

# Global Limited Partners Survey

Investors' Views of Private Equity  
in Emerging Markets

2012



**EMPEA** 

Emerging Markets Private Equity Association

## About EMPEA

The Emerging Markets Private Equity Association (EMPEA) is an independent, global membership association whose mission is to catalyze the development of private equity and venture capital industries in emerging markets. EMPEA's 300 members share the belief that private equity can provide superior returns to investors, while creating significant value for companies, economies and communities in emerging markets. Our members include the leading institutional investors and private equity and venture capital fund managers across developing and developed markets. EMPEA leverages its unparalleled global industry network to deliver authoritative intelligence, promote best practices, and provide unique networking opportunities, giving our members a competitive edge for raising funds, making good investments and managing exits to achieve superior returns.

In support of its mission, EMPEA:

- Researches, analyzes and disseminates authoritative information on emerging markets private equity;
- Convenes meetings and conferences around the world to promote information exchange between leading fund managers and institutional investors;
- Offers professional development programs to enhance knowledge transfer; and,
- Collaborates with stakeholders from across the globe.

**EMPEA's members represent nearly 60 countries and over US\$1 trillion in assets under management.**

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## Methodology and Disclaimer

This Survey is a snapshot of the attitudes of global Limited Partners (LPs) towards private equity in emerging economies and provides an annual overview of LPs' plans for investment in those markets.

Between December 2011 and February 2012, EMPEA surveyed 106 LPs from organizations headquartered in 28 countries and representing public and corporate pension funds, insurance companies, banks, asset managers, endowments and sovereign wealth funds. Survey participants account for collective private equity assets under management of nearly US\$400 billion.

This 8th edition of the Survey covers topics that include:

- LPs' appetite for emerging markets private equity
- LPs' return expectations
- Attractive areas for GP investment
- Key considerations in the manager selection decision
- Obstacles to investing in select emerging markets
- LPs' preferences for GP commitments
- Influence of ESG considerations on LP investment decisions

## Definitions and Abbreviations Used:

Emerging markets (abbreviated to "EM") is defined as the private equity markets of all countries *outside* of the United States, Canada, Western Europe, Japan, Australia and New Zealand. Emerging Asia encompasses all of Asia excluding funds whose primary investment focus is Japan, Australia or New Zealand.

The term private equity (abbreviated to "PE") encompasses leveraged buyouts, growth capital, venture capital and mezzanine investments. By emerging markets private equity (abbreviated to "EM PE") funds, we mean PE funds that principally target investments in emerging markets.

For the purposes of this survey, limited partners (LPs) are investors in private equity funds. General Partners (GPs) are private equity fund managers. We defined LPs with more exposure as those with institutional PE exposure to 11 or more EM PE funds and three or more emerging market geographies.

Responses from Development Finance Institutions and EM-dedicated Funds of Funds were excluded from select findings (e.g., percent of PE allocations directed at EM PE), as indicated in the report.

# 2012 Global Limited Partners Survey

## Executive Summary

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In this 8th annual edition of our Global Limited Partners Survey, the Emerging Markets Private Equity Association (EMPEA) collected the views of LPs around the world to better understand their changing attitudes towards private equity investing in emerging markets. The objective of this study is to provide EMPEA members and the broader industry—LPs, GPs and other stakeholders—with a greater understanding of how LPs view the asset class, how their attitudes have changed over time, what their plans are for investment and what factors will shape the future of private equity investment in emerging markets.

The findings of this study are based on data collected from 106 LPs headquartered in 28 countries and globally representative of the diversity of institutions investing in the asset class, including public and corporate pension funds, insurance companies, banks, asset managers, endowments and sovereign wealth funds. Surveyed LPs collectively represent PE assets under management of nearly US\$400 billion. The findings represented generally reflect the views of LPs experienced in investing in the asset class, e.g., five years or more and in at least six EM PE funds.

Key findings from the 2012 Survey include:

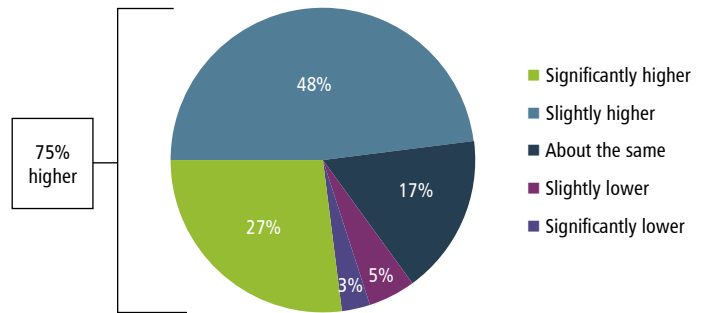
- Three-quarters of LPs expect their commitments to emerging markets to increase over the next two years. By contrast, only 26% of LPs anticipate they will expand their investments in developed markets in the same time period. This differential in planned commitments is consistent with overall patterns in global fundraising: in 2011, emerging markets captured 15% of total PE capital raised globally, from only 4% of the global total in 2004.
- More than half of LPs (57%) expect that emerging markets will account for 16% or more of their total PE allocation in two years' time, on par with the 58% having similar expectations in the 2011 Survey.
- The shift in PE allocations towards emerging markets reflects persistent LP optimism about emerging markets' ability to outperform developed markets. Nearly three-quarters of LPs (72%) expect 2011-vintage EM PE funds to deliver net returns of at least 16%, compared with only 26% of LPs believing the same of developed market PE funds.
- China and Southeast Asia funds are predicted to generate the highest net returns over the next 3–5 years, followed by Latin America funds.
- Latin America (ex. Brazil) has edged out Brazil as the region viewed as most attractive for dealmaking, with Brazil, China and Southeast Asia close behind. India continued its slide, falling to sixth place, while Central and Eastern Europe, once viewed as among the most attractive markets for PE, slipped into last place.
- LPs are increasing their focus on less-penetrated markets, with Latin America (ex. Brazil), Southeast Asia, Turkey and Sub-Saharan Africa all poised to see increased commitments. However, for the fourth year, Brazil stands to see the largest influx of new investors.
- Fund manager instability is the single greatest concern for LPs considering an investment in an EM PE fund, followed by worries about portfolio company management talent and corruption issues—all dwarfing concerns about macro issues such as currency or inflation risk.
- While issues at the fund manager or investee level are most worrying to LPs generally, concerns about macro-level challenges in select markets, particularly political and regulatory risk, pose the most significant deterrents to new entrants.
- More than half (53%) of LPs now expect GP commitments of more than 2% to a fund, with pension funds generally having the highest expectations for GP commitment percentages.
- Environmental, social and governance (ESG) considerations influence, at least in part, the manager selection decisions of two-thirds (65%) of LPs, but only 14% of LPs have investment mandates directly restricted by ESG considerations.

# Planned Commitments to EM PE Still on the Rise

Three-quarters of LPs expect increases in their new EM PE commitments in 2012/2013 versus their commitments in 2010/2011. This growth in commitments is attributable both to LPs executing on previously planned increases in EM PE fund commitments—tied to growth of their overall PE portfolios and to EMs' rising share within their PE programs.

Only 8% of LP respondents plan to decrease their commitments, all of whom indicated a pause and not a retreat, as their institution had met its EM PE portfolio goals for now.

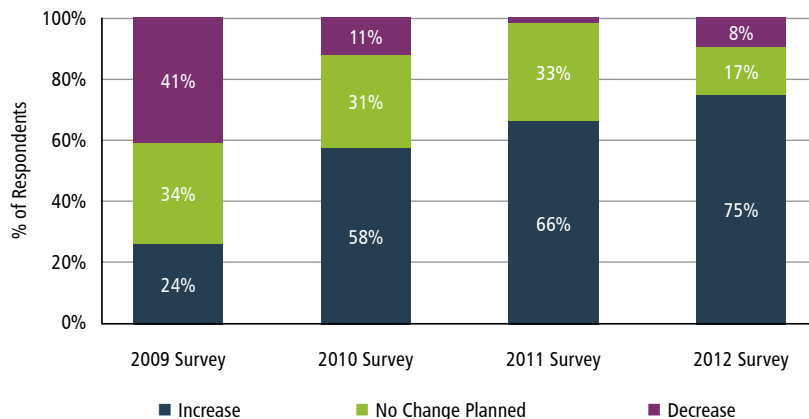
Exhibit 1: LPs' Anticipated Level of New Commitments to EM PE Over the Next 2 Years\*



\*Excludes Development Finance Institutions and EM-dedicated Funds of Funds

This expectation of increasing commitments to EM PE marks the continuation of the trend since the depths of the financial crisis. The portion of LPs anticipating they would increase commitments to EM PE rose from only 24% in 2009—when many LPs were in a holding pattern due to cash constraints and stress elsewhere in their portfolios—to 75% in 2012.

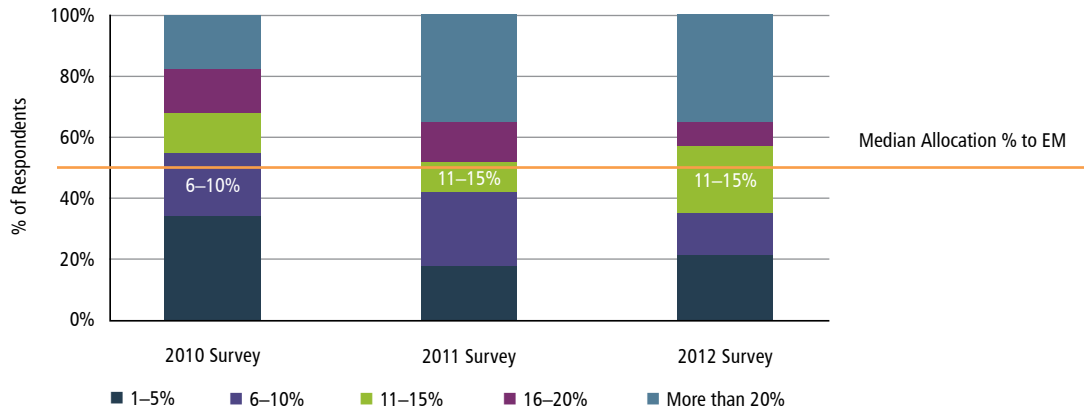
Exhibit 2: Anticipated Level of New Commitments to EM PE Funds in Next Two Years, 2009–2012\*



\*Excludes Development Finance Institutions and EM-dedicated Funds of Funds

Among LP respondents, the share of *current* PE allocations aimed at emerging markets is rising. For the typical LP in our 2012 Survey, emerging markets accounts for 11–15% of their *current* total PE allocation, versus 6–10% in our 2010 Survey. Among pension funds, the typical share of PE allocations directed at EM PE has moved from 5% in 2010 to approximately 11% today.

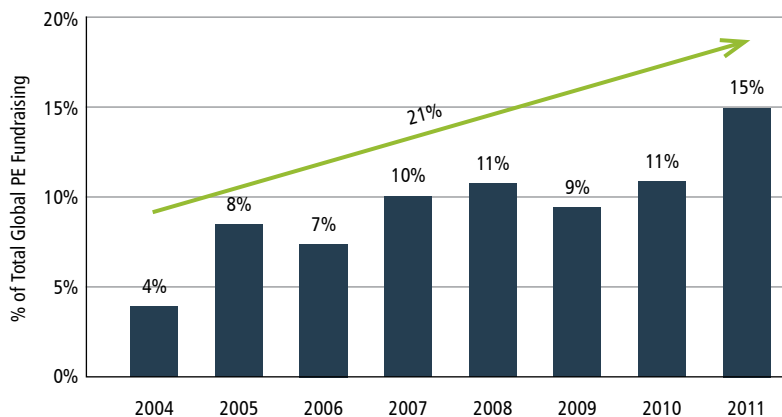
**Exhibit 3: EM PE Investors' Proportion of Total PE Allocation Targeted at EM PE\***



\*Excludes Development Finance Institutions and EM-dedicated Funds of Funds

EMPEA's data on global fundraising trends gives further evidence that emerging markets are accounting for a larger percentage of investor portfolios. Emerging markets' share of global PE fundraising has risen steadily since 2004, reaching 15% of the global total in 2011. This represents annual growth of 21%, whereas emerging markets' share of global GDP grew 6% annually over the same period.

**Exhibit 4: EM PE Fundraising as a Percent of Global Total, 2004–2011**

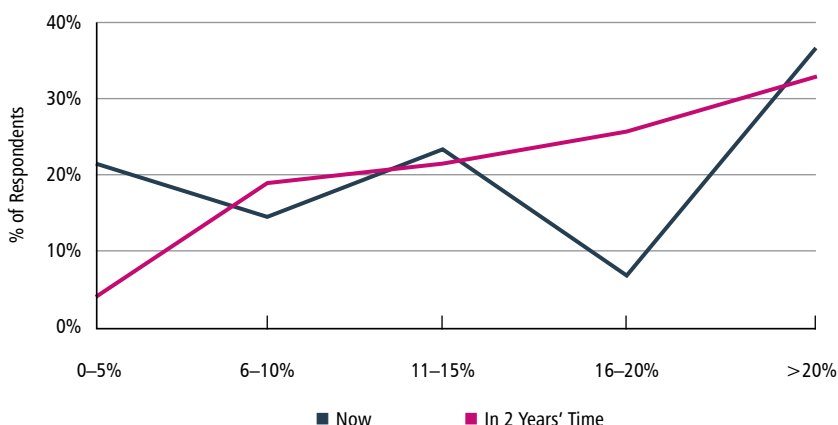


Source: Emerging Markets Private Equity Association. Data as of 31 December 2011. Published 15 March 2012.

# The Shift Towards Emerging Markets Continues

Whereas the median LP *currently* directs 11–15% of total PE commitments to emerging markets (58% of LPs committing 1–15% to EM PE), in two years' time the median LP expects to direct 16–20% of their PE portfolios towards EMs, with 57% claiming EM PE will capture 16% or more of total PE commitments. This compares with 58% of LPs in 2011 projecting they would allocate 16% or more to EM PE, and 39% with similar allocation expectations in 2010.

**Exhibit 5: Investors' Proportion of Total PE Allocation Targeted at EM PE\***

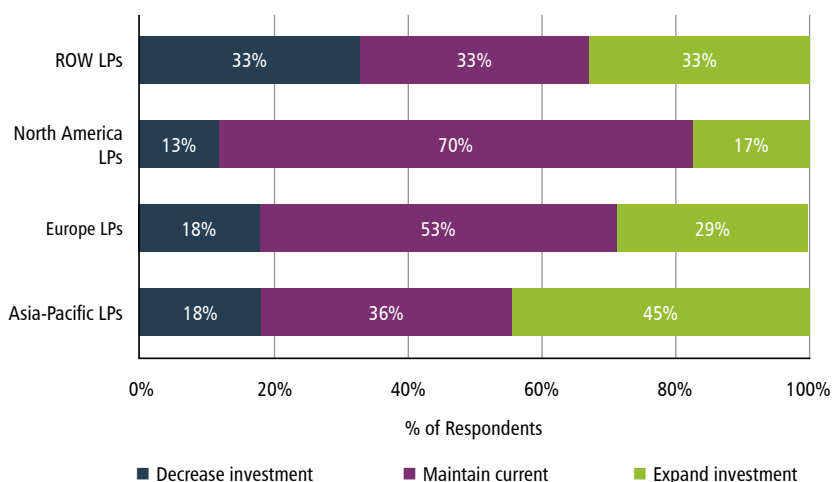


\*Excludes Development Finance Institutions and EM-dedicated Funds of Funds

The growing share of PE allocations being directed to EM PE funds is suggestive of the broader secular shift taking place in LP portfolios. Overall, the majority of LPs plan to maintain (57%) or shrink (16%) their developed markets PE commitments over the next two years, with only 26% planning to increase investment.

The exception to this trend was among Asia-Pacific LPs, known historically to have a developed market bias in their portfolios (see *EMPEA's 2012 Special Report: Asian LP Sentiment Toward PE*). Asia-based LPs indicated they were more likely than LPs in other regions to grow their developed markets PE commitments.

**Exhibit 6: LPs Planned Changes to their Developed Markets PE Investment Strategy over the Next 2 Years, by Location\***



\*Excludes Development Finance Institutions and EM-dedicated Funds of Funds. Note: Does not include LPs with "no plans to invest" in Developed Markets.

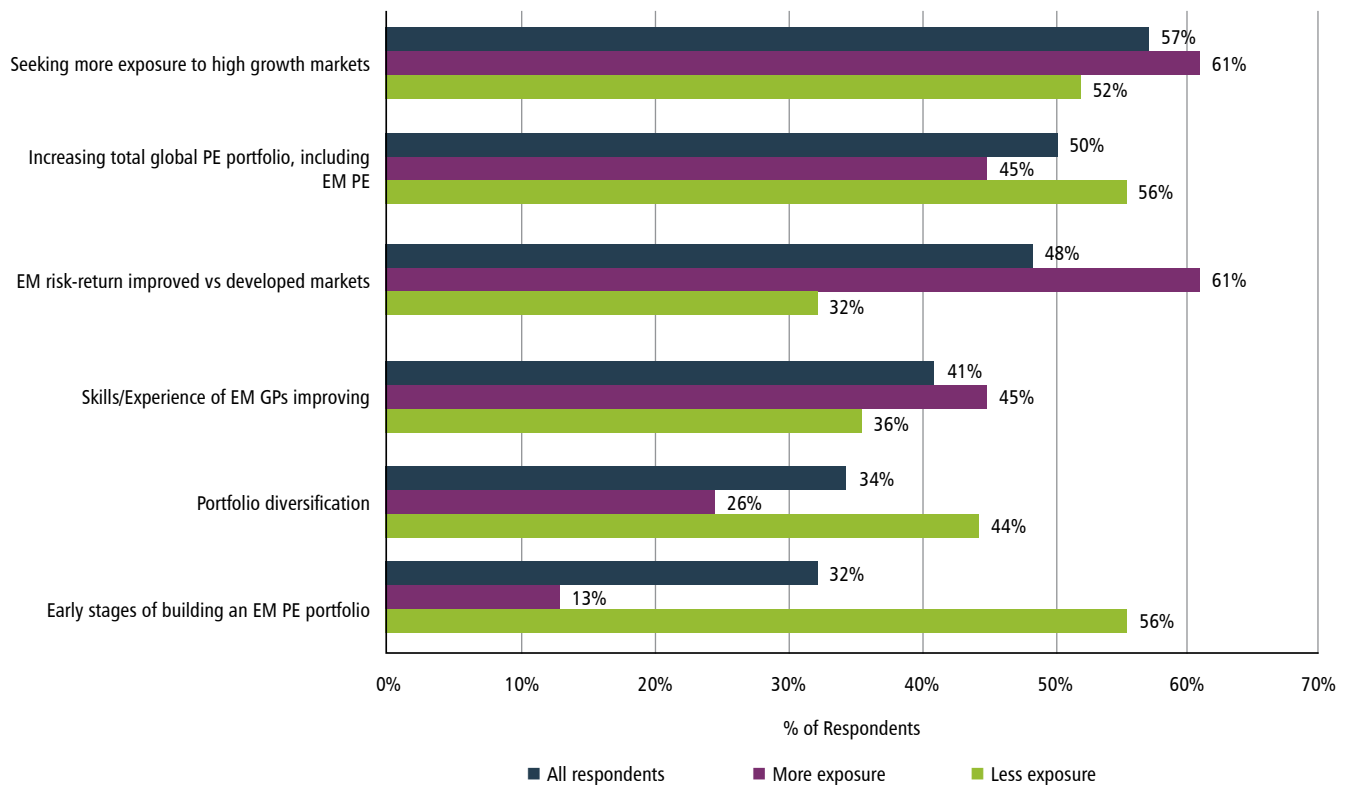
# Superior Growth Prospects Continue to be the Leading Driver of Increased Commitments to EM PE

For the 3rd year in a row, faster economic growth remains the leading reason that LPs expect to step up their commitments to EM PE funds.

Overall, 57% of LPs cite the desire for more exposure to high-growth economies as a reason for increasing their EM PE commitments in the coming year. Half of LPs also point out that commitments to emerging markets funds will grow along with the rest of their PE commitments.

LPs with greater exposure currently to EM PE point to an improving risk-return profile (61% of LPs) and the pursuit of growth (also 61%) as the leading drivers. LPs with less current exposure to EM PE most commonly cited being in the early stages of building an EM PE portfolio as the reason for accelerating their EM PE commitments (56%).

Exhibit 7: LPs' Reasons for Accelerating New Commitments to EM PE funds in 2012/2013\*



\*Excludes Development Finance Institutions and EM-dedicated Funds of Funds. "More exposure" defined as LPs with institutional PE exposure to 11 or more EM PE funds and three or more emerging market geographies.



# LPs Continue to Believe that EMs' Higher Growth will Translate to Higher Net Returns Than in Developed Markets

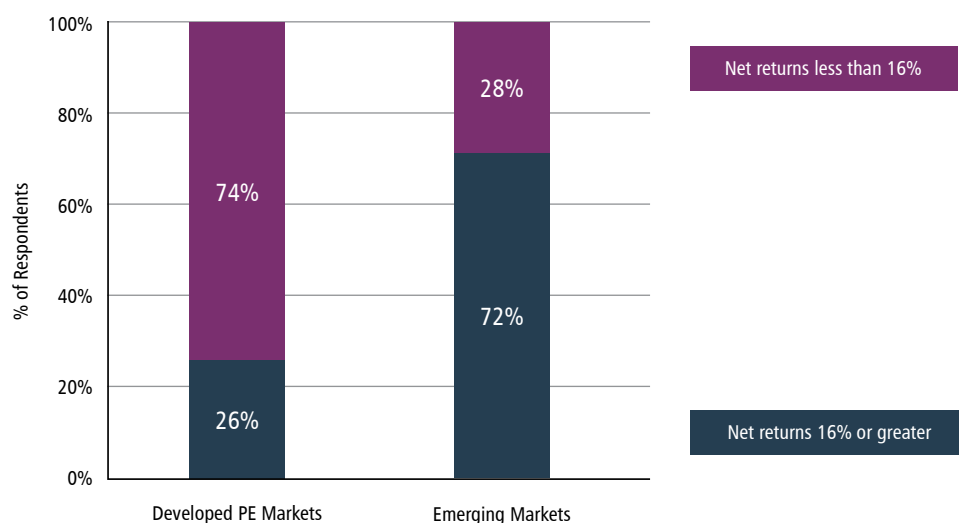
Nearly three-quarters (72%) of LPs anticipate their EM PE funds will deliver net returns of at least 16%, compared to only 26% of LPs who predict their developed market funds will do the same.

The leading explanation behind LPs' expectation of higher net returns from EM PE versus developed markets lies in macroeconomic and demographic drivers, i.e., superior GDP growth and better opportunities to access that growth. Additionally, LPs noted that structural inefficiencies, namely lower entry valuations on a

comparative basis and less vulnerability to credit markets, factor into their expectations for higher net returns from emerging markets.

According to performance data from Cambridge Associates, through 30 September 2011, EM PE outperformed both developed markets PE as well as listed markets over a three- and five-year period, delivering a net internal rate of return of 12% for both periods, versus 7% and 5% for listed emerging markets over a three- and five-year period, respectively.

Exhibit 8: LPs' Annual Net Return Expectations for Developed Market vs. Emerging Market PE Portfolios over 3–5 Years



“ Each emerging market is unique, but overall the investable opportunities and superior economic growth in emerging markets appear likely to sustain strong returns compared to developed markets, where we’re seeing a contraction both in market size and in fund managers.”

— Fund of Funds

# LPs are Most Bullish about their Asian and Latin American Funds

LPs have the highest net returns expectations for their Chinese 2011-vintage funds, with 76% expecting returns of 16% or more. 71% of LPs expect similar returns for 2011-vintage Southeast Asian funds, while nearly two-thirds of LPs have similar expectations for the 2011 fund vintages in Latin America (ex. Brazil) (65%) and Brazil (64%).

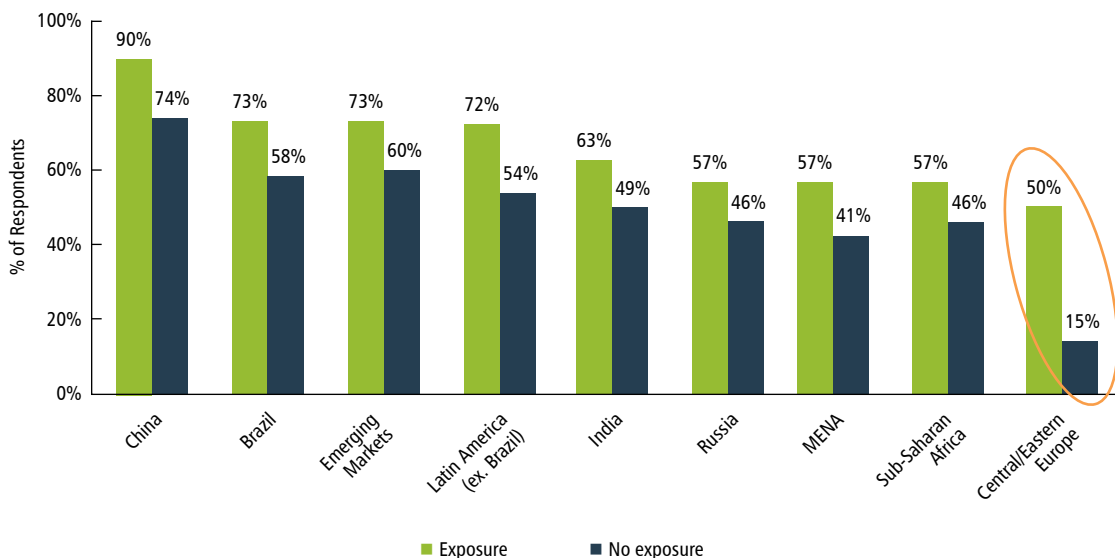
Exhibit 9: Ranking of Net Return Expectations from 2011-Vintage Funds

Ranking	Market	% LPs Expecting 16%+ Net Returns	Highest return expectations
1	China	76%	
2	Southeast Asia	71%	
3	Latin America	65%	
4	Brazil	64%	
5	Turkey	61%	
6	India	56%	
7	Sub-Saharan Africa	50%	
8	Russia/CIS	49%	
9	MENA	44%	
10	CEE	32%	

LPs currently investing in emerging markets generally have a more optimistic view on performance than do LPs *without* exposure. This is in contrast with the 2011 Survey results, which showed that investors *without* exposure to emerging markets overall—and in particular, those without exposure to the markets of Emerging Asia or Latin America—had higher expectations of performance than did investors *with* exposure to those markets.

The most striking gap in performance expectations was in relation to the performance of Central and Eastern European funds, with half of LPs *with* exposure expecting 16%+ net returns, compared with only 15% of LPs *without* exposure to the region expecting net returns of 16% or more.

Exhibit 10: Net Returns Expectations of 16% or More, by Current Exposure



# Latin American Markets (ex. Brazil) Take Center Stage

LPs believe Latin American markets (ex. Brazil) represent the most attractive destination for GP investment over the next 12 months, jumping from 4th to 1st place, followed by Brazil, China and Southeast Asia. This may reflect LPs' anticipation of an increasingly competitive market for dealflow in Brazil, after record-breaking fundraising in 2011 in which six Brazil funds raised capital totaling US\$7.5 billion.

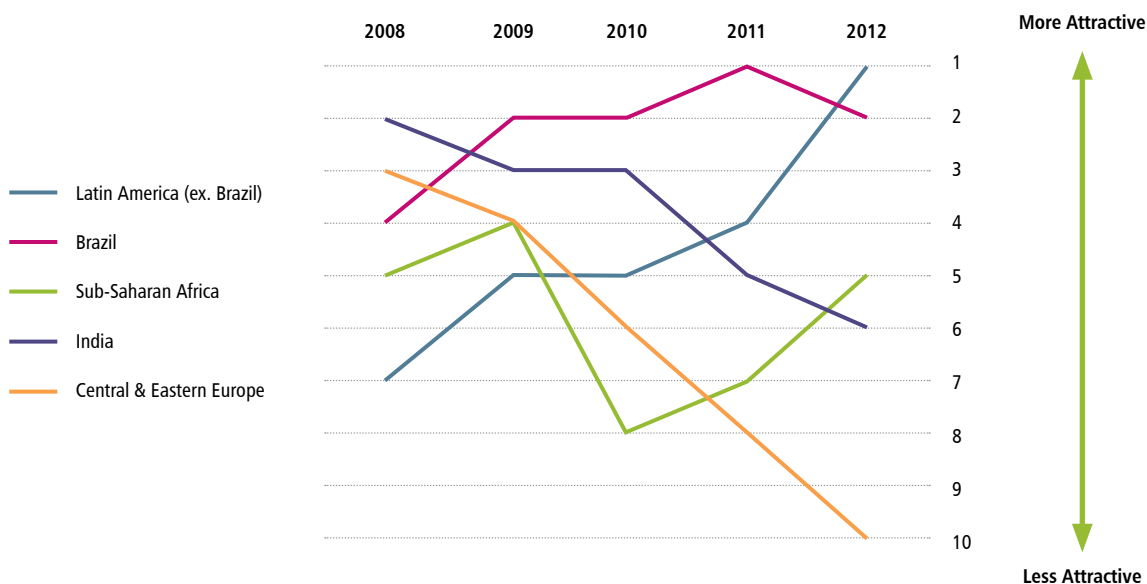
Other movers in 2012 included Sub-Saharan Africa, which climbed into the number five slot from seventh place in 2011 and eighth in 2010. Sliding down the ranks for the fourth consecutive year, India fell to sixth place. Once solidly among the three most attractive markets, Central and Eastern Europe fell to last place while Russia moved up slightly in attractiveness from tenth to eighth place.

Exhibit 11: The Attractiveness of Emerging Markets for GP Investment over the Next 12 Months – LP Views

	Overall Ranking		
	2012	2011	2010
Latin America (ex. Brazil)	1	4	5
Brazil	2	1	2
China	3	2=	1
Other Emerging Asia	4	2=	4
Sub-Saharan Africa	5	7	8
India	6	5	3
Turkey	7	6	N/A*
Russia/CIS	8	10	10
MENA	9	9	9
Central & Eastern Europe	10	8	6

\*Turkey replaced South Africa in the 2011 survey.

Exhibit 12: Market Attractiveness Rankings, Greatest Shifts 2008–2012



# LPs Are Increasing Their Focus on Less Penetrated Markets

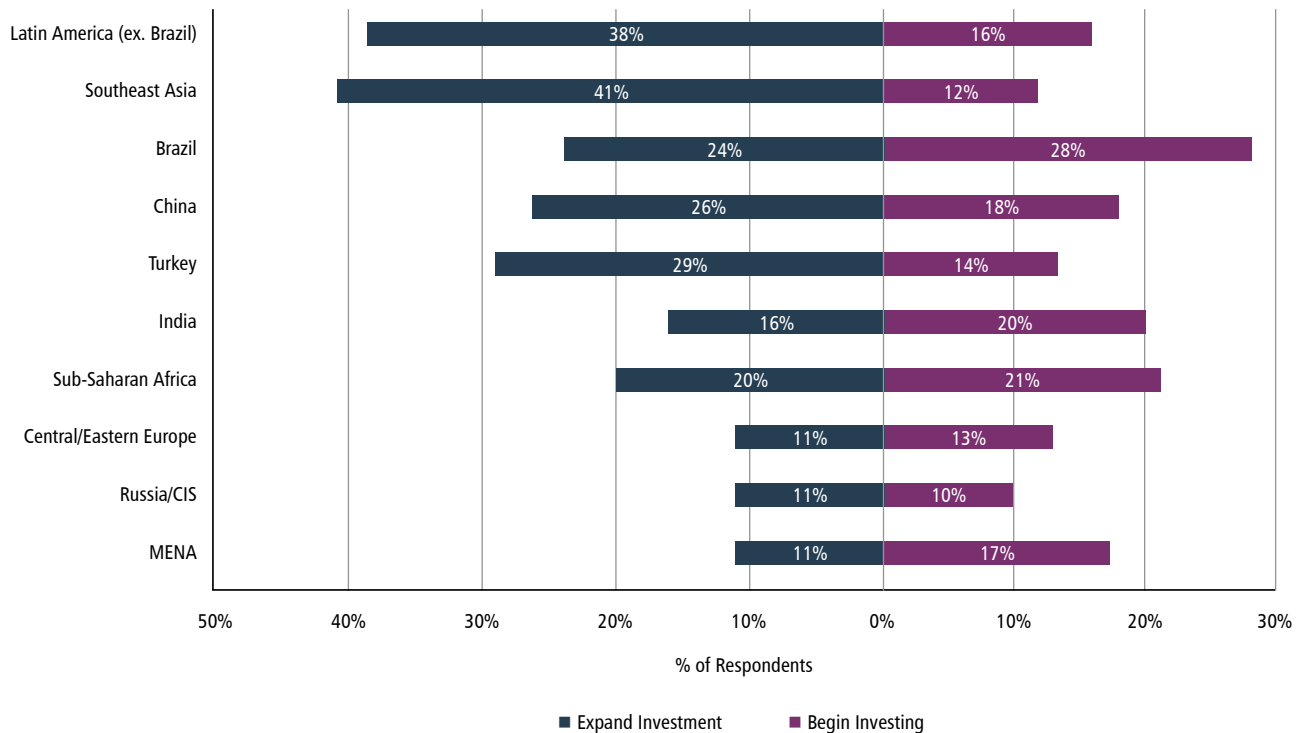
While LPs will continue to invest in Brazil, China and India, they also anticipate expanding into the less penetrated markets of Latin America (ex. Brazil), Southeast Asia, Turkey and Sub-Saharan Africa.

Latin America beyond Brazil and Southeast Asia are poised to capture the greatest gain, with 54% of LPs planning to expand or begin investment in Latin American markets such

as Colombia, Peru, Mexico and 53% in Southeast Asian markets such as Indonesia, Thailand, Vietnam and Malaysia.

For the fourth year in a row, Brazil leads among markets gaining new entrants, with 28% of LPs planning to begin investing there in the next two years, followed by Sub-Saharan Africa (21%).

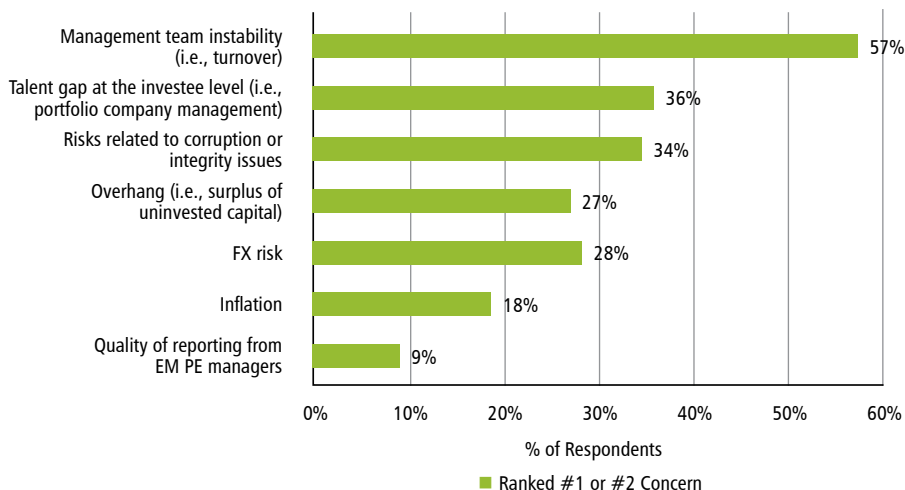
Exhibit 13: LPs' Planned Changes to EM PE Investment Strategy Over the Next 2 Years



# LPs Worry Most about Fund Manager Instability – Not Macro Risks or other Exogenous Issues

When investing with an EM PE manager, LPs care most about continuity, with 57% identifying management team instability as a #1 or #2 key concern. Secondly, LPs are also looking for assurances of a manager’s ability to acquire and retain skilled management at the portfolio company level, with 36% of LPs identifying the talent gap at the investee level as a top concern. Risks related to corruption and integrity issues are top of mind for 34% of LPs.

Exhibit 14: LPs’ Key Concerns When Committing to an EM PE Fund



## Perceived Political and Regulatory Risks are Keeping Some Investors Out of Select Markets

Political risk is the single greatest market-specific deterrent to LP willingness to invest at all in six of the 10 markets evaluated, and is most pronounced in the case of Russia (cited by 73% of LPs) and Sub-Saharan Africa (66%). A corollary to political risk in many markets—a challenging domestic regulatory environment—was cited as a factor in Russia by 50% of LPs and an issue in Sub-Saharan Africa by 38% of LPs.

LPs voiced concerns about oversupply of capital in both Brazil and India, with 27% of LPs citing competition as an issue in Brazil and 20% in India. By contrast, an undersupply of established fund managers was flagged as an issue for Sub-Saharan Africa (50%), MENA (34%), Turkey (32%) and Latin America (ex. Brazil) (29%). The small scale of underlying opportunities presents a hurdle for LPs considering MENA (cited as a deterrent by 32% of LPs) and Sub-Saharan Africa (41%).

These results contrast with the 2011 Survey, in which the leading deterrent identified was the limited number of established GPs in many markets. While political risk was also a primary deterrent in many of the same markets as in this survey, other key hurdles in the 2011 Survey were entry valuations for India (58%), China (45%) and Brazil (31%), weak exit environments in Southeast Asia (35%), and scale challenges in MENA (33%) and Sub-Saharan Africa (24%).

Exhibit 15: Factors Likely to Deter LPs from Entering Select Markets\*

	Limited number of established GPs	Oversupply of funds/too competitive	Scale of opportunity to invest is too small	Entry valuations are too high	Weak exit environments	Challenging regulatory/tax issues	Political Risk
China	6%	6%	0%	0%	6%	31%	31%
India	13%	20%	7%	33%	13%	20%	20%
Southeast Asia	13%	0%	20%	7%	13%	20%	7%
Russia/CIS	20%	0%	13%	3%	15%	50%	73%
Turkey	32%	7%	21%	7%	11%	18%	25%
Cent./East. Europe	21%	4%	25%	8%	8%	13%	25%
Brazil	13%	27%	0%	7%	0%	0%	7%
Latin Amer. (ex. Brazil)	29%	0%	12%	6%	24%	18%	29%
MENA	34%	2%	32%	5%	24%	37%	63%
Sub-Saharan Africa	50%	0%	41%	3%	28%	38%	66%

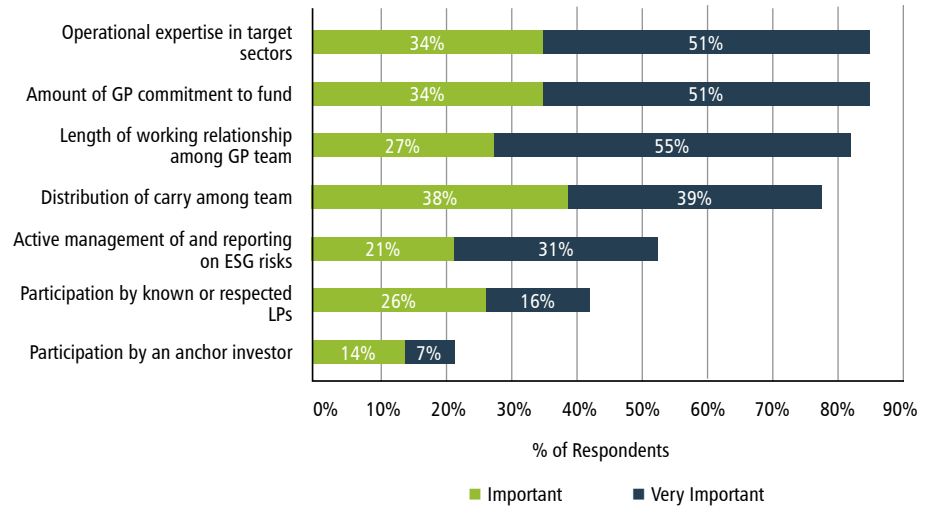
\*Indicates percentage of respondents answering for each region.

# LPs are Seeking GPs with Operational Expertise and Willingness to Make a Higher Commitment

LPs attach the greatest importance to a GP's operational expertise and level of commitment to the fund, with 85% of LPs citing both as important or very important factors in EM PE manager selection. GP team cohesion is likewise an important consideration to LPs evaluating an EM PE fund, as measured by the length of working relationship (important for 82% of LPs) and how deeply within a team carry is distributed (77%).

Fund managers' treatment of ESG risks in the portfolio matters a great deal to 52% of LPs. Less important are the size or brand of the other LPs in a fund.

Exhibit 16: Important Factors in Evaluating an EM PE Manager

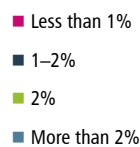


## Nearly Half of LPs are Now Seeking GP Commitments of More than 2%

More than half of LPs (53%) prefer fund managers to make commitments of more than 2% to the fund.

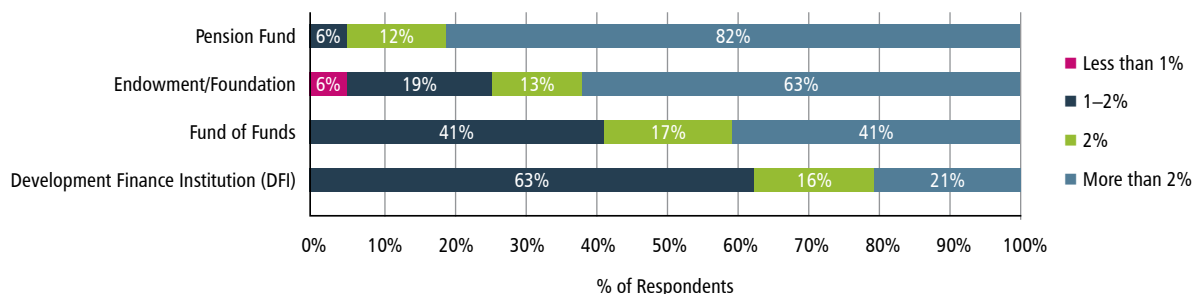
Pension funds are the most demanding, with 82% preferring a commitment above 2% of the fund from their EM PE managers. Endowments/Foundation are not far behind, with 63% expecting a GP commitment greater than 2% of the fund.

Exhibit 17: Preferred Commitment from an EM GP\*



\*Excludes Development Finance Institutions

Exhibit 18: Preferred Fund Commitment from an EM GP, by Institution Type

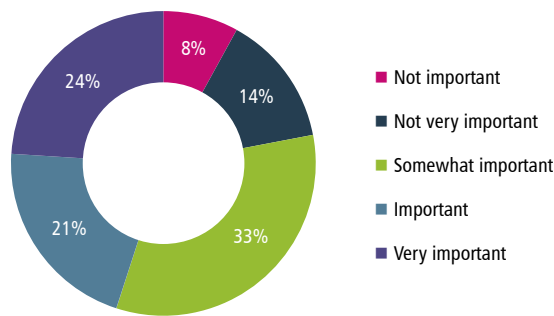


# ESG Considerations Weigh Most Heavily in the Manager Selection Decisions of European LPs

LPs are increasingly evaluating a fund manager’s ability to identify, address and report on ESG risks within their portfolios, with 78% of LPs overall considering active management of these issues as at least somewhat important in their manager selection.

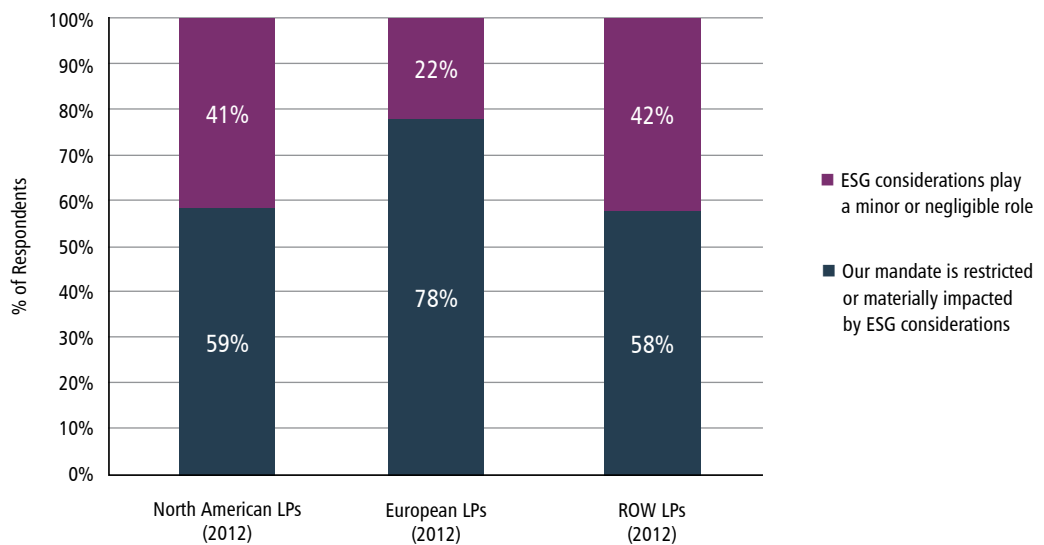
For 65% of LPs, manager selection decisions are materially impacted or directly restricted by ESG considerations, versus 66% of LPs surveyed in 2011. As in the 2011 Survey, European LPs factor ESG issues most heavily into their EM PE investment decisions.

Exhibit 19: Importance of “Active Management of and Reporting on ESG Risks” in Evaluating EM PE Managers\*



\*Excludes Development Finance Institutions

Exhibit 20: Impact of ESG Considerations on Fund Manager Selection, by Location\*



\*Excludes Development Finance Institutions



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