foundations.

In turn, Andonov *et al.* (2021) adopted a division into the public sector and the private sector. He included public pension funds, government agencies (international development banks are accepted as government agencies, including: International Finance Corporation, European Investment Bank, World Bank Group) and sovereign wealth funds in the public sector, and open pension funds, insurance companies and banks, as well as university funds and foundations in the private sector (Andonov *et al.*, 2021).

Čelik and Isaksson (2014), taking into account the number and diversity of institutional investors, separated three broad categories of institutional investors, which to some extent reflect this development. The first category of institutional investors is referred to as *traditional* institutional investors and comprises pension funds, investments funds and insurance companies.

Second – called *alternative* institutional investors for hedge funds, private equity firms, exchange-traded funds and sovereign wealth funds. Third category covers *asset managers* that invest in their clients' name. The main reasons for adding this third category is the rapid growth of outsourcing to asset managers (Čelik and Isaksson, 2014).

The vast majority of PE funds are organized as limited partnerships and they have a finite life (10 to 15 years). Their investors are principally institutional investors which allocate money to PE funds. These investors, called limited partners (LPs), commit a certain amount of capital to private equity funds, which are run by general partners (GPs) (Phalippou, 2007; Jindrichovska *et al.*, 2020).

PE fund managers act as financial intermediaries between institutional investors and entrepreneurial firms. PE is a viable and important asset class for institutional investors (Cumming and Johan, 2007). For example in 2022 there were 1800 private equity firms in Europe (Invest Europe 2023) with the top largest management companies in allocating and investing PE funds in Europe, like as 3i Group (London UK), Ardian (Paris, France), EQT Partners (Stockholm, Sweden), Partners Group (Baar, Switzerland), PAI Partners (Paris, France) (List, 2023).

3. Methodology

The basis for conducting research and considerations regarding the position of institutional investors on the European PE investment market are many years of observations of phenomena, sizes and entities operating on this market. PE refers to investments that could be executed in two ways: in direct manner through private placement or in indirect through PE funds.

This paper is about indirect investments, so it means about PE funds and companies that pool investors' funds to invest in undervalued companies and assets. The groundwork for observations was mainly statistics from Investing in Europe. A review of English and Polish publications on the problems of developing and financing the development of private equity funds against the background of their dynamic growth was the premise for setting a research goal - assessing the role of institutional investors in this market segment.

The study used secondary data published mainly by Invest Europe in 2023. When making the assessment, attempts were made to maintain a holistic approach in order to combine partial elements into a whole to obtain a synthetic assessment of the role of institutional investors in financing private equity investments.

The assessment of the share of institutional investors in PE funds was carried out in relation to first stage of PE funds activity that means the increase in the value of funds during the year for all funds and divided into venture capital funds, growth funds and buyout funds. Then, the share of institutional investors in European countries included in six groups was examined.

These groups are: UK and Ireland, DACH (Austria, Germany, and Switzerland), Nordics (Denmark, Finland, Norway and Sweden), France and Benelux (France, Belgium, Netherlands and Luxemburg), Southern Europe (Greece, Italy, Portugal and Spain) and CEE (Central Eastern Europe).

4. Results

The arena of activity of PE funds includes venture capital, growth capital, real estate, mezzanine finance, leveraged buyout and fund of funds. Special account, because of their engagement, is paid on growth capital, venture capital funds and buyouts. The most important parameters determining the scale of PE activity in a given period are the size (in terms of number and value) of capital (funds) acquired, investments made and disposal of owned units. The biggest PE funds in Europe in 2022 with seats in the best developed regions are presented in Table 1.

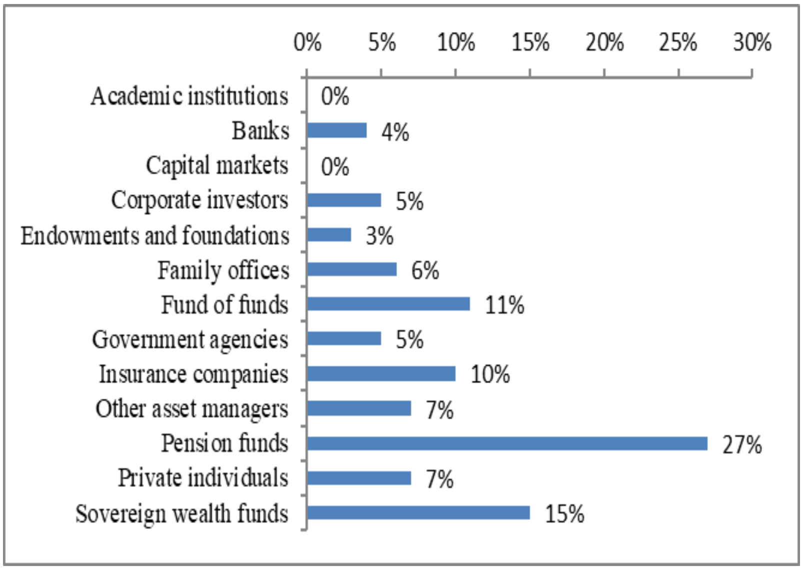
Table 1. *Top 5 largest European PE funds in the market*

Fund name	Manager	Target	Fund Country
Eighth Cinven Fund	Cinven	€10B	UK
KKR European Fund VI	KKR	€7.42B	UK
Bridgepoint Europe VII	Bridgepoint	€4B	UK
Permira VIII	Permira	€3.37B	UK
Carlyle Europe Technology Partners V	Carlyle	€2.41 B	Luxemburg

Source: *Woodman 2023.*

In Europe there were 518 institutional investors operated with 802 PE funds in 2022. The largest participants were pension funds, sovereign wealth funds, fund of funds and insurance companies with share of 27%, 15%, 11% and 10% appropriately. The share of the rest institutional investors was on the level beneath 10%. A detailed picture of the share of institutional investors in the incremental growth of PE funds is provided in Figure 1.

Figure 1. *European PE Funds raised by type of investor in 2022 in total- % of the total amount*

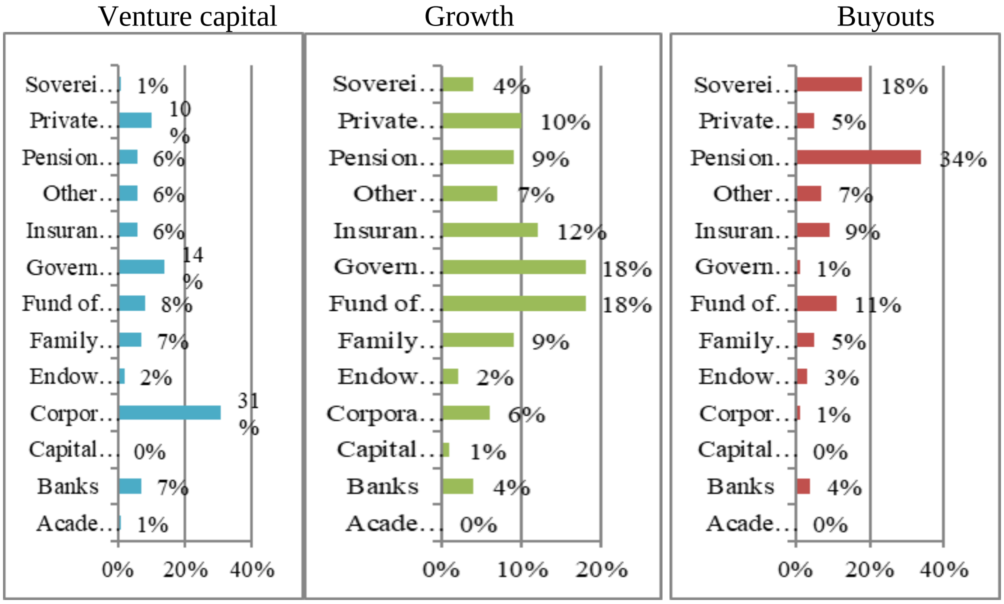


Source: *Own study based on Investing in Europe: Private Equity Activity 2022, https://www.investeurope.eu/research/activity-data/.*

The proportions of participation of individual groups of institutional investors presented in Figure 1 should be assumed as average values for individual types of PE funds. The share of given groups of institutional investors in specific types of PE funds can differ significantly from the average results, which is an effect of the specific features of these funds.

Depending on the adopted strategy, approach to risk, expected return on investment or investment period, investors choose the type of PE funds and create an investment portfolio. Differences among PE funds are reflected in the structure of institutional investors (Figure 2).

Figure 2. *Venture Capital, Growth and Buyouts funds raised by type of investor in 2022 - % of the total amount*



Source: *Own study based on Investing in Europe: Private Equity Activity 2022, https://www.investeurope.eu/research/activity-data/.*

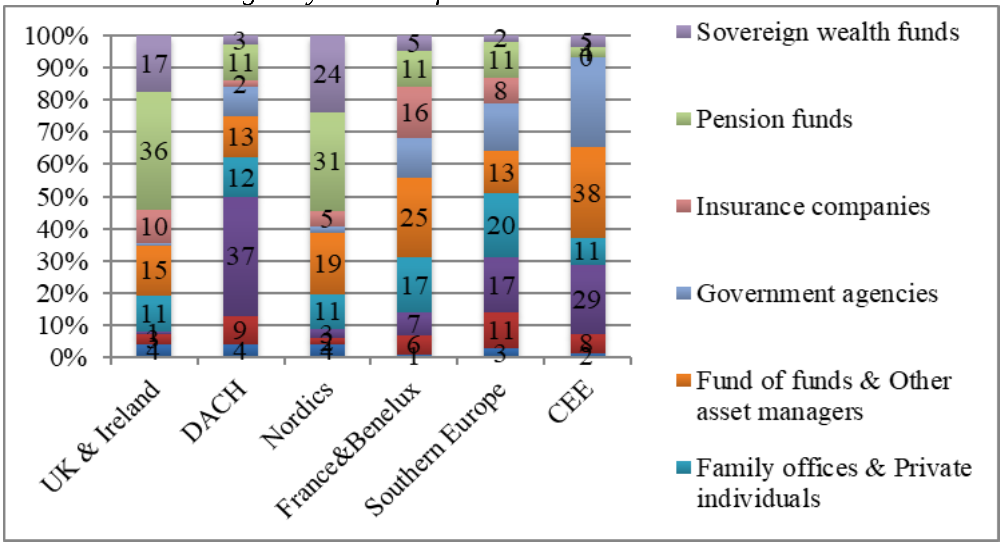
255 institutional investors invested in 343 VC funds, and the largest shares went to corporations (corporate investors), over 30%, followed by government agencies and individuals. The share of other investor groups was, with minor exceptions, at the level of 6-8%.

In 200 growth funds, the spread of shares between 127 institutional investors was smaller and was distributed proportionally between government agencies and funds of funds (18% each). Significant shares also belonged to insurance companies (12%), individuals (10%), and pension funds and family businesses (9% each).

In 151 buyout funds, the dominant group among 124 institutional investors were pension funds (34%), sovereign wealth funds (18%) and funds of funds (11%). The share of other investor groups was single-digit.

Another issue examined was the assessment of the involvement of all types of institutional investors in the previously adopted groups of countries in Europe. The research results are presented in Figure 3.

Figure 3. *Funds raised by region of management and investor type. Incremental amount raised during the year – % of total amount*



Source: *Own study based on Investing in Europe: Private Equity Activity 2022, https://www.investeurope.eu/research/activity-data/.*

In UK Ireland, the largest shares in PE fundraising worth EUR 80 billion in 2022, which accounted for 47% of all funds in PE funds in Europe, were held by pension funds (36%), sovereign wealth funds with a twice lower share of 17% and funds of funds 15 %. Government agencies, corporations, capital markets, banks and universities had relatively low shares.

In the DACH countries, PE fundraising amounted to EUR 11.1 billion, which represented approximately 7% of all PE funds in Europe in 2022. The largest shares were recorded by corporations (37%), followed by an almost three times lower share of funds of funds (13%), family businesses and pension funds. The remaining groups had single-digit shares ranging from 0 to 9%.

In the Nordics group, with the value of growth PE funds amounting to EUR 34.9 billion (20% of all PE fundraising in Europe in 2022), the structure of institutional investors was dominated by pension funds, sovereign wealth funds, funds of funds and family offices.

In the France and Benelux countries, the amount of growth in PE funds in 2022 amounted to EUR 34.9 billion (with a share of 20% in European fundraising PE), the largest shares belonged to funds of funds, then family businesses, insurance companies, government agencies and pension funds.

In the Southern Europe group with an increase in PE funds of EUR 8.3 billion and 5% participation in all European PE funds, the share of individual types of institutional investors, apart from universities, capital markets, sovereign wealth funds and insurance companies, was approximately at the level of 11 to 20 %.

Finally, with a share of 1% in the total increase in PE funds in Europe worth EUR 1.5 billion, the countries from the CEE group ranked the largest shares: funds of funds and government agencies (38% each), as well as corporations (29%) and family businesses (11%). The remaining types of institutional investors have had shares at the lower limits of occurrence.

5. Discussion

European countries have been very active in PE investments. Their roles in PE fundraising is reflected by almost 50% share in global scale. High exposure to PE has become a challenge faced by institutional investors like insurers, pension funds, banks, endowments, and sovereign wealth funds who in recent years have been building considerable allocations to this vehicle. Investors usually contribute to PE funds to capitalize on investment opportunities that may not be available to them through other channels of investment. Institutional investors do not make decisions on their own. They are highly dependent on PE fund managers as financial intermediaries between institutional investors and entrepreneurial firms.

In Europe there were 518 institutional investors operated with 802 PE funds in 2022. The largest participants were pension funds, sovereign wealth funds, fund of funds and insurance companies.

However, taking into account the shares of institutional investors in venture capital, growth and buyouts funds, the results obtained were significantly different from the average results for all PE funds in Europe. Large differences in the involvement of institutional investors in PE fundraising also occurred in the study according to the country criterion.

6. Conclusions

Institutional investors are important players in financial markets. Investors from various countries, despite low interest rates and high volatility of capital markets, are looking for assets that will generate long-term returns. Institutional investors take different approaches to investing in PE funds depending on the risk level, investment period and the possibility of portfolio diversification. The main investors of PE funds are pension funds, insurance companies, sovereign wealth funds, family offices and funds of funds.

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