



empea

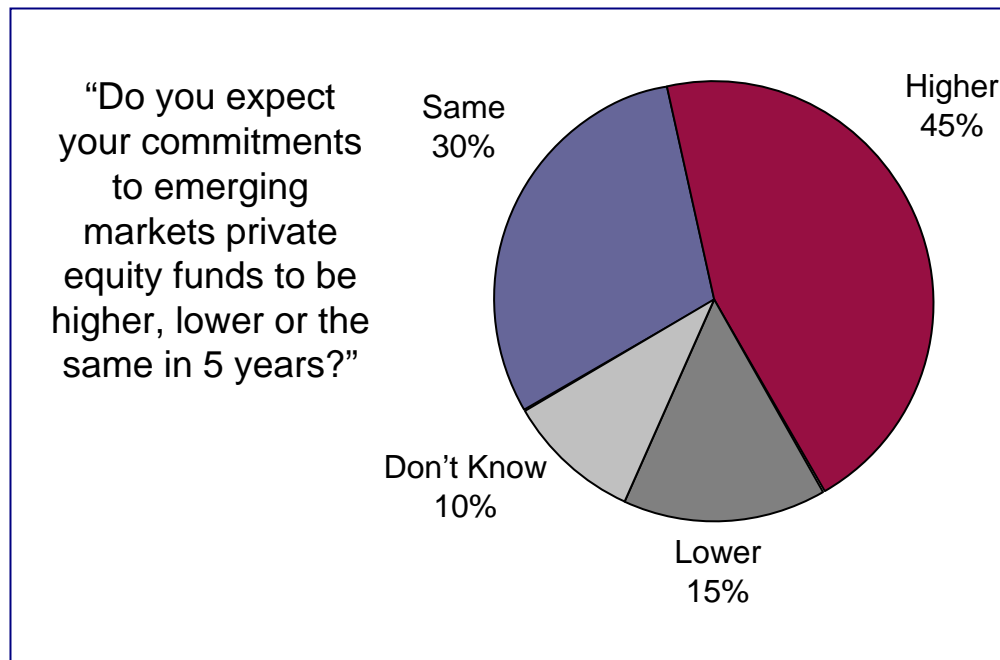
Emerging Markets Private Equity Association

Institutional Investor Views on Emerging Markets Private Equity

*Initial Survey Results for IFC Global Private Equity
Conference, May 6, 2004*

Survey Results: Key Findings

- An EMPEA survey, conducted in March 2004, indicated that many LPs plan to increase investments in emerging markets



- Several bellwether US endowments have significantly increased commitments, particularly to Asia

Context to the EMPEA Survey

Background

- Conducted as part of the EMPEA business plan development
- Other surveys/discussions under way with GPs, service providers, and VCAs

Objectives

- Take the pulse on investor perceptions of emerging market private equity
- Ensure that EMPEA programs are designed from a clear understanding of the key issues in the market place
- Provide EMPEA members with information that can help in investor relations, fund development, marketing, etc
- Provide an early demonstration of EMPEA's value proposition of collective action at the pan-emerging-markets level

Method

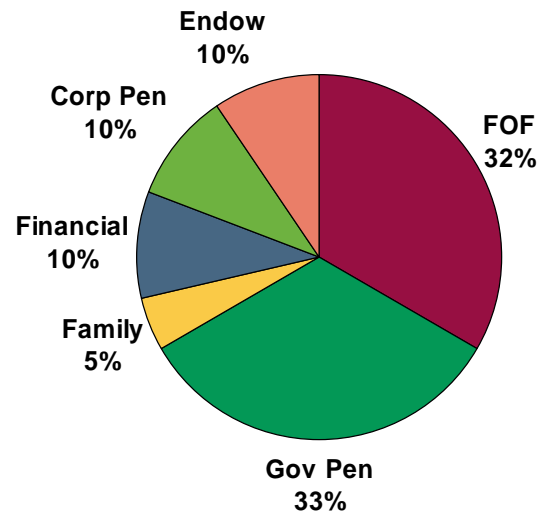
- Informal, off-the-record interviews with LPs
- Initial results presented here

Survey Participants

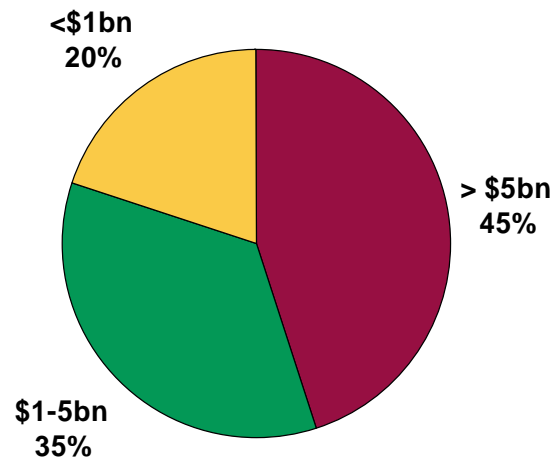
Summary

- 26 respondents in total, of which 22 Institutional investors and 4 intermediaries
- Institutional investors surveyed manage \$108 billion in private equity assets
- Five European, all others from the US
- Mostly older established programs with at least 15 years experience in fund investing
- Respondents program head (11 out of 22) or senior staff member

Survey Respondents by Category



Respondents by Size of PE Portfolio



Survey Questions: Overview

Commitments to Emerging Markets Funds

- % in emerging markets funds now; five years ago; five years hence

Experience and perceptions

- Regions, results
- Source of problems: market or management?

New Fund Review Process

- Emerging market allocation?
- Dedicated staff?
- Specific skill set?
- Risk premium?

LP/GP Issues

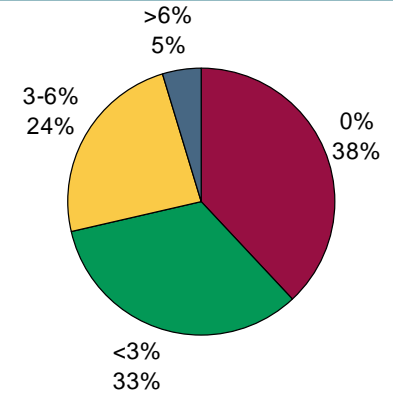
- Emerging markets compared to US/Europe? Issues of concern re reporting, transparency, monitoring, etc?

Views on EMPEA

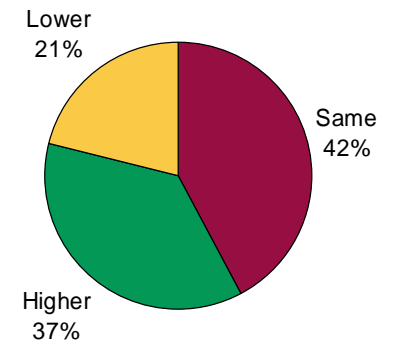
- Would it make a difference if a fund approaching you were an EMPEA member?
- Would EMPEA programs help you? What should EMPEA focus on?

Portfolio Trends

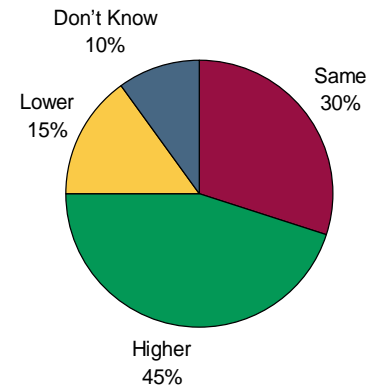
“What % of your current commitments are in emerging markets funds?”



“Was the percentage higher or lower five years ago?”



“Do you expect that percentage to be higher or lower in five years?”



Perceptions of Emerging Market Private Equity

Overall Perceptions and Experience

- Mostly negative views about experiences with past funds
 - “Bottom line: the returns haven’t been there”
 - The older the program, typically the more negative the comments
 - Advisors marginally more negative than the investors

Explanation of Performance Problems

- Macro issues:
 - currency
 - liquidity
 - volatility/crises
 - legal/institutional challenges
 - political risk
 - “There is fundamentally a lack of the basics for private equity investing in terms of rule of law, entrepreneurial management, transparent accounting, service providers, fungibility of assets, these are the core requirements and they haven’t been present.”

Perceptions of Emerging Market Private Equity - Continued

Explanation of Performance Problems (cont.)

- Cultural interpretations:
 - Entrepreneurship: “The business culture of entrepreneurship is still in its infancy and the notion of taking on a financial partner with a view to mutual upside is still developing... contrast with California where the mindset is we’re all going to get rich lets do what it takes”
 - Access: “You have to be an insider to get rich in these markets, and a private equity firm is an institution, by definition an outsider”
- Management issues
 - Strategy: “too many funds didn’t try or weren’t able to really influence portfolio companies”
 - Staff turnover
 - Institution/process: “senior guys do the deals but don’t stay involved to work with the companies”
 - Skill: perception that the best managers aren’t attracted to these regions
 - Insufficient risk mitigation strategies

Perceptions of Emerging Market Private Equity – continued

So Why Invest?

- Diversification?
 - Differing views on this issue
 - Most see some correlation between EM and US/EU private equity but not complete
- Macroeconomic developments?
 - “There seem to be compelling economic and demographics trends in some of these markets”
 - “Clearly there are bridges being built between US venture and Asia”
 - “The market opportunity is there, but the teams lack experience and we don’t want them learning on our dime.”
 - Many see incremental improvement in the macro/institutional context in Eastern Europe, and believe that makes a difference
 - Again some naysayers: “we’ve seen that movie and know how it ends”
- Reaction to US Europe Market?
 - Declining returns in the main markets
 - “we think returns are converging given the poor performance in the US and we want to be there when that convergence happens”
 - “one good argument [for going into emerging market funds] is the excess of capital in the US.”
- Get in early?
 - Some perceive value creation by emerging market funds stems more from asset arbitrage than business building – so believe they have to be in funds early
 - Others will wait: “We expect these markets will come around but we don’t need to be first”

Fund Review

New Fund Review Process

- Emerging markets allocation?
 - Only 1 of 21 have a specific EM allocation
 - Most judge funds in comparison to US/European alternative
 - Several reluctant to do a single fund in a region for staff and monitoring cost/benefit reasons
- Risk Premium?
 - Minority use a specific risk premium in assessing funds
 - Most say they should get it but don't specifically look for it
- Dedicated staff?
 - 1 respondent currently has a staff person dedicated to emerging markets; 2 are looking to hire for that position
- Different skill set?
 - Key is the combination of all of the core skills plus local capabilities.
 - "We used to think the team had to be indigenous, but not so sure, our best returns have been from firms that are not indigenous"
 - "Investors want them to look like what they are used to in the US Europe"
 - "Required skill set is lower.. More of an asset arbitration process"
- Institutional Preference?
 - Some preference for larger institutions – perceived as necessary given the risks in the market
- Information:
 - Lack of information is a hurdle: "We don't have the level of intelligence about these markets we need to feel comfortable so we wont do it"

Fund Oversight Issues

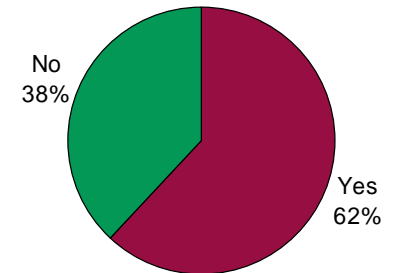
LP/GP Issues

- Transparency and communications
 - “Transparency and valuations are big issues for LPs generally and a bigger concern in terms of non US funds”
 - “Hard to know what is going on, hard to get information, hard to know whom to trust;”.. “we learned one day the manager was in jail”... “they took everything and disappeared”
 - LPs looking for more thorough discussion of the risks up front
- Monitoring
 - “Monitoring these funds is a hassle”
- Institutional issues:
 - Question of whether the firms are being developed for the long term, with established procedures, mentoring, succession planning, etc
- Flexibility
 - “A manager has to be opportunistic to make money in these markets and that doesn’t square well with LPs need for continuity and consistency with the PPM. LPs don’t like change.”

Views on EMPEA

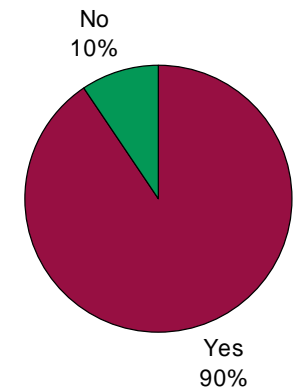
“Would membership in EMPEA make a difference in how you view a fund?”

- “If we see a fund that cares about these things [reporting and valuation standards, best practices] that’s an important part of the package”
- “If there is an overlaying group that has come up with a rule book that everyone agrees to play by, that would help”
- “If I get comfortable with the market, yes that would make a difference in how I’d select a fund”
- “No, these things aren’t correlated with higher returns and that’s what matters”



“Would EMPEA information and research programs be useful to you?”

- “Yes raising the standards for the industry generally would be a great thing”
- “Would be enormously useful”
- “Developing benchmarks should be your priority”
- “The absence of benchmarks means you have to rely on anecdotal evidence which points toward poor returns”
- “Anything you can do to dispel the myths”



“What else should EMPEA focus on?”

- Training around corporate governance for portfolio companies
- Standards for fraud detection in portfolio companies
- Lobbying emerging market governments to improve corporate governance requirements for public companies
- Success stories: “We’re looking for models that have been proven to work”

Conclusion

- Perceptions are negative but may be getting better
- The main input required to significantly change perceptions is higher returns
- There appear to be steps that GPs can take individually and collectively to help improve perceptions incrementally in the short term
- Some examples:
 - Inform institutional investors: dispels “myths” and reduces the time and resource cost to managers of understanding these markets
 - Increase upfront discussion of the risks in these markets and the risk mitigation strategies
 - Commit to high standards of professionalism, transparency, etc
 - Reduce management team turnover
 - Give LPs a better understanding of the business culture of portfolio companies
 - Develop and standardize mechanism for mid-course corrections
 - Other?