

STANWICH ADVISORS – 10 YEARS OF EMERGING MARKETS FUNDRAISING

Emerging institutions

In the last decade, managers in emerging economies have weathered tough environments. Some have not only survived but thrived, says Charlie Daugherty of Stanwich Advisors



Daugherty: finding quality in emerging economies

Over the last decade, one of the most significant changes in emerging markets private equity has been the institutionalisation of managers in developing economies.

In fledgling markets, local firms are established that attract local capital. Those that perform well in their early funds can then attract larger commitments from bigger organisations like financial institutions and international pensions. As they do so, they have to adopt the stricter standards demanded by the larger, more mature limited partners in the asset class – better quality reporting and greater transparency, for example, or more opportunities to co-invest in deals.

“Those emerging markets managers that have been successful have had to change. The firms that want to be successful in raising international capital have had to adopt best practices,” says Charlie Daugherty, managing partner with placement agency Stanwich Advisors. “They are no longer able to obtain the capital if they’re not viewed as institutional quality.”

This evolution has been apparent in Asia, especially China and India, and in Latin America, particularly Brazil. The trend toward more formal, structured organisations will only continue as international investors continue to pour money into one of the few areas where they’re finding growth these days – emerging markets.

NARROWER FOCUS

One way private equity managers have

changed as their home markets have matured is that they have become country-specific operators rather than broader pan-regional investors, according to Daugherty.

“In Asia, private equity firms started out with pan-regional strategies because none of the individual markets were big enough to support country-specific funds,” Daugherty says. “There were some exceptions like Japan and Australia, but most were pan-regional and included India, China, south-east Asia and South Korea.” But times have changed, he says. “Many developing countries have experienced significant economic growth over the past decade and have in turn developed markets that are big enough and robust enough to support country-specific funds.”

This trend is particularly evident in Asia, where small, local managers are attracting capital, including commitments from governmental entities. A key driver has been that teams of investment professionals have spun out of larger regionally-focused investment firms, to start their own shops focused on specific countries, says Daugherty. In many cases, he adds, these executives have come from former bank-sponsored emerging markets platforms, which have been shedding private equity operations for regulatory reasons.

In China, these managers have been raising local currency funds too. The rise of the RMB vehicle has been a big story in the region for the past few years, as Chinese municipal governments have started

committing capital to funds raised by local players and international funds.

These developments have changed the way many LPs think about these markets. “Early on, investors in emerging markets generally focused on pan-regional strategies, as the volatility in developing economies made it difficult for institutional investors to get comfortable with country-specific funds,” Daugherty says. “[But] as emerging economies have continued to mature, investors are now looking to identify the countries that they find most attractive and then find the best managers in each market.”

The challenge for limited partners now is to figure out which independent teams will produce the best returns – because according to Daugherty, it’s sometimes hard to assess the track record of new managers. Often the big question, he says, is: “Can they generate deal flow on their own, or is the track record that they’re representing as their own someone else’s?” As these markets continue to mature, “those that are able to pass the diligence test will represent the next wave of exciting managers in these markets.”

LATIN AMERICA EVOLVES

Latin America has gone through several cycles of development since the 1990s. Brazil’s private equity industry started with Brazil-only funds in the 1990s; then came funds focusing on Brazil and Argentina, the strong economies at the time. After a hiatus following Argentina’s debt default, private

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equity has slowly come back into favour in the past decade; within the last few years more large funds have emerged, including some pan-regional vehicles, according to Daugherty.

“The market in Latin American in the last two years has changed dramatically,” he says. “Four years ago, there were maybe four or five groups raising institutional capital. Now there are many more – 40 or 50, perhaps.”

Institutional investors left Brazil *en masse* after the 1990s, but in the past three or four years they’ve been coming back, attracted by the country’s growth story, Daugherty says. In fact, LPs in general have been eyeing up the region as a possible bright spot in an increasingly gloomy world economy.

“The wide interest in Latin America today clearly reflects the robust economic growth of the region, but also the fact that the majority of investors have previously had no exposure there at all,” he explains. “Many LPs are now aggressively focused on getting up to speed on who the best players are.”

LOOKING AHEAD

Managers in these markets will continue to grow more sophisticated over the next few years, Daugherty believes – at least the ones that continue to perform well, stick to their investment strategies and stay disciplined on fund size.

Those managers will continue to attract capital from investors who are increasingly diverting their attention, and their money, to emerging markets rather than the more sluggish developed markets.

This could result in a period of slower growth and consolidation for private equity going through in the US and Western Europe – a situation where “you have to be very special to create outsized returns”, as Daugherty puts it – and some great opportunities for emerging managers.

“Emerging markets will remain very exciting,” Daugherty says. “There is a great opportunity for LPs that are ahead of the curve to partner with the most promising managers and capitalise on the outsized returns that they are expected to generate.” 🌸