impact investing institute

ASSET CLASS PROFILE

Private equity funds

Asset class trends in emerging markets

Private equity funds represent a large opportunity set for investors in emerging markets who are willing to make longer-term investments:

- Over the last decade, private equity penetration in emerging markets has expanded, raising over USD 100 billion annually since 2014
- Private equity is the most commonly used asset class in impact investing, and the third largest by assets under management. 13% of all impact funds' capitalisation globally is in emerging markets, according to Cambridge Associates
- Growth private equity represents the largest share of private equity investments, focusing on middle-sized businesses ready for scale
- Institutional investment in venture capital for impact-related companies in emerging markets, particularly in Sub-Saharan Africa, remains more limited
- A track record of successful exits is building rapidly in India, but is still consolidating for Sub-Saharan Africa

Key features

- **Longer-term opportunities:** Private equity focuses on the long-term growth of portfolio companies, with an average holding period of five to seven years before exit
- **Active management of portfolio companies:** Several funds provide active management to their portfolio companies, making strategic and operational improvements and supporting them during scale-up. This is particularly important in underdeveloped markets, in which business execution risk for companies is higher
- **Experienced fund managers:** Experienced fund managers like Actis and Leapfrog are currently launching the third or fourth generations of their funds, implementing lessons from previous generations

Sources: i) ImpactAssets, "Private Equity in Emerging Markets" ii) Cambridge Associates, "Private Equity & Venture Capital Impact Investing" 2020. iii) Preqin "Private equity in emerging markets", 2018.

Historical challenges

- **Poor historical returns:** Concerns around business capabilities and execution, high volatility and poor returns
  - **Solutions include:** Working with experienced investment managers, with strong processes for the identification, selection and monitoring of investee companies and proven track records
- **Illiquidity:** Given the low market capitalisation of several developing markets, private equity positions can be challenging to exit, particularly during economic downturns
  - **Solutions include:** Experienced fund managers engage closely with several large corporate buyers to secure different exit options during the course of the fund

Why invest?

- **Opportunity for patient capital to benefit from strong growth:** Emerging markets have the fastest growing economies globally, projected at around 6% growth compared to around 1% in developed countries, and it is not uncommon for businesses to see accelerating growth
- **Strong impact opportunity:** Private equity is essential in supporting local businesses to grow, provide goods and services to individuals, generate more tax revenue, and generally drive economic and social well-being

Examples of private equity funds in emerging markets include:

- African Development Partners III
- agRIF
- India Fund II
- Africa Fund I & II
- Financial Inclusion Fund II
- IHS Fund II
- The Danish Climate Fund
- Energy 4