Growth Funds and Emerging Markets

Jessica Duong reveals the regional trends of growth funds in the private equity industry and explores the reasons why this investment strategy is more prominent in emerging markets.

A growth fund is a private equity vehicle that typically takes significant minority positions in companies without the use of leverage. This strategy targets profitable, but still maturing, investee companies with significant scope for growth. Though considered to be one of the more niche strategies of the alternative investment world, there is evidently a healthy appetite for growth funds among the LP community; Preqin’s Investor Intelligence tracks 2,149 LPs that currently express a preference for investing in growth vehicles.

Fig. 1: Annual Private Equity Growth Fundraising, 2003 - 2013 YTD (As at 08 October 2013)

Historical Fundraising

Fundraising figures show an unsurprising story for growth vehicles. In tandem with the rises and falls of the wider financial markets, the number of growth funds reaching a final close and the aggregate capital garnered by these vehicles have almost experienced year-on-year increases until the crash in 2009 (Fig. 1). Unlike the rest of the industry, however, growth funds have recovered to exceed their pre-crisis peaks. 2011 saw the highest level of fundraising for growth vehicles with 129 funds reaching a final close and raising a total of $35.4bn. As of the start of Q4 2013, 54 growth funds had reached a final close so far during 2013, raising a total of $10.2bn.

Prevalence of Emerging Markets

Despite the somewhat predictable fundraising narrative of growth vehicles over the years, analysis into the geographic focus and location of these funds reveals some interesting patterns. Data from Preqin’s Funds in Market module highlights the prominence of emerging markets in the private equity growth industry, both in terms of the investment focus of growth vehicles, with the majority of growth vehicles closed in recent years targeting these regions, and the location of GPs managing growth funds, with many of these GPs based in emerging markets. Asia in particular is the trailblazer, with China, India and Hong Kong especially comprising the most significant proportions of number of funds closed and amount of investor capital raised.

Fig. 3 illustrates the consistent manner in which emerging markets are a strong area for growth fundraising compared to the more

### Fig. 2: 10 Largest Private Equity Growth Funds Currently in Market (As at 08 October 2013)

<table>
<thead>
<tr>
<th>Fund</th>
<th>Manager</th>
<th>Target Size (bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology Crossover Ventures VIII</td>
<td>Technology Crossover Ventures</td>
<td>2.3 USD</td>
</tr>
<tr>
<td>CDH Fund V</td>
<td>CDH Investments</td>
<td>2.0 USD</td>
</tr>
<tr>
<td>Pine Brook Road Partners II</td>
<td>Pine Brook Partners</td>
<td>2.0 USD</td>
</tr>
<tr>
<td>Blue Economic Zone Industrial Investment Fund I</td>
<td>China Bright Stone Investment Management Group</td>
<td>8.0 CNY</td>
</tr>
<tr>
<td>China Momentum Fund</td>
<td>Fosun International</td>
<td>1.0 USD</td>
</tr>
<tr>
<td>China Ocean Economy Industry Investment Fund I</td>
<td>China Bright Stone Investment Management Group</td>
<td>1.0 USD</td>
</tr>
<tr>
<td>CSM International Fund</td>
<td>China Science &amp; Merchants Capital Management</td>
<td>1.0 USD</td>
</tr>
<tr>
<td>Elevation Partners II</td>
<td>Elevation Partners</td>
<td>1.0 USD</td>
</tr>
<tr>
<td>Inventis China Growth USD Fund VI</td>
<td>Inventis Investment Holdings (China)</td>
<td>1.0 USD</td>
</tr>
<tr>
<td>AgBank (Wuxi) Private Equity Fund</td>
<td>ABC International Holdings</td>
<td>5.0 CNY</td>
</tr>
</tbody>
</table>
established private equity markets of North America and Europe; Asia-focused funds represent the largest proportion of aggregate capital raised by growth funds annually from 2006 onwards. Other regions, including the Middle East & Israel, Latin America and Africa, all contribute to the significant proportion of growth fundraising that emerging markets account for.

We can see a notably stronger presence of Africa-focused growth funds as we move through 2013, with these vehicles accounting for 9% of all capital raised by growth funds closed in the year to date. This is a marked increase from the average of 3% that they accounted for in the period between 2006 and 2012. Overall, the general trend is the same, with emerging markets, especially Asia, comprising the large majority, and the traditional markets of North America and Europe representing a relatively smaller proportion of aggregate capital secured by growth funds.

For the years 2006-2013 YTD, the average proportion of capital garnered by closed growth funds represented by primarily North America-focused vehicles is 19%; Europe-focused funds 15%; funds with a focus on markets outside of North America and Europe represent 60%; and specifically Asia-focused funds, 51%. Despite the increase in 2013 from the previous year for North America- and Europe-focused growth fundraising, emerging markets still constitute the greater majority in 2013.

Fig. 4 uses Preqin’s Funds in Market data for growth funds that have a primary geographic investment focus outside of the traditional markets of North America and Europe. The chart depicts the proportions that are made up by managers based in different regions and illustrates clearly that the majority of these growth funds targeting emerging markets are being raised by GPs based in emerging markets. Asia in particular comprises the largest proportion at 70%.

The 12 countries that account for the greatest number of GPs raising growth funds that are headquartered in those locations is shown in Fig. 5. Though the US tops the table, with 49 growth fund managers, countries in emerging markets dominate the rest of the table, with significant numbers of GPs based in Asia, Africa and Latin America raising funds. Furthermore, it should be noted that 57% of the GPs located in other countries are also based in the regions outside of North America and Europe.

Why Growth Investments in Emerging Markets?

Emerging markets are exciting environments, conducive for strong growth opportunities, and also provide an alternative to traditional markets for portfolio diversification. Emerging markets encompass countries in transition such as China and India, which are attractive to investors because of the tremendous economic growth and development underway there, creating potential that can be translated into promising returns. Typically, these regions have undergone or are in the process of undergoing political and economic reforms striving toward greater liberalization, privatization and international trade and foreign investment, which support that growth.

As the markets in these regions are not as mature as the traditional giants of North America and Europe, there is a consequently lower...
volume of buyout opportunities. Investee companies in emerging markets may be adequately mature and successful, but small enough to have good growth prospects, with the target on finding promising companies that require capital to expand — exactly the focus of growth investments.

Benefits of Growth Funds vs. Other Types

The different nature of growth deals compared to buyout or venture capital investments brings a range of benefits. For instance, unlike in a buyout situation, business owners and key shareholders in a growth deal are able to take their money off the table if they believe too much of their personal wealth is tied up in the company, without having to hold an outright sale of the business. Growth equity investors also allow owners to maintain an active role in their companies.

In contrast to venture capital investments, there is no early stage concept risk for growth deals, as they are traditionally made at a point of time when strong financial growth is proven in the business.

Notable Growth Deals

Hundreds of growth deals have been announced over the years and many have captured the interest of those in the private equity world and beyond. The accomplishments of relatively young portfolio companies following the injection of growth capital have been enthusiastically reported in global media, and those cases involving in-vogue industries and companies that have displayed significant success outside of the traditional North America and European markets are of particular interest.

Alibaba Group is an example of a recent large growth capital deal with an Asian portfolio company. In September 2012, Alibaba Group raised $1.9bn from Boyu Capital, CDB Capital and Citic Capital, as well as returning investors including DST Global, Silver Lake and Temasek Holdings. The private equity investment was part of a $5.9bn funding package, which also included a $2bn investment by China Investment Corporation and a $2bn debt component from a consortium of lenders. The funding was used by Alibaba to acquire the 20% stake in itself that was held by Yahoo. Alibaba is a titan in the Chinese e-commerce world and despite a relative lack of exposure in other geographies, it has actually become the biggest internet retailer in the world. It is interesting to note that it has surpassed the transaction volumes of its American competitors, eBay and Amazon, combined.

Edita Food Industries is the largest independent snack food business in North Africa with a suite of iconic brands including Twinkies, Hohos and Bake Rolz. In June 2013, Actis invested $102mn in Edita Food Industries S.A.F. The growth capital deal was an investment from a global private equity firm with an exclusive focus on emerging market opportunities. Actis particularly makes commitments in response to the trend of rising domestic consumption driven by the rapid expansion of the new consumer class.

These examples highlight the way private equity growth deals ride on the socio-economic shifts in emerging markets, finding opportunity in the phenomenon of a growing middle class and increasing appetite for consumer goods and services, for instance. The cases of Alibaba and Edita, internet and FMCG companies respectively, illustrate this trend that has been picked up by GPs and LPs pursuing growth capital investments.

Outlook

With 232 growth funds currently in market seeking an aggregate $63bn, this segment of the private equity universe has the potential to improve on recent annual fundraising figures. The attempts by fund managers to raise such vehicles demonstrates that industry professionals recognize the promise that growth opportunities currently hold.

What is less likely to change significantly in the near future is the prominent focus among growth funds on investing in emerging markets. As the figures for Europe and North America have fluctuated over the years, emerging markets of the world have maintained their clear overall majority in growth fundraising. Asia in particular looks set to continue to be an area of demand for growth investment, constituting the largest proportion of number of growth funds raised and aggregate capital garnered. The social and economic developments that these areas are going through provide extremely fertile grounds for this investment strategy.
Fund Coverage: 32,319 Funds
- 14,480 Private Equity* Funds
- 12,945 Hedge Funds
- 4,210 PE Real Estate Funds
- 716 Infrastructure Funds

Firm Coverage: 15,385 Firms
- 7,154 PE Firms
- 6,012 Hedge Fund Firms
- 1,829 PERE Firms
- 390 Infra. Firms

Performance Coverage: 13,733 Funds (IRR Data for 5,077 Funds and Cash Flow Data for 2,462 Funds)
- 5,327 PE Funds
- 7,139 Hedge Funds
- 1,127 PERE Funds
- 140 Infra. Funds

Fundraising Coverage: 13,379 Funds Open for Investment/Launching Soon
Including 1,997 Closed-Ended Funds in Market and 391 Announced or Expected Funds
- 1,653 PE Funds
- 10,524 Hedge Funds
- 952 PERE Funds
- 250 Infra. Funds

Deals Coverage: 84,244 Deals Covered; All New Deals Tracked
- 31,086 Buyout Deals**
- 48,828 Venture Capital Deals***
- 4,330 Infra. Deals

Investor Coverage: 11,244 Institutional Investors Monitored,
Including 8,036 Verified Active**** in Alternatives and 85,087 LP Commitments to Partnerships
- 5,229 Active PE LPs
- 4,342 Active Hedge Fund Investors
- 4,007 Active RE LPs
- 2,083 Active Infra. LPs

Alternatives Investment Consultant Coverage: 454 Consultants Tracked

Fund Terms Coverage: Analysis Based on Data for Around 8,100 Funds

Performance Coverage: Funds (IRR Data for 5,077 Funds and Cash Flow Data for 2,462 Funds)
- 5,327 PE Funds
- 7,139 Hedge Funds
- 1,127 PERE Funds
- 140 Infra. Funds

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