

Underdevelopment in the BRIC Countries - Opportunity or Obstacle for Private Equity?

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Abstract

This thesis aims to qualitatively assess the risks and rewards of private equity investment in the BRIC countries, which are special in their transformative period of high growth and development. We look into private equity attractiveness drivers in Brazil, Russia, India and China in depth. We then quantitatively assess which key drivers are of significance in developed and underdeveloped countries separately and try to shed light onto the evolution of private equity penetration among markets of various stages of development and into what, throughout this evolution, drives private equity investment. We find that once investors are protected and their governance rights are in place, they tend to focus on more variables in their investment decision making. Ultimately then, it is investor protection and corporate governance that are the cornerstone of private equity investment in early penetration and other factors only come into play with higher economic, market, social and legislative development. For emerging markets, we also find that local market expertise is of crucial importance to investors.

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1 Introduction to the paper

According to a Partners Group (2012) research, the capability to execute operational improvements at a portfolio company's level differentiates private equity (PE) investors from their peers, with private equity investments beating public equities while offering an attractive risk profile at the same time. Davis et al. (2011) prove that PE-backed companies experience a net intensification of job creation, yielding substantial productivity growth differential within two years after transaction. It has also been proven that PE-backed companies create more relevant innovation than non-PE-backed companies in terms of economic value (Lerner, Sørensen, & Strömberg, 2011). While this holds true generally, private equity is not yet as developed in emerging markets; at first sight it would seem that emerging markets' need for efficiency, employment, and innovation should be even stronger than in developed countries, thus leading to a greater need to attract private equity activity. Growth potential in these countries seems very high, providing PE firms with the rationale to invest in them, as considerable investments are needed to finance development. As private equity and venture capital (VC) firms could provide such capital, countries would not have to rely exclusively on domestic capital, making the need for private equity and venture capital even more evident. Governments should therefore focus on creating an adequate environment for these firms to enter their markets.

So the question rises: what are the factors that mostly attract PE and VC investing and that make a certain environment more or less favorable for its development? Why are certain countries able to attract more investment than others?

Spatial variations of private equity activity, according to Alexander Groh (2009), can

result from numerous factors. The purpose of this paper is to understand what drives this variation across countries, and to assess the factors that determine the flow of private equity investments across countries. Ultimately, this paper should be able to provide a checklist for governments in emerging markets of what needs to be done or improved in their countries' systems in order to best attract private equity activity.

The finance and growth literature suggests that financial development is beneficial for attracting capital; in the context of emerging markets financial development is often lacking, thus hindering capital attraction. Previous literature fails to provide a more detailed checklist of the most important elements for capital attraction specific to the emerging markets. The purpose of our paper is thus to determine what are the differences between private equity attraction between developed and developing countries.

First we provide a general overview of the private equity industry, which is followed by a literature section on the main factors of attraction for private equity investing. We provide a thorough overview of the situation in the emerging markets of Brazil, Russia, India and China, collectively known as the BRIC countries. We assess the BRIC macroeconomic environments as well as private equity specific factors. We find that there are factors common to all four economies, which represent an opportunity for private equity. These include privatizations and consolidations of industries, growing economies, the need for foreign knowledge and expertise, tens of millions of people entering the middle class, government incentives for private equity etc. We find that the major obstacles on the other hand are primarily knowledge of local markets, business culture and networks. Furthermore, private equity specific legislation is a problem mainly in Russia and general legislative

problems relating to corruption, intellectual property, trial times and so forth are a problem common to all the BRIC countries. Other obstacles include protectionism of certain attractive, but strategically important industries, and still relatively underdeveloped capital markets hindering opportunities for IPO exists and/or debt financing. The first hint of what our results are comes in the fact that Russia is lagging behind Brazil, India and China mainly due to its complicated legislative environment.

Next, we introduce the research methodology, followed by a quantitative analysis of the factors affecting private equity across countries. Our analysis revolves around The Global Venture Capital and Private Equity Country Attractiveness Index by Groh and Liechtenstein (2009/2010) and Groh, Lichtenstein and Lieser (2011, 2012), which we consider to provide the most up-to-date aggregated information on the quality of the investment environments for private equity in 116 countries in its latest edition. We, however, due to data limitations focus on 19 countries, which include both the most developed countries for private equity in the world, as well as the BRIC and other leading developing countries. We run regressions for seven years of data in which private equity penetration and number of deals over GDP are our independent variables and the VCPE Country Attractiveness Index six key drivers are our primary dependent variables. The statistically significant results suggest that the only crucial factor of private equity attractiveness in developing countries is Investor Protection and Corporate Governance. When we run the regression on the developed countries, we see that many more factors turn out significant. Namely, they are GDP, GDP growth, Economic Activity, Depth of Capital Markets, Taxation, Investor Protection and Corporate Governance, and Entrepreneurial Culture and Deal Opportunities.

The results of our survey among GPs, LPs, investment bankers, consultants and regulators working with or in emerging markets follows and the main insight is that one of the most important aspects of private equity investing in the emerging markets are personal networks, knowledge of local market, culture, players and other connections. This is vital to our analysis for it is a factor which is unquantifiable and sheds further light on the matter of investigation.

Following the above summary of our findings, we conclude that the opportunities created by the states of the BRIC markets are advantageous to private equity shops with the knowledge of the respective markets and that the only significant variable in terms of private equity penetration in the developing markets is Investor Protection and Corporate Governance. Once basic legislation to protect funds and their investments is in place, we see that many more factors come into play when allocating capital in the developed world. Our hypothesis is that this is mainly due to the fact that markets in the developed world are closer to the definition of perfect than in developing countries. It is thus much harder to achieve high returns and funds start to scrutinize ever more factors when making investment decisions. Our hypothesis is also supported by a higher coefficient of determination in the case of developed countries for the key drivers of attraction. Up to what extent it is true is up to further research to determine.

The implied takeaway for private equity practitioners is that opportunities for high returns await those with good knowledge of local markets and culture in the high growth developing world, where good investor protections laws and corporate governance rules are in place.

2 Introduction to Private Equity

Private equity is an asset class consisting of equity securities in companies that are not publicly traded on a stock exchange. Private equity is long-term capital commitment aimed at achieving even longer-term value creation through active management, yielding higher returns than the public markets (Yong, 2012; Harris, Harris, Jenkinson, & Kaplan, 2012). Private equity investments usually display total or quasi-total control of the invested companies. Private equity investments differ from public equity investments in that they are not deployed in liquid markets where they can be divested in a short period of time.¹

2.1. Stages of Development of a Company from a Private Equity Perspective²

A typical investment life cycle of a company goes through five main stages: seed, start-up, expansion, maturity, and distressed. As corporations grow, they constantly need new inflows of capital in order to fuel their expansion; the amount varies according to growth stage. Private equity investments are usually channeled into more mature phases.

2.1.1 Seed Stage

In the seed stage, investments are made in companies that are in the early development stages or companies that are perceived to have a breakthrough invention or idea. Venture capital investments are generally of small size. Investing in early stage involves high risk, as the company does not yet have a track record.

¹ Private Equity (PE) Investments will hereinafter refer to investments made in the Expansion to Maturity phase of a given company; this is to differentiate them from Venture Capital (VC) investments which occur in the earlier stages of Seed and Start-up

² The following section is based on Yong (2012)

2.1.2 Start-Up Stage

In this phase companies focus on actual development of a product with the goal to commercialize it. The management team will have to assess the potential of the product in the market, while financing at this stage involves less risk compared to the first seed stage.

2.1.3 Expansion Stage

This is when most equity investment is made: companies need capital to grow their operations, restructure, enter new markets, or finance acquisitions. In this phase, a minority stake is usually sold in return for both capital and management expertise.

2.1.4 Maturity Stage

Companies at this stage experience slower growth, but they generate more stable operating cash flows. Private equity firms can also invest in companies that are listed on the stock exchange through a PIPE (Private Equity in Public Equity) deal, which can be a minority or a majority stake investment. The former is typical in emerging markets (Yong, 2012), whereas the latter in developed ones due to the greater availability of credit necessary to execute leveraged buyouts. While in the former case the possibility to influence the company's decisions is lower, it is still possible to reap significant upsides; in the latter case, when a majority stake is involved, these deals are defined as buyouts. PIPE deals in unexplored sectors and markets can represent a platform to learn and later expand. In majority PIPE deals (buyouts) a premium is paid over the publicly traded stock price.

Deals done using a mix of both capital and debt financing are defined as leveraged buyouts (LBO). As these types of investments usually involve substantial amounts of money, private equity firms use leverage, collateralizing the assets of the target company while getting

loans from several financial institutions to finance the LBO. After the LBO the company is delisted from the stock exchange and gets re-organized; the private equity firm employs managerial expertise to restructure the company's assets and liabilities, its management, and its strategy. Restructuring usually takes up to a couple of years in order to get changes implemented and in order to see the results. After the restructuring phase, the company is ready to be re-listed or to be sold to an acquirer at a valuation that could justify the initial investment.

2.1.5 Distressed Stage

Some private equity investments focus on companies that are in a distressed situation. This could entail a severe decline of their business or cash flow problems jeopardizing the company's operations. A private equity firm specialized in turnarounds has the expertise to extract the intrinsic values of the corporations they invest in. A systematic plan will be prepared on how to turn around the troubled assets.

2.2. Structure of a Private Equity Fund

A private equity fund is usually composed by:

- General Partners (GPs), who are the people managing and running the fund
- Limited Partners (LPs), i.e. the investors in the fund
- The investment committee, composed by representatives from both LPs and GPs
- Advisors and professionals contributing with consulting and advisory services

The most typical form of a private equity fund is a limited liability partnership, where GPs raise funds from LPs. The life of a fund, on average, lasts between three to eight years.

2.2.1 General Partners

GPs are the people in charge of managing and running the fund. Their responsibilities span fund raising, detecting investment opportunities, conducting due diligence, managing the investment processes, implementing strategies, and finally exiting the investments. Compensation for GPs come both from fees charged to LPs as well as from a share in profit gains generated when exiting an investment.

2.2.2 Limited Partners

LPs are investors, i.e. financial institutions, funds, or other types of entities willing to commit their capital for the entire life of a fund. Their liability is limited to the capital committed.

2.3. Private equity investment process

There are usually five stages involved in a private equity investment process:

- Planning
- Due diligence
- Structuring and negotiating
- Managing
- Exiting

In the planning phase, the general partners determine the fund's strategy, its type, as well as its structure. This phase also involves fund-raising, with the GPs approaching potential investors and pitching their investment potentials and opportunities. The track record of a firm is usually of main concern to potential investors. A limited partnership

agreement will then determine how the business will be run, the fees, and the sharing of profits or losses.

In the due diligence phase, the deal is screened and undergoes a thorough process to analyze potential upsides, risks, feasibility, and viability of the investment opportunity. Private equity firms tend to involve investment banks, consulting and auditing firms in this phase to conduct due diligence on the target companies, with the primary goal to gain a better understanding of the target organization. This includes legal and tax issues, risk management as well as valuation. If due diligence signals a good investment, the private equity firm enters the structuring phase; this involves the determination of the capital structure, the type of financial instruments to be used, the legal structure, appointment of key executives, etc.

2.4. Three main types of deal structuring

First is plain-vanilla equity, wherein the private equity firm simply buys the equity stake of the target company by paying the corresponding valuation directly. In the second type of structure, convertible bond, the private equity firms receive some protection by ensuring a fixed rate of return in case the target company is unable to reach the expected returns. In the third type, leveraged buyouts (LBOs), the takeover is mostly financed by debt with minimum equity investment. Managing the portfolio, the fourth stage of the investment process, occurs when the private equity firm is involved in the management of the various companies under investment. The general partners or their hires firm assume key executive positions in the companies; they coordinate key aspects of operations and provide advice and expertise to the management. General partners provide high-level perspectives using their analytical skills and

industrial knowledge, and apply best practices to reach results. In the final stage of the investment process, the private equity firm pursues the best strategy to exit the investment; this stage is also when the private equity firm realizes most of its returns. Private equity firms do not have to be limited to one exit strategy when entering the investment, but can leave open several opportunities and strategies to attain the highest value possible in this last phase.

3 Literature Review

As mentioned in the introduction to the paper, the Global Venture Capital and Private Equity Country Attractiveness Index by Groh, Liechtenstein and Lieser (2010, 2011, 2012) represents a starting point for the analysis, and it is vastly used in the quantitative part. The Index quantifies 49 factors of PE/VC attraction, further clustered into 6 key drivers of attractiveness. The six key drivers used by the index are, in order:

- a. Economic Activity
- b. Depth of the Capital Market
- c. Taxation
- d. Investor Protection and Corporate Governance
- e. Human and Social Environment
- f. Entrepreneurial Culture and Deal Opportunities

As these six drivers represent a cluster of 49 factors (see Appendix I for further details), they are considered to give an exhaustive view of attraction drivers for Private Equity.

3.1. What drives private equity attraction

It is argued that strong economic growth in many developing countries has been the

main reason for attraction of private equity investing to emerging markets.

Research highlights the outmost importance of the stock market for private equity activity, with Black and Gilson (1998) showing that IPOs are the strongest driving force of PE investing. While GDP growth and market capitalization do not result to be as significant, risk capital is more accessible in countries with well-developed stock markets. Supporting institutions are also of outmost importance in the development of the private equity industry; law firms, investments banks, M&A boutiques, auditors and consultancies are all relevant to create the needed conditions for deal creation and exit opportunities.

An analysis by Da Rin, Nicodano and Sembenelli (2006) concludes that certain policies result to be effective for the creation of active PE and VC markets: the opening of stock markets targeted at entrepreneurial companies, the reduction in the corporate capital gains tax rate, and the reduction in labor regulation. According to Megginson (2004) a very important role in PE and VC attraction is played by the level of development of a solid R&D culture, both academic and corporate. Aizenman and Kendall (2008) also researched what the main points of attractiveness for PE and VC investing are; based on what they define the "Big 5" countries - the US, UK, Germany, France, and Canada³ – they group and confirm in their analysis different findings coming from several research papers. According to their conclusions, a correlation exists between the level of attractiveness to PE and VC investing and the following elements: (i) institutions; (ii) orientation towards high-tech; (iii) human

³ These countries represent the main sources of origination of PE funds in Aizenman and Kendall (2008) research

capital in terms of university level education in a country; (iv) entrepreneurial environment; (v) stock market depth relative to GDP; (vi) banking sector depth and development.

The aforementioned elements of attraction of private equity and venture capital were mostly investigated within developed markets, while research on emerging markets is less widespread, leaving room for this paper to assess whether the aforementioned also applies within the emerging markets of developing nations.

3.2. PE in the Emerging Markets

Thus far a general overview of the private equity industry and its main drivers were given without putting much emphasis on the differences across countries and without going into detail with respect to the Emerging Markets. In this section a more thorough view on the emerging markets – with a strong focus on the BRIC countries – is presented, both from a macroeconomic point of view as well as from a private equity specific one.

4 Private equity attractiveness assessment of the BRIC Markets⁴

Private equity first appeared in the emerging markets in the 1970s, and this was often government driven rather than privately motivated (Lerner, Leamon, & Hardyman, 2012). Many different challenges were present in the emerging markets to limit and discourage private equity activities. Often, basic business infrastructure was missing, not to mention developed financial markets; opportunities to invest were rare, and financing scarce or non-existent. In the emerging markets in particular, values of assets were difficult to estimate and

⁴ Summary table in Appendix II

high levels of uncertainty represented further discouragement for foreign investors. The lack of developed stock markets limited the opportunities for exit, while M&A activities were limited due to scarce presence of purchasers. Currency fluctuations, political and legal instability, weak accounting and tax standards, and unfair competition made returns on investments in emerging markets particularly volatile and unpredictable, increasing the risk factors for foreign investors. Despite these limitations, private equity investment in emerging markets has picked up starting in the early 2000s, especially through acquisitions of local companies by multi-national corporations. Fund raising has increased, as has investment activity, which recovered more quickly than in developed markets after the 2009 slump (Bain & Company, Inc, 2012). Much of the interest in the emerging markets thus seems to have arisen from the wide spectrum of economic reforms that occurred in the past decade, including a stronger adoption of capitalistic economic systems (even China, although officially it centrally plans its economy, has adopted capitalistic market structures and systems).

4.1. Brazil

Qualitatively, Brazil would rank second to Chile in terms of PE/VC investment in Latin America (LAVCA, 2012). Quantitatively, however, it captures around 80% of all capital invested in the region, the majority of which is invested in late stage growth-equity or buyout firms. In 2012, 90% of all funds in terms of absolute value were raised by local or quasi-local shops: one by Gávea Investimentos under J.P. Morgan's control, one by BTG Pactual, one by Vinci Partners and two by Patria Investimentos, partly owned by Blackstone (Leamon & Lerner, 2012).

Brazil has a complicated history of PE/VC. The first efforts were national, pursued during the high growth policies of the mid-70s, which were driven by foreign debt and internal striving for development. The Banco Nacional de Desenvolvimento Economico e Social was set up for this purpose but its existence was short-lived, drowned by hyperinflation and an unsupportive legal framework. The first successful firm was CRP Companhia de Participacoes, founded in 1981, which, by 2012, had made 68 investments out of which 41 were successfully exited and 15 were still in its portfolio (Leamon & Lerner, 2012). During the 1980s and 1990s, Brazil privatized its conglomerates in state-dominated industries such as mining, petroleum, insurance and telecom. Also, Brazil established a democratic government in 1990 and that led to stabilization across the region and marked a move towards inclusive political and hence economical institutions. During the crisis, the central bank adopted stringent monetary policies and cut interest rates to boost consumption and lending, all with success. This set the grounds for the future accessibility for private equity funds on not just a government, but also private and foreign level.

4.1.1 Economic Activity

According to the IMF, Brazil has the 7th largest economy in the world with huge FDI and exports. It is bound to thrive from the expected US\$50 billion infrastructure investments before the 2014 World Cup and 2016 Olympic Games it is hosting, both in terms of immediate employment and GDP growth and consequential infrastructure efficiencies. More government policies saw 30 million Brazilians enter the middle class in the past decade and create one of the world's largest consumer markets on the planet. According to Ernst & Young (Ernst & Young, 2010), Brazil is among the five largest consumer markets

for cosmetics, mobile phones, computers, soft drinks, vehicles and more. With a young and mobile population nearing 200 million and a fading tradition of family-owned businesses in Brazil's many very fragmented industries, there are huge opportunities for consolidation and PE roll-ups (Ernst & Young, 2010).

Brazil grows crops on approximately only 20% of its cultivable land amid growing demand and exports and huge new oil deposits have been found. Also, Brazil is a beneficiary of vast amounts of renewable energy investment. According to the CIA World Factbook, only 14% of Brazilian roads are paved and utilities are poor. The government recently renewed the Growth Acceleration Program, worth \$880 billion, which acts toward building better transport, housing, sanitation and water supply infrastructure (Williams, 2011).

The trend for Brazil is paradoxical at first sight. Groh et al. (2011) conclude that Brazil's recent outperformance in the PE/VC industries is due to almost exclusively general GDP growth. Yet, in the past year, despite growing only 1% macroeconomically, PE capital invested in Brazil has surged by 78% (EMPEA, 2013).

4.1.2 Depth of the Capital Market

Relative to the LATAM region, Brazil has a good public equities market, which is a huge factor for exit opportunities. The BM&FBOVESPA is one of the largest stock exchanges in the world. As of February 2013, its capitalization was BRL2.26 trillion (US\$1.06 trillion) with 363 companies listed and dozens of others waiting to go public once the macro factors ameliorate (BM&FBOVESPA, 2013). However, the local currency and derivative markets don't match up to the stock one (LAVCA, 2012). In order to obtain local currency, the central bank requires registration of all inward investments in order for investors

to secure their rights to the BRL from authorized institutions and does not require any reserves held. Brazil's bank settlement system has now been operating in real time for a number of years, which we think further adds confidence to market players.

The lending markets in Brazil remain underdeveloped, interest rates expensive and PE capital is very welcome among businesses generations apart from their founders (INSEAD - PwC, 2011).

4.1.3 Taxation

Brazil has been consistently working on providing a benign background for PE/VC investors. This includes the tax on financial transactions (IOF) being lowered to 0% in 2011, after being initially lowered to 2% from 6% in 2010. Brazil operates two fund structures, one for PE (FIPs) and one for VC (FIEEs). The Brazilian Association for Private Equity and Venture Capital (ABVCAP) has created a code of regulation that applies to both and entered into effect in 2011. This code sets standards for fund creation and governance in terms of transparency, conflicts of interest, related party transactions, and composition of investment committees. In 2006, foreign investment in regulated PE/VC funds became exempt from income and capital gains tax in the case that it does not come from tax havens and the stake doesn't surpass 40%.

4.1.4 Investor Protection and Corporate Governance

According to LAVCA (2012), minority shareholder protection is among the very best in the LATAM region. Shareholder controls, tag along rights and mandatory distribution of dividends are all positive factors. Preferred, non-voting shareholders must be

distributed dividends at least equal to those of common, voting shareholders. Shareholders in possession of 10% or more capital have the right to elect one member of the audit committee. Open pension funds have a generous 60% AUM limit for instruments including PE/VC investment, providing huge amounts of capital.

Brazil has also recently revised and improved its intellectual property laws, very much improving protection and enforcement. The process of registering patents and trademarks has been overhauled, further leading to investor confidence. Another improvement is the bankruptcy procedures enacted in 2005, which are based on Chapter 11 and which closed loopholes that set minority shareholders at risk.

As for corporate governance, public companies are subject to external audit and the need to publish annual financial reports. The CMV, the local securities commission, requests companies to submit to governance standards. While this is not mandatory, the CMV does publish a list of companies that fail to do so. An additional set of non-binding standards has been created by the BOVESPA and most of the listed companies do indeed adhere voluntarily. For non-listed companies, legally enforceable shareholder agreements are commonplace when it comes to these practices. The World Bank (2012) reports that director liability and disclosure requirements are among the strongest in the LATAM region.

Brazil is striding towards international accounting standards (LAVCA, 2012). In order to be listed on the exclusive Novo Mercado section of the BM&FBOVESPA, companies not only need to comply with the superior governance standards as outlined above, but also they need to comply with the US GAAP. All listed companies had to adhere to IFRS by 2010. Corporate Law also newly requires all companies, public and private, to

converge Brazilian GAAP to IAS. Brazil welcomes international auditors, who are present. The downside is a very complex tax system with one of the highest numbers of taxes in the world, creating a regulatory burden.

Other problems are that pension funds are still able to demand seats on investment committees of funds, thus fueling concerns about conflicts of interest, and that insolvent firms still easily evade taxes and hence create wrong incentives (LAVCA, 2012).

4.1.5 Human and Social Environment

The 2012 World Bank Doing Business report notes that resolving insolvency is time-consuming and yields very low recovery rates, although the process is not costly. The report also finds that shareholders continue to have a limited ability to bring suits.

The biggest problems, however, are perceived corruption and judicial systems. Corruption remains a major obstacle when dealing with divisions of government and Brazil's tax and social security systems. All of this despite reforms; Transparency International ranked Brazil only 69th in the world in 2012. Enforcement of corruption laws varies across states. In general, contracts in Brazil are upheld but when they aren't, cases move very slowly through the judicial system. World Bank reports 731 days to enforce a contract on average even though, once again, the costs are lower relative to other LATAM countries. However, the system is generally viewed as fair.

Other problems relate to the labor market, which is rather pro-labor with high termination and retirement payments. Benefits are very generous in terms of vacation allowances and job security. The labor force is still strongly unionized across industries and states and may have significant impact on the success of a transaction. Also, Brazil has strict

policies on the protection of its vast natural resources so it is tough for companies to enter these markets and internal help is often needed (Ernst & Young, 2010).

4.1.6 Entrepreneurial Culture and Deal Opportunities

Setting up a business in Brazil takes longer than regional average but remains inexpensive. The government supports the development of SMEs by subsidizing loans and simplifying tax procedures. The 2012 budget for the state-backed Brazilian Innovation Agency, FINEP, has increased year over by 63% to BRL6 billion in 2012 (Portal Brasil, 2012). This money is directed at funding investment projects among entrepreneurs. The ease of engaging in entrepreneurship has been strengthened by a 2012 law, which revokes the need for a partner in order to apply for limited liability.

4.1.7 Other

Other risks include the currency, which tends to strengthen as a by-product of FDI and exports (INSEAD - PwC, 2011). There is strong competition for the best deals, wiping out potential profit multiples and top managerial talent is still scarce and the country lacks proper technology and hence data collection among SMEs (Ernst & Young, 2010).

Another factor for outsiders is the lack of knowledge of the local environment. A recent survey conducted by Collier Capital (Collier Capital; LAVCA, 2012) figures that only 18% of foreign LPs would contemplate direct proprietary investment in the region and still only 51% would invest alongside GPs rather than into well-established funds with a track record and strategy. What investors do appreciate according to Collier Capital, though, are the ever more favorable exit opportunities; from the well-functioning stock exchange, to the

flourishing domestic M&A market, to the now-possible cross-border listings, the realization of exit multiples is ever easier in Brazil.

4.2. Russia

Russia achieved a major breakthrough with its joining of the WTO in 2012. The membership is dramatically reducing bilateral tariffs and given that the country, just like Brazil, is hosting two events in need of vast infrastructural investments – the 2014 Olympic Games and the 2018 FIFA World Cup – it is expected to attract huge capital investments.

4.2.1 Economic Activity

The World Bank in Russia (2012) forecasts that Russian GDP growth is to profit from an 11% GDP annual growth bonus thanks to the country joining the WTO. When China joined in 2001, it profited hugely from cheap exports of especially consumer goods. However, Russia exports mainly commodities and its ongoing state ownership and interventions in many industries hinders growth potential. While it is naturally reluctant to change this in oil and gas, Russia's situation is already shifting in consumer goods and manufacturing related sectors. These, along with financial services, communications and industrials account for a crushing majority of capital invested. Industries small in size but big in relative growth have been ecology, IT and chemicals & materials (RVCA Yearbook 2012). Furthermore, according to Ernst & Young (2012), manufacturing accounted for 51% of investment projects and 92% of job creating between 2007 and 2011 with the remainder dominated by industrials and food. If China can be taken as a precedent, then the lifting of trade restrictions cannot be underestimated as an opportunity for private equity as restrictions

will be removed and industries liberalized, ready for foreign investment (Kirkland & Ellis LLP, 2007). We think that since Russia ranked only 67th out of 144 on the 2012 World Economic Forum, its industries and companies will have to either transform into competitive players on a global scale or suffer damage from foreign competition. This is where the role of private equity funds as agents of operational improvement steps in and opportunities emerge.

Ernst & Young (2012) also conducted a panel survey among 100 PE investors with the key strengths being identified as domestic market growth, in which 25% of the population has risen to middle class standard over the past decade. Other key strengths identified are labors costs, education and skills, all of which are factors translating into a cheap but effective labor force.

4.2.2 Depth of the Capital Market

As for exits, trade sales are most frequent. IPOs have also picked up thanks to several huge exits in 2010-2011 and the development of the Russian stock exchanges MICEX and RTS, which have merged in one in 2011 (MICEX-RTS Group, 2012). However, 2012 witnessed a sharp decline in initial public offerings again, way down from the 2006-2007 peak when the number averaged at thirty per year (PwC, 2012). In response to the most recent World Bank report, which assesses Russia unfavorably, president Putin has pledged to take Russia to among the top 20 by 2018 (Smirova, 2012), which is promising of further positive development. Putin called for more IPOs of especially Russian companies to take place in the country, as many companies prefer to list abroad, the primary destination being the London Stock Exchange (PwC, 2012).

4.2.3 Taxation

According to the latest World Bank Doing Business report, the country made a huge jump in terms of burdens connected to taxation, when it decreased the process of paying taxes by 39%. Practical Law Company (Wack & Rose, 2011) conducted a survey among prominent lawyers specializing on private equity in Russia and found that further encouragement stems from the advantages PE shops gain when investing jointly in the aforementioned Skolkovo program and when investing in R&D. These include VAT exemptions with the exception of VAT on imported goods, exemptions from corporate, property and land taxes, and significantly reduced social funds payment rates (14% vs. 30%).

4.2.4 Investor Protection and Corporate Governance

Common problems in the Russian PE/VC space relate to overestimated valuations and other managerial failures (Ivashkovskaya & Kuznetsov, 2007). It is not uncommon for funds to negotiate equity ratchets for the failure of management to meet targets and failure to exit by a pre-specified date. Solomon Brothers (Klyachin & Kuznets, 2010) report on corporate governance in their Russian private equity handbook, the relevant of which spans the remainder of this section. Laws are in place to make board members personally liable for losses a company incurs as a result of misconduct by said officers. The Russian PE/VC model differs in that it is not common for investors to hold seats on the board of directors, as it is not that important of an organ in an organization. The shareholders control the company and make decisions on meetings. Deferred and share-based compensation are becoming commonplace in order to incentivize management. In order to give PE funds management control, common practice is veto rights and special quorum requirements in approving

business plan, financing rounds, acquisitions, dividends, and offices appointment. A contingent mechanism is in place for preferred shareholders. While they have no voting rights, they obtain these in case the company fails to pay pre-agreed levels of fixed or rated interest to them. The Russian legislation does not recognize drag-along or tag-along rights. These can only be obtained through share holdings in foreign investment funds, which then invest in Russian companies.

4.2.5 Human and Social Environment

Coming at just n. 112 in the World Bank's Doing Business ranking, Russia remains tragically weak in areas such as construction permits and getting electricity, in which it beats only Bangladesh. The Russian labor force and laws governing it are extremely flexible according to Institute for the Study of Labor (Gimpelson & Kapeliushnikov, 2007). We see this as favorable to the ease of operational improvements for private equity firms. According to PwC (2011), Russia also profits from an educated and skilled population, which ought to remain a resource for further growth.

4.2.6 Entrepreneurial Culture and Deal Opportunities

In 2011, president Medvedev communicated measures intended to attract private equity investment in Russia (Wack & Rose, 2011). These included allowing not only individuals but also legal entities to be participants, de facto copying the Anglo-Saxon model of limited liability partnerships and amendments dismantling administrative barriers for transactions of shares and assets of Russian entities. Practical Law Company (2011) reports that the majority of deals in Russia will be done through minority interest acquisitions in

expansion capital transactions and therefore debt-financing possibilities (or the lack thereof) does not affect the Russian PE landscape severely. Private equity investments in Russia are usually all-equity, but there has been a recent emergence in convertible loans; LBOs are rare. Further reasons for this are relatively strict anti-takeover rules, due to which it is hard and capital-intensive to acquire more than 30% of a public company's voting shares as it is compulsory to make an offer approved by the Federal Financial Markets Service within 35 days after acquiring more than the 30% threshold. This process must then be repeated for 50% and 75%. Moreover, the Practical Law report states that there are strict rules governing investment in forty-two sectors considered strategic. These industries include natural resources, defense, nuclear energy, aerospace etc. Special approvals must be sought and granted in order to acquire 25% or more of a mineral resources company by a foreign company and 5% or more by a foreign state, international organization or organizations under their control. These numbers are 50% and 25% respectively for the remaining strategic sectors.

Squire Sanders (Wack & Rose, 2011) draw out further restrictions relating to the actions of the Federal Antimonopoly Service when explaining the unusual nature of investments in Russia. Approval must be granted for any purchase, joint venture creation, statutory merger or consolidation, or acquisition on a similar threshold principle as described above. Furthermore, whenever competition in the Russian market might be damaged according to the FAS, the Service's approval for action is needed and this goes for as low as 20% voting share control.

The source of funding for private equity deals is somewhat particular in Russia. One major difference is that Russian pension funds and insurance companies aren't allowed to invest in private equity due to restrictions on investment into alternative assets. This is partially offset by a number of government entities that have been established in order to invest venture and growth capital (Klyachin & Kuznets, 2010). These include Russian Venture Company, a fund of funds aiming to promote investment into especially the high-tech industry, Rusnano, with over \$6 billion in AUM, created to grow nanotechnologies in Russia, Skolkovo Innovation Centre aiming to promote technology investment under tax-friendly conditions, and Russian Direct Investment Fund, a \$10 billion vehicle aiming to attract major private equity players to Russia.

4.2.7 Other

Despite all the efforts, the Russian legal framework for PE is severely underdeveloped. Salomon Brothers, a Russian law firm specializing in financial law, inform that all major funds operating in Russia are established under foreign law and their activities are only subject to Russian law when actually investing as their operations are governed by the jurisdiction of the fund's establishment (Klyachin & Kuznets, 2010). Domestic funds in Russia are subject to The Law on Investment Funds and FSFM regulations.

An interesting insight from Ernst & Young (2012) is that the PE companies already in place have a much better view of the Russian economic and business landscape than do firms contemplating entering the market. This can be attributed to two reasons, the weights of which are uncertain: these companies have already overcome the hurdles that stood in the

way of their establishment in the Russian market and/or they have come to understand the market better and why it is so attractive to them.

4.3. India

India ranks 32nd in the Global Venture Capital and Private Equity Country Attractiveness Index (2013), following in its peer group China and Malaysia. India was the fastest-growing PE market in Asia in 2011, with PE players investing US\$14.8 billion into the region, which represents a 55% increase over 2010 and, with 531 deals closed, a 40% annual increase in deal count (Bain & Co., 2012).

Up to the 1970s there was hardly any foreign investment in India, but rather an outflow with some firms leaving the country. Inflows of foreign capital remained meager in the 1980s with less than \$0.2 billion per year from 1985 to 1990. It was only following wide liberalizations of the economy that foreign capital started to flow into India (Suma & Kapur, 2011), reaching \$6 billion in 1996/1997. Starting in 1991 India created a de facto more attractive business environment, directing particular attention towards foreign investments. Also, in contrast to e.g. China, India has the oldest stock exchange in Asia, a legal structure inherited by the British Empire's system, and a widespread knowledge of the English language (Lerner, Leamon and Hardyman 2012).

4.3.1 Economic Activity

With a population of more than 1.2 billion people, India today is the world's largest democracy and, thanks to an average 8% growth over the last decade, it also represents the world's 4th largest economy in purchasing power parity terms. Tighter macroeconomic

policies combined with slow growth in the core OECD countries have slowed down growth over the past year to below 7%, with further weakening of investments also because of investors' pessimism about the government commitment to pursue further economic reforms. Yet, India's growing economy is placing huge demands on critical infrastructure – power, roads, railways, ports, transportation systems, and water supply and sanitation. While the government has raised its investments in infrastructure, the investment gap remains daunting with an estimated \$1 trillion required to meet the country's resource needs over the next five years (The World Bank, 2013).

4.3.2 Depth of the Capital Market

India offers quite developed and active capital markets, both in terms of size and liquidity, reflecting the country's growth and development over the last two decades. By 2007, India had reached the sixth position in the global list of countries in terms of funds raised through Initial Public Offering (Ban & Bench, 2010). A USAID (2007) report on capital markets stated that India was able to achieve this position because of, among other factors, a developed regulatory environment and a modern market infrastructure.

As mentioned, in 2011 India was the fastest growing PE market in Asia, and yet during 2011 there was both a dramatic decrease in number of exits – mostly due to a depressed IPO and stock market – and an increased difficulty in fund-raising, with LP's becoming much more selective (Bain & Co., 2012).

4.3.3 Taxation

According to the Ease of Doing Business report (2013), India has made significant

progress mostly in the “ease of paying taxes” index, although important regulatory hurdles still create uncertainty within India’s tax regime (Deloitte, 2012). From 2008, long-term – one year or more – capital gains from equities are not taxed if shares are sold through a recognized stock exchange. Also, from an accounting point of view, Indian accounting standards are converged with International Financial Reporting Standards (IFRS).

4.3.4 Investor Protection and Corporate Governance

In terms of corporate governance, India is characterized by concentrated ownership and by the widespread use of company groups, often in the form of pyramids. All listed companies must have audit committees and a one share, one vote capital structure. The new companies bill of 2012, according to the Albright Stonebridge Group (2012), seeks to enhance the accountability of companies, provide for greater disclosure, and protect the interest of employees and small investors, while encouraging companies to undertake social welfare activities.

According to Grant Thornton (2013), political burdens and policies are having an adverse effect on corporate growth. According to the firm, some of the policy measures like retrospective taxation and misunderstandings related to GAAR (General Anti-Avoidance Rules) have contributed to negative sentiment from an investor perspective. According to the firm, moreover, there is a clear perception of lack of decisiveness on the part of the government in major policy areas, especially those relating to infrastructure.

4.3.5 Human and Social Environment

With more children entering elementary school, the need for universalizing secondary

education has emerged. Equally important is building the skills of India's rapidly expanding workforce, whose ranks are joined by 8 to 9 million people each year. According to the IMF (2013), India has many long-term challenges that it has yet to fully address, including poverty, corruption, violence and discrimination against women and girls, an inefficient power generation and distribution system, ineffective enforcement of intellectual property rights, decades-long civil litigation dockets, inadequate transport and agricultural infrastructure, limited non-agricultural employment opportunities, inadequate availability of quality basic and higher education, and accommodation of rural-to-urban migration (I.M.F., 2013).

According to the CIA World Factbook (2013), the outlook for India's medium-term growth is positive due to a young population and corresponding low dependency ratio, healthy savings and investment rates, and increasing integration into the global economy.

4.3.6 Entrepreneurial Culture and Deal Opportunity

According to a survey by Ernst & Young (2011) India has the strongest entrepreneurial culture among G20 nations: 98% of the Indian entrepreneurs surveyed for this report agreed with the statement that Indian culture encourages entrepreneurship, compared to 80% for other rapid growth markets and 72% for the mature economies.

FDI into India during the 2011-12 fiscal year totaled almost \$47bn, up from \$35bn in 2010-11, for a cumulative FDI between 2000 and 2011 of \$243 billion (Reserve Bank of India, 2011). The biggest destinations of foreign direct investment have been the services industry, telecommunications, computer software and hardware, as well as construction and real estate. India has been careful, however, to limit access to areas of the economy where

there are concerns in relation to either national security or where there might be a serious social impact. On the positive side is also the government's announcement in late 2012 of additional reforms and deficit reduction measures to reverse India's slowdown, including allowing higher levels of foreign participation in direct investment in the economy. According to the CIA World Factbook (2013), the outlook for India's medium-term growth is positive due to a young population and corresponding low dependency ratio, healthy savings and investment rates, and increasing integration into the global economy. According to D.S. Rawat, Secretary General of Assocham⁵, India needs private equity more than ever to push forward its structural agenda. The Indian PE market saw a surge particularly in deals focused on formative stages of growth, with 28% of the investments in 2011 focused on companies founded less than three years before, with e-commerce companies leading this trend and amounting to about 40% of early stage capital dedication.

4.3.7 Other

India's remarkable economic growth has raised the issue of environmental sustainability. With its high population density, stressed ecological systems, and substantial dependence on natural resources, the country is very vulnerable to climate change, the first impact of which will most likely be felt in the water sector. India is undergoing a massive urban transformation: by 2030, the urban areas will be home to 40 percent of the country's people – doubling the urban population within a span of thirty years, and thus placing great

⁵ Assocham is the Associated Chamber of Commerce and Industry of India

pressure on the governments' ability to guarantee sustainability and quality of life.

While agriculture's share in the country's economy is progressively declining, India also remains a global agricultural powerhouse. It has the world's largest area under wheat, rice, and cotton, and is the world's largest producer of milk, pulses, and spices.

India seems to represent a very emblematic case: on one side, its growth of the past decade made it a very interesting case for PE/VC investing, reflected by its high growth in PE investing for 2011, but at the same time concerns about its current government commitment to pursue economic reforms and further openings of the economy create a concern for investors.

4.4. China

China ranks fifth in the Global Venture Capital and Private Equity Country Attractiveness Index (2013) in Asia, behind Singapore, Hong Kong, South Korea and Taiwan. Between 2000 and 2012, more than 10,000 deals were completed in the country for a combined \$230 billion worth of investment, with growth equity being the most common type of PE/VC investment; with approximately \$200 billion annual inflow, today China receives more foreign capital in the form of FDI than any other country in the world (Bain & Company, Inc, 2012).

PE/VC in China was relatively unknown in the 1990 and early 2000, with the first relevant investments starting to enter and gain public attention only in mid-2000s, especially after the height of the economic boom of 2006 (McKinsey & Company, 2012), when China Investment Corporation (CIC) paid US\$3 billion for a stake of close to 10% in Blackstone in

2007. Before that time, both the capital and the bond markets were underdeveloped, and the primary sources of capital for domestic companies were local, state-owned banks or rural cooperatives. The lack of easy access to capital restricted the expansion of local firms, and both foreign capital and expertise have since then been crucial for the full development of the Chinese PE/VC industry.

According to David Rubenstein⁶, the Chinese market in late 2010 “is more favorable for private equity capital than most other markets - more favorable even than the United States – and it will become the largest private equity player both in terms of investments and in terms of funds raised over the next five years (Rubenstein, 2010).

4.4.1 Economic Activity

China has the 2nd largest economy in the world with an income level defined by the World Bank as Upper-Middle, and its GDP growth averaging about 10 percent a year has lifted more than 600 million people out of poverty in the past decade (The World Bank, 2013).

With a significant decrease in GDP growth in 2012, the Chinese economy is today in the midst of a gradual slowdown due to the combined impact of a weaker global economic environment and tighter domestic policies: slow growth in the Euro area and sluggish recovery in the US limited the contribution of net exports, as exports decelerated more rapidly than imports, while tighter domestic policy conditions dampened investments

⁶ David Rubenstein is co-founder and Managing Director of the Carlyle Group

particularly in infrastructure and real estate. On the positive side, consumption growth remained robust as consumer confidence was sustained and household income continued to grow rapidly. With its 12th Five-Year Plan (2011-2015) China seems to shift its focus from rapid growth to long-term sustainable development: the Five Year Plan in fact highlights the development of services and measures to address environmental and social imbalances, setting targets to reduce pollution, to increase energy efficiency, to improve access to education and healthcare, and to expand social protection (The World Bank, 2012); a GDP growth target of 7% is the consequence.

China's agricultural and industrial productions each exceed those of the US; according to the CIA World Factbook (2013) China is in fact the world leader in gross value of industrial output, especially in mining and ore processing, machine building, textiles, cement, and chemicals, but at the same time China is the world leader in gross value of agricultural output, and especially in rice, wheat, potatoes, corn, and tea. Yet, per capita income is below the world average.

4.4.2 Depth of the Capital Market

China seems to offer quite developed and undoubtedly active capital markets, both in terms of size and liquidity. China's capital market has grown more than ten-fold in the past seven years, from \$400 billion in 2005 to more than \$4 trillion in 2012, which makes it the fifth largest stock market worldwide. The country opened its first stock exchange in 1990, and by the mid-2000s the IPOs of Chinese companies routinely set records as 'World's largest to date' (Lerner, Leamon, & Hardyman, Venture Capital, Private Equity, and the Financing of Entrepreneurship: the Power of Active Investing, 2012). The equity market has

been evolving towards a more even distribution of investor classes, with institutions such as investment funds, pension funds, insurance companies, corporate, and sovereign wealth funds playing a more prominent role. China's corporate sector still remains highly dependent on Bank financing, but there is a growing interest in corporate bonds, and this trend is expected to further grow in the expectation of ongoing tightening of the banking regulatory environment.

According to Groh et al. (2012) the slow speed of regulatory approval for IPOs represents a strong weakness and impediment to the IPO market, and thus to PE/VC investing. According to China First Capital, a Shenzhen-based investment bank, more than \$100 billion invested in Chinese Private Equity since 2001 remains un-exited. Of that, \$22 billion is tied up in 2,200 deals completed before 2008, meaning that the standard 5-7 year time limit of the investment cycle is approaching for these firms to find a way to return cash to investors. The Shenzhen-based investment bank blames a drought of activity in the IPO and capital markets as the main reason to this; trade sales, it is argued, are extremely rare in the country, and a market for secondary sales has yet in fact to develop to full potential. While capital flow to private companies remained paralyzed during the first quarter of 2013, a research from Goldman Sachs (2013) reveals that 349 IPOs are expected to occur in China throughout 2013 alone, with a precise amount of cash to be raised of \$29billion.

4.4.3 Taxation

From a fiscal perspective, China levies a wide range of taxes including income taxes, turnover taxes, and real estate taxes. There is no capital gain tax as such in the PRC, which is taxable as ordinary income. Corporate Income Tax (CIT) regimes adopt the “predominantly

industry-oriented, limited geography-based” tax incentive policy, with emphasis on those industry sectors supported by the state, as well as to qualified new high tech enterprises (PwC, 2013), with incentives that go from total exemption, to rate reduction, to tax holidays for several years, according to individual cases.

China is striding towards international accounting standards. Although China has very unique accounting standards deriving from its socialist period, it is now taking large steps forward with the integration of International Accepted Accounting Standards, of which many standards have been adopted.

4.4.4 Investor Protection and Corporate Governance

In terms of corporate governance, China officially regards the issue of minority shareholder protection as a major regulatory objective of those responsible for controlling the securities market. Company Law 2005 is regarded as an investor friendly law as it for the first time introduced institutions to protect the interests of minority shareholders. In practice though, despite the progress that has been made, the position of minority shareholders is not yet well protected (Tomasic & Andrews, Minority Shareholder Protection in China’s Top 100 Listed Companies, 2007), especially within corporations with state participation. Although the law states that corporations should set up convening procedures for shareholder meetings and board composition, the law does not fix or set a minimum composition by law.

Among other obstacles, the protection of intellectual property rights still remains problematic. For instance, damage awards in China, when given, are usually very meager (\$30,000 on average per ruling, by estimate), which does not even justify the costs of litigation. Moreover, judges often do not publish detailed rulings, or do so only with a

prolonged delay, which makes it hard to understand verdicts reached, what they say about the evidence presented, and whether a particular judge is competent.

As mentioned, today China receives more FDI than any other country in the world, and this occurred despite ongoing criticism of its government in the foreign media (Fan, Morck, Lu, & Yeung, 2008). As FDI involves much irreversible fixed investment, FDI is sensitive to investors' perception of public policy and property rights. According to Fan et al. (2008) FDI inflows correlate across countries with three key dimensions of good government, which are the general quality of the government, the strength of constraints on executive power and its track record which investors apparently perceive as traits embedded in the Chinese government (Fan, Morck, Lu, & Yeung, 2008).

4.4.5 Human and Social Environment

China displays a fast-growing middle class with high savings and a strong urbanization among second and third tier cities. While a growing middle class is supposed to drive demand for consumer and financial goods, a fast urbanization provides growth opportunities for enterprises as well as plentiful supply of low-cost labor. According to the CIA World Factbook (2013), the Chinese government faces challenges including reducing its high domestic savings rate and correspondingly low domestic demand, reducing corruption and other economic crimes, and containing environmental damage and social strife related to the economy's rapid transformation. Also, while the estimated unemployment rate for 2012 is only 6.4%, another challenge for the Chinese government is to sustain adequate job growth for tens of millions of migrants and new entrants to the work

force, as one consequence of the population control policy is that China is now one of the most rapidly aging countries in the world.

4.4.6 Entrepreneurial Culture and Deal Opportunity

According to a survey by Ernst and Young (2011) across G20 countries, China is described as one of the most favorable environments for entrepreneurship. According to the firm, access to credit in China has become much easier in recent years; the population is increasingly educated, and investment in research and development (R&D) has risen, leading to a dramatic improvement in the country's science-related indicators.

China has made significant progress in improving its business landscape to attract and promote investments: according to the Ease of Doing Business report by the World Bank (The World Bank, 2012), China has implemented policy changes in 9 areas of business regulation in the years since 2005, although starting a business in China is still more procedural than in the average of the G20 as a whole, and the group's fastest growing countries (Ernst & Young, 2011).

4.4.7 Other

Deterioration in the environment – notably air pollution and the steady fall of the water table especially in the North is a long-term problem. Also, China continues to lose arable land because of erosion and economic development.

Despite the many obstacles described, the Chinese market seems to represent a fertile ground for private equity investment, even more so because of its shift from high growth to

long-term development and because of a higher and more transparent regulatory environment. It is a place with huge market potential due to its population and its growing middle class with increasing purchasing power and high rate of personal saving. Finding and retaining management and players familiar with western business practice and yet familiar with language and local customs will be crucial.

5 Methodology of the Quantitative Model

While PE investment flows increased in EM in the past few years, it is still to be analyzed and understood what factors developing countries need to focus on and develop the most in order to attract more private equity and venture capital investments. The following section of the paper will focus on a quantitative assessment of the impact of a selected number of factors on the BRIC countries' private equity industries and their development in order to assess which are the key drivers of PE/VC investment statistically. While we do not believe it is possible to fully quantify all factors and happenings, and we realize there is a gap between an event and its consequences, we attempt to find the drivers that are quantitatively more significant than others.

5.1. The Model and Data

In order to determine which drivers are more statistically significant than others, we use a simple model that is composed of the following:

- i. Capital IQ data on Total Transaction Value and Total Number of Transactions in target countries, taken annually based on the date of announcement as this is more in line with the immediate state of a PE/VC landscape in any given country than the close date. The metrics we use within Capital IQ are as follows
 - a. Target is either a Public or Private Company
 - b. Transaction Primary Features are Acquisition of Equity stake OR Private Placement – PIPE OR Private Placement – Growth Capital/Private Equity

c. Buyers/Investors are Private Investment Firm OR Public Investment

Firm OR All Investment Firms OR Public Fund OR Private Fund

- ii. GDP of all sample countries, which we use in order to adjust for huge variations in sizes of economies. GDP allows us to calculate Private Equity Penetration of sample countries, which is our independent variable. Private Equity Penetration is simply

$$PEP_{xi} = \frac{\text{Total Private Equity Capital Invested in Country } X \text{ in Year } i}{GDP_{xi}}$$

When taking numbers of transactions in a country, we also adjust for the sizes of respective economies. In these cases our independent variable is simply

$$nGDP_{xi} = \frac{\text{Total Number of Private Equity Deals in Country } X \text{ in Year } i}{GDP_{xi}}$$

In order to determine whether GDP growth is a factor and given the lag in between economic development and possibility of investment, we take GDP growth of previous year. All macro data used is taken from Datastream, specifically from the IMF World Economic Outlook database.

- iii. Country Scores from the IESE Business School Global Venture Capital and Private Equity Country Attractiveness Indexes (hereinafter only referred to as “Index”), published annually by Alexander Groh, Heinrich Lichtenstein and Karsten Lieser. The Index, in its latest edition, quantifies 49 factors, which it further clusters into 6

key drivers of PE/VC attractiveness. These scores, as they fluctuate throughout time, are our dependent variables. The six key drivers, further explained in Appendix I, are

- a. Economic Activity
- b. Depth of the Capital Market
- c. Taxation
- d. Investor Protection and Corporate Governance
- e. Human and Social Environment
- f. Entrepreneurial Culture and Deal Opportunities

Hence, the regression model is the following in the case of private equity penetration:

$$y_{PEPx} = \alpha + \beta_{GDPx} * GDP_X + \beta_{GDPGx_{i-1}} * GDPG_{X_{i-1}} + \beta_{EAx} * EA_X + \beta_{DCMx} * DCM_X + \beta_{Tx} * T_X + \beta_{IPCGx} * IPCG_X + \beta_{HSEx} * HSE_X + \beta_{ECDOx} * ECDO_X + \epsilon$$

In the case of number of private equity deals over a country's GDP, it is:

$$y_{nGDPx} = \alpha + \beta_{GDPx} * GDP_X + \beta_{GDPGx_{i-1}} * GDPG_{X_{i-1}} + \beta_{EAx} * EA_X + \beta_{DCMx} * DCM_X + \beta_{Tx} * T_X + \beta_{IPCGx} * IPCG_X + \beta_{HSEx} * HSE_X + \beta_{ECDOx} * ECDO_X + \epsilon$$

We limit our model in terms of countries due to the fact that there are too many missing transaction values for underdeveloped countries in Capital IQ and the model didn't return any significant results when tested on a sample of all the 64 countries with which the IESE Index works. We deem total private equity capital invested in a country relative to that country's GDP the most appropriate factor for determining the maturity of a given country's

private equity market for it is a relative measure. Given this relativity, it is then easier to determine which countries are more attractive to private equity than others.

Given the data limitations, we test the model on a sample of 19 countries across all 7 years the Index has been constructed for. The countries, in alphabetical order, are Australia, Brazil, Canada, China, Germany, Hong Kong, India, Indonesia, Japan, Mexico, Philippines, Russia, Singapore, South Africa, Sweden, Switzerland, Turkey, United Kingdom and United States. The years are 2007-2013 for the Index publication, they therefore reflect the years 2006-2012 in assessment. This gives us a data set of 133 observations in total; none is missing.

We run the regressions on the sample as a whole and then we divide the sample in two parts in terms of overall Index attractiveness, i.e. the upper and lower halves based on ranking. Table 1 includes aggregate average values for the 19 countries over the 7 year period with the BRIC countries highlighted. Our independent variables are scaled to fit the Index data. The country of reference is the US, whose score values are all set to 100. The first column represents the average number of deals in a country and the second the total private equity transaction value average of that given country, both per annum. Follow our two independent variables, the absolute average GDP value in \$ billion and average GDP growth from previous year. Then come the averages of the Index scores for Economic Activity, Depth of Capital Markets, Taxation, Investor Protection and Corporate Governance, Human and Social Environment, and Entrepreneurial Culture and Deal Opportunities. All drivers are explained in depth in Appendix I.

This table summarizes aggregate average values for the 19 countries over the 2006-2012 period with the BRIC countries highlighted. Our independent variables are scaled to fit the Index data. The country of reference is the US, whose score values are all set to 100. The first column represents the average number of deals in a country and the second the total private equity transaction value average of that given country, both per annum. Follow our two independent variables, the absolute average GDP value in \$ billion and average GDP growth from previous year. The averages of the Index scores for Economic Activity, Depth of Capital Markets, Taxation, Investor Protection and Corporate Governance, Human and Social Environment, and Entrepreneurial Culture and Deal Opportunities are the last six columns respectively. All drivers are explained in depth in Appendix I.

Upper Half by Attractiveness													
Country	# of Deals	Total Volume (\$ Bn)	Scaled Deals	Scaled PEP	GDP (\$ Bn)	GDP <i>g</i> -1 (%)	EA	DoCM	Taxation	IP&CG	H&SE	EC&D	
Australia	197,29	34,21	105,33	188,34	1149,61	0,13	95,25	87,71	106,42	92,85	107,99	82,27	
Canada	551,14	34,64	218,01	117,28	1556,49	0,09	92,87	93,06	107,72	105,70	111,60	88,28	
Germany	267,57	32,68	47,44	55,37	3357,44	0,04	96,74	84,63	99,30	93,74	95,95	92,82	
Hong Kong	60,00	16,28	161,46	440,64	225,56	0,06	91,78	86,19	98,55	109,87	102,75	76,11	
Japan	98,86	22,76	11,23	27,98	5136,26	0,04	95,67	87,23	91,37	94,74	86,08	96,85	
Singapore	37,71	13,24	107,31	446,61	210,97	0,13	96,51	77,21	99,02	117,11	116,85	85,36	
Sweden	130,43	10,68	171,25	130,14	469,08	0,06	89,48	76,43	121,06	97,66	91,65	90,28	
Switzerland	53,14	9,38	61,29	113,66	533,33	0,09	90,13	81,75	116,78	64,67	113,82	86,87	
UK	524,71	95,89	127,98	210,56	2469,46	0,02	92,03	91,51	98,50	103,87	100,90	90,98	
US	2444,57	265,84	100,00	100,00	14418,63	0,04	100,00	100,00	100,00	100,00	100,00	100,00	
Average	436,54	53,56	111,13	183,06	2952,68	0,07	94,04	86,57	103,87	98,02	102,76	88,98	
Median	163,86	27,72	106,32	123,71	1353,05	0,06	94,06	86,71	99,65	98,83	101,83	89,28	
Std Dev	729,88	78,72	61,95	147,49	4330,89	0,04	3,33	7,20	9,17	14,02	9,92	6,93	
Lower Half by Attractiveness													
Brazil	61,86	14,15	19,69	51,46	1822,84	0,21	99,76	76,78	76,66	55,23	53,94	46,54	
China	259,86	41,13	31,91	51,70	5313,86	0,21	123,56	81,87	88,61	60,11	50,99	68,36	
India	166,43	12,85	71,67	59,59	1411,75	0,15	108,84	81,54	77,99	62,03	49,59	60,63	
Indonesia	10,00	0,69	9,49	8,17	611,44	0,19	99,62	67,70	76,76	42,91	41,05	35,02	
Mexico	11,29	2,79	6,27	14,46	1047,55	0,07	96,04	68,58	78,99	57,71	33,76	57,59	
Philippines	9,86	0,54	33,08	18,95	184,07	0,14	91,44	61,95	87,32	45,38	35,19	31,25	
Russia	108,57	9,77	42,81	41,22	1517,07	0,20	100,46	67,31	79,18	44,81	32,92	62,20	
South Africa	73,57	12,02	145,48	247,56	322,20	0,09	83,79	75,69	97,15	85,08	42,98	61,07	
Turkey	20,71	1,85	17,10	16,06	689,02	0,11	96,34	71,03	95,20	58,63	45,78	54,70	
Average	80,24	10,64	41,94	56,57	1435,53	0,15	99,98	72,50	84,21	56,88	42,91	53,04	
BRIC Average	149,18	19,47	41,52	50,99	2516,38	0,20	108,15	76,88	80,61	55,55	46,86	59,43	
Median	61,86	9,77	31,91	41,22	1047,55	0,15	99,62	71,03	79,18	57,71	42,98	57,59	
Std Dev	85,92	12,69	43,62	74,12	1556,89	0,05	11,17	6,86	8,07	12,81	7,80	12,78	

Table 1

A couple of numbers stand out when looking at this table. The number of deals done in the US is staggeringly higher than anywhere else in the world. However, when adjusted for GDP, Canada is by far the most prolific market. In terms of private equity penetration, Hong Kong and Singapore outperform highly. Out of the underdeveloped countries, South Africa seems to have a huge private equity sector relative to GDP. We see that the BRIC countries have experienced rapid double-digit growth. This, combined with their relatively huge economies is what makes them outliers and why we decided to analyze them so thoroughly in the first place. We see that even though they can compete with the developed world in terms of economic activity and perhaps up to a point in Depth of Capital Markets and Taxation, they very much lag behind in all other criteria including private equity deals and penetration.

5.2. Regression Results and Comments

We are first going to comment on the results for the regressions in which private equity penetration is our independent variable, as this is our primary measure of reference. The results are in Appendix III.

Based on the Index it can be seen that the only variables significant for the sample as a whole are “Investor Protection and Corporate Governance” and “Entrepreneurial Culture and Deal Opportunities”. Both are significant at 1% and the negative beta of Culture is very surprising. While not significant, negative betas of “Economic Activity”, “Depth of Capital Markets” and “Taxation” are also counter-intuitive. This could mean that for the sample as a whole PE shops direct their money towards countries in which knowledge of and experience

within the target markets are key to returns and in which they have a competitive advantage of skill in a less business-friendly environment. This first result hints to the hypothesis that key drivers vary for countries in different stages of development and we thus separate the sample. The coefficient of determination suggests that dependent variables account for 49,6% of the independent variable change.

We then run the model for the countries listed in the lower half of the sample in terms of attractiveness ranking. These countries are Brazil, China, India, Indonesia, Mexico, Philippines, Russia, South Africa and Turkey. In the case of the less attractive countries, there appears to be only one significant variable, which is “Investor Protection and Corporate Governance”, and which is significant even at 1%. In the case of less attractive countries, the factors account for 56,9% of the change in the independent variable.

However, when we run the model on the more attractive half of the countries, which are Australia, Canada, Germany, Hong Kong, Japan, Singapore, Sweden, Switzerland, UK and US, we see that now, there are already six significant variables. Namely, they are GDP, “Economic Activity”, “Depth of Capital Markets”, “Taxation”, “Investor Protection and Corporate Governance” and “Entrepreneurial Culture and Deal Opportunities”. Again, there are highly negative betas for all but two of the significant variables, which is somewhat perplexing. Now, the dependent variables account for a good 65,7% of the changes in the independent variable.

It must be stated at this point that a lot of deals in the cases of even the most developed countries lacked amounts invested for quite a high portion of the total. We assume that the values of private company acquisitions were not disclosed and thus not accounted for

in the Capital IQ data in some instances and this probably represents a bias in our quantitative analysis as this ratio is higher the less developed a country is.. However, running the model on only public company investments would have been a bias even bigger.

What we therefore do is run the model again, only this time our independent variable is the number of deals in a country over that country's GDP. The results of these regressions are in the second part of Appendix III. This time, for the sample as a whole we see six statistically significant variables. Namely, they are GDP, "Depth of Capital Markets", "Taxation", "Investor Protection and Corporate Governance", "Human and Social Environment", and "Entrepreneurial Culture and Deal Opportunities". With the number of deals, as opposed to their reported volume, the number of negative betas decreases and the R-squared is already at 61,5%. In the case of the more developed or attractive countries, we see four significant variables, GDP growth from previous year, "Depth of Capital Markets", "Taxation", and "Investor Protection and Corporate Governance". Now, the variables account for more than two thirds of the changes in the independent variable, 76,8%. Our attention is caught by the negative beta of -127,7 of GDP Growth, significant at 5%. Our explanation is partly given by Partners Group (2012), who show that private equity is a particularly attractive asset in times of high economic uncertainty. As for positive GDP growth, an explanation could be high multiple prices fueled by positive sentiment leading to a reduced number of deals or fewer but larger deals. This theory would be supported by a positive beta for this variable in the case of private equity penetration. When we run the regression the lower half of the countries in our sample the only significant variable remains "Investor

Protection and Corporate Governance”, still at 1%. Now, the variables only explain 55,2% of the independent variable changes.

We acknowledge the fact that both regressions include shortcomings. In the case of private equity penetration, it is the fact that a part of deal values is unaccounted for in Capital IQ and in the case of deal numbers, deal value is not controlled for. A small economy with a 100 deals doesn't make a more attractive private equity market than a twice bigger economy with 50 deals five times the size. However, the results of each regression are ultimately in tune and support our findings and interpretation because they both point towards the same hypothesis.

5.3. Interpretation

It can be concluded that the most important factor is “Investor Protection and Corporate Governance”. This variable is significant at 1% in all cases including the less attractive and, at the same time, less developed countries. Then, when we assess the more attractive and more developed countries, many other factors come into play as significant.

Thus follows our hypothesis that once rules to protect investors and instruments giving these investors good control over their assets are in place, private equity capital invested grows. Once countries become developed and private equity investment becomes very much commonplace, i.e. private equity penetration becomes high, other factors come into scrutiny and determine the volume of funds invested.

What this means in practice is that especially given the interconnectedness of the developed world in terms of trade, common business practices and laws, westernized culture etc., it is easy to direct capital from fund to fund geographically and both limited and general partners

will be ever more picky in terms of which geographical area will attract their money. It is also true that the biggest PE companies have their operations and offices in many countries across the developed world and while these will be autonomous entities in some instances, they will fall under one roof in others. Capital channeling thus becomes easier and more reactive and competition for funds increases. To what extent this hypothesis is true is up to further investigation.

6 Survey

We conducted a survey among GPs, LPs, investment bankers, consultants and regulators operating within or working with private equity in emerging markets. The majority of responses comes from general partners.

Our respondents find that “Economic Activity” is the most important factor for private equity attractiveness. This is followed by “Entrepreneurial Culture and Deal Opportunities”, “Investor Protection and Corporate Governance” and “Depth of Capital Markets”. “Taxation” and “Human and Social Environment” come as least important with a noticeable gap. This is not in line with what our findings.

Unsurprisingly, within “Economic Activity” GDP growth is the most important. Within “Depth of Capital Markets”, M&A market activity and debt and capital markets are more important than IPO market activity. Within “Taxation”, administrative tax burdens are most important in all but one response. Within “Investor Protection and Corporate Governance”, security of property rights come as by far the most important, followed by quality of legal enforcement and corporate governance. As for “Human and Social Environment”, bribing and corruption are of prime importance. Lastly, within

“Entrepreneurial Culture and Deal Opportunities”, the ease of starting and running a business comes by far as the most important.

When asked about other drivers, respondents mentioned competition and domestic pools of capital as important. Also, valuation levels in emerging markets were reported to be higher than fair value, which, according to our respondents, discourages investment.

We then asked how much of the projected or expected economic growth is likely to be factored into acquisition prices and most of our respondents answered that a big or an extreme amount.

When asked how limited they see general partners’ ability to add value in emerging markets beyond the intrinsic fast growth of these economies, our respondent’s answers were ranged from not limited at all to somewhat limited. Overall, the answer was that slightly less limited than in developed markets.

Our next question was what are the biggest barriers to entry in emerging markets and here the responses revolved around the same issue: local market expertise, knowledge of local environment, language etc. This supports our findings in that the only significant driver in the emerging markets was identified as “Investor Protection and Corporate Governance” and once markets were developed, investors scrutinized many more factors. We believe that the fear of entering emerging markets creates more potential returns to those with local knowledge and the willingness to invest in them.

Perhaps surprisingly in the context of the previous question, a vast majority reported that both foreign and domestic limited partners are willing to invest directly in emerging markets.

7 Conclusions

Private equity is an instrument that helps drive both efficiency and efficacy. It has many benign consequences on both a micro and, when employed on a large enough level, macro levels. However, the fact that private equity capital and consequently the associated risks are concentrated onto a small number of direct investors makes it an asset class that is very sensitive to the environments impacting those investors.

We have seen that the main drivers of private equity attractiveness vary across countries with respect to their stages of development. We have assessed the BRIC countries based on the factors explained in Appendix I in depth. The BRIC countries are very special in that they are, *ceteris paribus*, the most attractive markets to private equity capital of all. The reasons are many and range from huge GDP growth, tens of millions of people entering the middle class in their respective countries, the associated consumption growth, massive infrastructural investment and tax incentives to upcoming sport events of global importance, vast natural resources, government spending, opening of markets, industry consolidations, gradual privatizations and so forth. In this sense, they are a huge opportunity for private equity.

However, we have also seen that there are still obstacles in these countries aplenty. They range from government interventionism, corruption, lack of infrastructure and insufficient legal frameworks to business culture and language barriers, state monopolies, protectionism of strategic industries and the necessity of local networks.

What we have ultimately discovered in our quantitative analysis is that once basic but solid investor protection mechanisms and corporate governance laws are in place, private

equity is ready to make its mark on the local market. This makes sense for it ultimately renders the private equity firms masters of their investments legally. This is supported by our qualitative analysis in which we see that Russia, the BRIC country struggling with legal and governance issues the most, is lagging far behind the other three countries in private equity attraction. We also see that once governments understand of how big of a value private equity can be to them and once they get actively involved in building an ecosystem of quality, assurances and support for private equity, their private sector flourishes thanks to private equity capital invested, financial and operational engineering, transference of knowledge and training. All of these factors are of major importance to efficiencies brought over by expertise spillovers from more developed countries.

Finally, we see that in developed countries, private equity firms are driven by many more factors than in the case of their developing counterparts. We hypothesize that this is due to the fact that safeguards to investment are in place, the markets are much more penetrated by private equity and hence abnormal returns need to be sought through much more detailed analyses of other drivers. Another factor that we assume to drive this deeper focus is the interconnectedness of the developed markets, their similarities in terms of legislation, various standards (e.g. tax codes), cultures etc. and the implied easier transference and direction of capital. Lastly, the biggest private equity firms will have operations across most of the developed world and they can thus profit from a deep international knowledge base and are able to allocate capital in a much more reactive fashion when compared to funds narrowly focused on one particular region.

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8 Appendices

8.1. Appendix I

Six Key Drivers (Groh, Liechstenstein, & Lieser, The Global Venture Capital and Private Equity Country Attractiveness Index 2012 Annual, 2012) Explained

Driver (Weight)	Components (All equally weighted)
Economic Activity (0,1364)	Comprises of GDP, Expected real economic growth and Unemployment
Depth of the Capital Market (0,3182)	Comprises of Size of the stock market (Market capitalization of listed companies, Number of listed domestic Companies), Stock Market Liquidity (trading volume), IPOs and public issuing activity (Market volume, Number of IPOs), M&A Market Activity (Market volume, Number of deals), Debt and Credit Market (Domestic credit provided by banking sector, Credit information index, Interest rate spread), Bank non-performing loans to total gross loans, and Financial market sophistication.
Taxation - Entrepreneurial tax incentives and administrative burdens (0,0455)	Comprises of Entrepreneurship incentive, Number of payments, Time spent on tax issues
Investor Protection and Corporate Governance (0,1364)	Comprises of Quality of corporate governance (Disclosure index, Director liability index, Shareholder suits index, Legal rights index, Efficiency of corporate boards), Security of property rights (Legal enforcement of contracts, Property rights, Intellectual property protection) and Quality of legal enforcement (Judicial independence, Impartial courts, Integrity of the legal system, Rule of law, Regulatory quality)
Human and Social Environment (0,1364)	Comprises of Education and human capital (Quality of the educational system, Quality of scientific research institutions), Labor market rigidities (Difficulty of hiring index, Rigidity of hours index, Difficulty of firing index, Firing costs), and Bribery and corruption (Bribery and corruption index, Control of corruption, Extra payments/bribes)
Entrepreneurial Culture and Deal Opportunities (0,2273)	Comprises of Innovation (General innovativeness index, Capacity for innovation), Scientific and technical journal articles, Ease of starting and running a business (Number of procedures to start a business, Time needed to start a business, Costs of business start-up procedure), Simplicity of closing a business (Time for closing a business, Costs for closing a business, Recovery rate) and Corporate R&D (Company spending on R&D, Utility patents)

8.2. Appendix II

BRIC Qualitative Summary Table

	Brazil	Russia	India	China
Economic Activity	☐ World's 7 th largest economy ☐ World Cup and Olympics investments	☐ 11% expected growth from WTO entry ☐ World Cup and Olympics investments	☐ World's 4 th largest economy PPP ☐ Growth slowed down <7%	☐ World's 2 nd largest economy ☐ Gradual slow down - target growth at 7%
Depth of Capital Markets	☐ Market US\$1.06 trillion, 363 companies	☐ Recent merge of two stock exchanges ☐ 2012 sharp decline in IPO activity	☐ 6 th largest fund-raising through IPO ☐ Developed regulatory environment and regulatory infrastructure	☐ 5 th largest stock market worldwide ☐ Slow speed of regulatory IPO approval
Taxation	☐ 0% financial transaction tax ☐ Code of Regulation	☐ Decreased process of paying taxes by 39%	☐ Significant progress in Ease of Paying Taxes (WB)	☐ Wide range of taxes ☐ Wide tax incentive policy
Investor Protection and Corporate Governance	☐ Strong minority shareholder protection ☐ Revised intellectual property law	☐ Overestimated valuations ☐ Investors usually do not seat on the board	☐ Concentrated ownership and company groups (pyramids) ☐ Lack of governmental decisiveness	☐ Improvement in Minority Shareholders protection ☐ Intellectual Property right still problematic
Human and Social Environment	☐ High perceived corruption and inefficient legal system ☐ Pro-labor market (high termination payment)	☐ Educated, young, skilled population ☐ Very weak in areas such as construction permits and getting electricity	☐ Strong long-term social problems (poverty, corruption, discrimination) ☐ Young population	☐ Fast growing middle class ☐ High domestic saving rates ☐ Very rapidly aging country
Entrepreneurial Culture and Deal Opportunities	☐ Setting up business takes more time than average, but inexpensive	☐ Introduction of limited liability partnerships to legal entities	☐ Strong focus on companies founded <3 years before	☐ Improved business landscape in 9 areas (WB)

8.3. Appendix III

Table 2 - Regression Results for Private Equity Penetration Independent Variable

VARIABLES	(1) All Countries Scaled PEP	(2) Upper Half Scaled PEP	(3) Lower Half Scaled PEP
GDP	-0.00389 (0.00506)	0.0293*** (0.00980)	0.00575 (0.00674)
GDP Growth	161.9 (207.4)	115.0 (287.9)	30.00 (129.2)
EA	-0.875 (1.316)	-13.71** (5.558)	-0.349 (1.033)
DCM	-2.768 (4.579)	-12.27* (6.689)	-1.424 (2.302)
Taxation	-1.268 (1.414)	-4.874* (2.680)	-1.057 (0.772)
IP&CG	5.856*** (1.547)	4.763*** (1.709)	6.409*** (2.337)
HSE	1.457 (1.187)	5.368 (3.458)	-0.889 (1.518)
EC&DO	-3.115*** (1.143)	-16.70*** (3.457)	-0.856 (1.023)
Constant		3,414*** (783.5)	-10.10 (137.7)
Observations	133	70	63
R-squared	0.496	0.657	0.569
F	8.155	12.08	3.099

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 3 - Regression Results for Number of Deals over GDP Independent Variable

VARIABLES	(1) All Countries Scaled #/GDP	(2) Upper Half Scaled #/GDP	(3) Bottom Half Scaled #/GDP
GDP	-0.00574*** (0.00157)	-0.00421 (0.00289)	-0.00528 (0.00426)
GDP Growth	-26.10 (54.69)	-127.7** (58.96)	-1.603 (62.93)
EA	0.0672 (0.480)	-0.617 (0.889)	0.265 (0.626)
DCM	2.846*** (0.959)	4.976*** (1.334)	0.557 (1.301)
Taxation	1.694*** (0.422)	5.328*** (0.675)	-0.0870 (0.493)
IP&CG	2.005*** (0.264)	3.449*** (0.340)	2.798*** (0.995)
HSE	-0.599** (0.286)	0.257 (0.506)	-0.882 (0.862)
EC&DO	-1.145** (0.505)	-1.539 (1.271)	-0.0971 (0.572)
Constant		-1,021*** (300.0)	-125.9 (86.85)
Observations	133	70	63
R-squared	0.615	0.768	0.552
F	19.41	18.53	4.586

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

8.4. Appendix IV

Survey

1. You are	☐	General Partner
	☐	Limited Partner
	☐	Investment Banker
	☐	Consultant
	☐	Regulator
	☐	Other
2. You are mainly operating within	☐	Brazil
	☐	Russian Federation
	☐	India
	☐	China
	☐	Other Developing Country
3. Please rank the following six key drivers from MOST important to LEAST important in terms of PE/VC attractiveness	☐	Economic Activity
	☐	Depth of Financial Markets
	☐	Taxation
	☐	Investor Protection Corporate Governance
	☐	Human and Social Environment
	☐	Entrepreneurial Culture and Deal Opportunity
4. Within Economic Development, please rank the following from MOST important to LEAST important in terms of PE/VC attractiveness	☐	GDP
	☐	GDP Growth
	☐	Inflation
	☐	Unemployment
5. Within Depth of Capital Markets, please rank the following from MOST important to LEAST important in terms of PE/VC attractiveness	☐	Size and liquidity of the Stock Market
	☐	IPO Market Activity
	☐	M&A Market Activity
	☐	Debt and Credit Market
	☐	Financial Market Sophistication
6. Within Taxation, please rank the following from MOST important to LEAST important in terms of PE/VC attractiveness	☐	Tax Incentives
	☐	Tax
	☐	Administrative Tax Burdens

7. Within Entrepreneurial Culture and Investment Opportunities, please rank the following from MOST important to LEAST important in terms of PE/VC attractiveness	☐ Innovation and R&D ☐ Ease of Starting and Running a Business ☐ Simplicity of Closing a Business ☐ Information and Communication Technology Infrastructure
8. Within Human and Social Environment, please rank the following from MOST important to LEAST important in terms of PE/VC attractiveness	☐ Education and Human Capital ☐ Labor Market Rigidities ☐ Bribing and Corruption ☐ Costs of Crime
9. Within Investor Protection and Corporate Governance, please rank the following from MOST important to LEAST important in terms of PE/VC attractiveness	☐ Corporate Governance ☐ Security of Property Rights ☐ Quality of Legal Enforcement ☐ Regulatory Quality
10. Apart from the above listed SIX KEY DRIVERS, do you think there are others we forgot to mention?	☐
11. How much of projected/expected economic growth do you perceive to already be factored into acquisition prices in emerging markets?	☐ None ☐ Some ☐ Quite a Bit ☐ Extreme Amount ☐ All
12. Excluding financing, how limited do you see the general partners' ability to add value in the emerging markets due to the fast-growth of these economies in themselves, i.e. beyond the intrinsic GDP growth?	☐ Not limited compared to developed markets ☐ Less limited compared to developed markets ☐ Same as in developed markets ☐ Somewhat limited compared to developed markets ☐ Very much limited compared to developed markets
13. What do you believe are the biggest barriers to entry for PE shops within your market(s) of specialization?	☐

14. Are foreign limited partners willing to
invest directly in your market of
interest?

☐

Yes

☐

No

15. Are domestic limited partners willing to
invest directly in your market of
interest?

☐

Yes

☐

No

16. Please list any recent
legislative/institutional etc.
developments in your country of
interest that are of significance to
PE/VC investment ease.

☐

8.5. Appendix V

PE deal number evolution in the BRIC countries across studied period

Figure 1- Number of PE Deals in the BRIC Countries 2006-2012

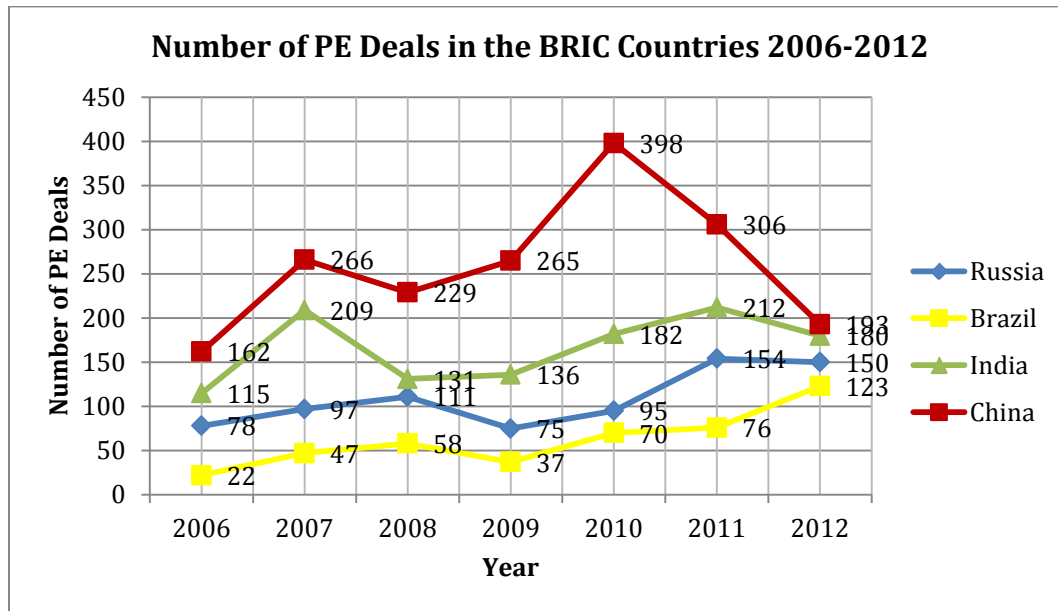


Figure 2 - Log Scale Comparison of BRIC vs UK/US PE Numbers of Deals 2006 - 2012

