



# A WORLD OF GROWTH

Lord Mark Malloch-Brown, who recently joined FTI Consulting as chairman of the Global Affairs Practice, discusses the opportunities and challenges facing private equity firms in emerging markets.

## Emerging Market Opportunities

- **Investors should look beyond the BRIC countries** to a second circle of developing nations.
- **Countries can afford to be choosy** about who invests in them, forcing investors to prove that they're in it for the long term.
- **The November G-20 Summit** in Seoul, South Korea could yield global regulatory changes.

Lord Mark Malloch-Brown is one of a handful of global leaders who have both successfully assisted developing nations in growing their economies and counseled investors seeking opportunities for creating wealth in those countries and beyond. He served as minister of state in prime minister Gordon Brown's cabinet, where he had particular responsibility for strengthening relationships with Africa and Asia. In addition, Malloch-Brown has served as deputy secretary general and chief of staff of the United Nations under Kofi Annan and, for six years before then, as administrator of the UN Development Programme, where he led development efforts around the world.

He is equally well versed in global markets, economics and investing. After an earlier career in consulting, he was the vice chairman of Soros Fund Management until he entered the British government. Throughout his career he has had frequent interactions with finance ministers, principal economists and high-profile business

leaders. Moreover, his heavy involvement in the G-20 summits, his tenure at the World Bank and his private sector experience providing financial services and investment strategies for various funds, as well as his early years as a journalist for *The Economist*, afford Malloch-Brown a unique and nuanced perspective on a wide array of global economic, political and social issues, including private equity and capital flows.

For the autumn 2010 issue of *FTI Journal*, the editorial staff sat down with Malloch-Brown to discuss private equity in emerging markets — especially those beyond the BRIC countries — and to outline some of the opportunities and challenges facing private equity firms seeking to invest overseas.

*From your vantage point, what is the current investment climate in emerging markets, and how should private equity investors consider it?*

**MALLOCH-BROWN:** Right now developed markets are experiencing an economic hangover. There are limited growth prospects for companies providing goods and services in these markets, which have matured and continue to face structural deficiencies that impede demand. The prevailing wisdom is to invest in markets showing prospects for rapid growth — whether it's private equity seeking investments or multinationals doing M&A — and these areas are increasingly not only in the BRIC countries but also beyond them to a second circle of growth, which



includes Indonesia, Malaysia, Thailand, Singapore, South Africa, Nigeria, Colombia, Chile and Mexico.

In the BRIC countries, asset values are already high, and it's hard, although not impossible, to find attractive deals. In contrast, a number of attractive opportunities clearly exist in the second circle. On the other hand, deal sizes can be smaller and exits can be a challenge. As a result, successful investing in these areas requires a very careful balance between deal size, due diligence, knowledge of local environment and an ability to get involved in the operations.

*What would you say are the most attractive geographic targets?*

**MB:** Attractive geographic markets that lie outside of the BRIC states include countries in Asia, Africa, Latin America and the Middle East, but the pros and cons of each of these regions must be weighed carefully.

Asia as a long-term option is one of the more important investment alternatives, largely because of its sheer size. Asia already accounts for more than half the world's population; in contrast, by 2050 the U.S. and Europe will account for less than 15%. The size of the Asian market of consumers and industries means that investors can't ignore it.

But Asian assets can be expensive, and depending on what you characterize as Asia — India, Pakistan, North Korea, Thailand, Myanmar — it is a region of the world where there is considerable territorial and sectarian conflict, and the effects of very rapid economic growth on economic inequality are also risks. Finally, while the sheer size of Asia makes it attractive, the rapid population growth and rate of urbanization have led to major environmental challenges. So this idea of Asia as El Dorado is not accurate, as attractive as the macroeconomic picture may be.

By contrast, Africa is just now finding its feet in terms of being a target for private equity investors. It is a very small market — unless you have an Africa-

wide roll-up strategy — but especially for long-term players, there are pockets of opportunity across the continent. Corruption remains a challenge in some countries, as well the fact that outside of such countries as South Africa and certain North African ones, investments in roads, infrastructure, health and education are only being made in fits and starts.

*Would you say these areas are pro private equity? Are they accepting of Western private equity investment?*

**MB:** Across much of Asia there is a continued desire to attract overseas investment. Hong Kong and Singapore are already highly sophisticated financial centers with homegrown private capital and public markets. But Vietnam and its neighbors — Cambodia and Laos — are now increasingly opening up to overseas private equity, as are South Asian countries such as Bangladesh. Asian countries are divided into the “fashionable” markets, if you will, which are more expensive but easier to enter, and the “less fashionable” markets, which are cheaper but in which success is perhaps harder to achieve.

In Africa, South Africa has a well-managed and sophisticated financial sector. Nigeria is a huge market that is rapidly developing, but it lacks the rule of law and transparency that Western investors generally seek.

Chile, Colombia and Mexico are also well-run countries with investor protections, solid infrastructure and a pro-investor mind-set.

*How would you describe changes in the landscape for global private equity investment over the past 20 years? Have the strategies shifted for investors?*

**MB:** Twenty years ago it was clearly more of a buyer's market. Countries as geographically disparate as Hungary, China and Mexico were desperately competing for



the same foreign investment. Now it is more of a seller's market, by which I mean a country has the opportunity to choose between investors, and private equity investors are therefore going to have to prove that they can be long-term partners prepared to contribute to local society and the growth of the country. They are going to have to be focused on job creation, demonstrate commitment to corporate social responsibility and contribute to tax revenues. In other words, investors seen as friends and partners of the region, as opposed to just foreign money, will have a definite advantage. To achieve this, they will have to strike the right balance.

In Asia, for example, there's a history of "financial nationalism" that was born in 1997 with their financial crisis and then was reinforced by the 2008–09 crisis. As a result, private equity investors now need to have more sensitivity toward local markets, businesses and leaders. It's the same in South Africa, where there are a lot of services available locally and resistance to importing services.

In many ways, it is no longer about simply buying and maximizing the value of the components of businesses but about buying "sleeping national monopolies" that need capital, infrastructure and technology. They have to be shaken up to make them stronger regional performers in a competitive global economy; they need to be capable of becoming acquirers themselves.

This is not to say there is an absence of good management in the emerging markets, because it is typically the younger, more highly trained generations running these businesses. But there is an absence of aspiration in terms of where businesses need to go. And the reporting and transparency and so on must be fit for a private equity market exit strategy down the road.

### *What do exit strategies look like in these emerging markets?*

**MB:** In all these regions, without doubt, exit strategies at the end of a seven-year investment cycle, for example, are not as straightforward as they are in the developed

world — there is not always a liquid local stock exchange on which to list the business. In many cases the journey between acquisition and exit will be longer than seven years because investors are buying family-owned companies without a listing, with limited disclosure and with significant restructuring to do. In other cases these companies are operating in single national markets, but the likely private equity strategy will be to make them players across an entire subregion. For example, the plan may be to acquire a company in Bangladesh and take it to market in India, where the market is much more active. Whatever the plan, it will almost always require a bigger corporate transformation than a private equity investment in Europe or North America. It will require more human capital as well as monetary capital, and therefore it will be a hands-on investment.

### *In terms of global regulation, are there any reforms or trends on the horizon that will impact private equity in emerging markets?*

**MB:** I think a significant inflection point will be the November G-20 Summit in Seoul, South Korea. While the principal focus will be reform of the banking sector, France and Germany have insisted that private equity remain on the table for reform discussions. Since the April 2008 G-20 Summit in London, which I helped organize, a lot of the energy for reform has dissipated. This is because we're now viewed as being on the other side of the crisis, and looking back, many are saying it was a subprime crisis or a crisis created by overleveraging and that private equity was peripheral to the meltdown. But others see private equity as a potential source of future crises, so there is not exactly consensus. And, of course, were there to be further economic setbacks and anything approaching a double-dip recession, the Seoul meeting would acquire the same political crisis stages that the London meeting had in 2008, in which case all bets would be off as to what leaders might choose to do. ■

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