

First Among Unequals

Frontier markets are poised to follow in the steps of the BRICS countries.



When looking to invest in growing economies, there's one startling fact: The developing world has 80 percent of the world's population, but accounts for roughly 10 percent of the world's market capitalization. This generally brings to mind emerging market private equity investments in the BRICS (Brazil, Russia, India, China and South Africa) for the lopsided double-digit returns due to the tremendous growth achieved in those economies vis-à-vis the developed world.

That's all changing since growth differentials in the BRICS have narrowed significantly. People are taking a step back to look at all of the developing nations. Jim O'Neill, who when at Goldman Sachs coined the "BRIC" acronym in 2001, hinted 10 years later that these goliaths of the emerging markets may have had their day. By 2011, many investors were publicly calling for increased allocations to the developing markets that were left behind by the BRIC euphoria. A Goldman report at the time stated that "In terms of the role of the BRICs in driving global growth, the most dramatic change is behind us."

Although the BRICS account for 40 percent of the world's population and about 10 percent of global market capitalization, frontier markets account for 20 percent of global population but only about half of one percent of global market capitalization, hence the opportunity for frontier market economies to follow in the steps of the emerging markets.

Frontier markets can be defined as a subset within the broader field of emerging markets, with lower market capitalizations and liquidity than the more developed emerging markets. Half of the world's population – 2.7 billion people – lives on less than \$2.50 per day and 1.2 billion people (22 percent) live on less than \$1.25 a day. Those earning above the \$2 per day level tend to be able to save money, are upwardly mobile and capable of driving a consumer-led economy. These economies' industrialization and infrastructure, including their ability to raise external financing, will be key to developing consumer spending capacity for these massively needy populations and their swelling demand for consumer goods and services.

Frontier Markets Defined

Although no definitive list exists, frontier markets comprise up to 40 countries spread across Asia, the Middle East, Africa, South America and Eastern Europe. The contrast between the differing frontier markets is marked from the very wealthy Middle Eastern economies to the less-developed but rapidly expanding African nations. All of these frontier market economies are at the early stages of industrialization. This provides opportunities for organic growth and investment returns that are intrinsically less correlated to global market movements. These economies are young, and address the fundamental needs of huge, growing populations – massively expanding middle-classes with enormous unmet needs. They have the potential to achieve above-average growth over the next five to 15 years.

As Daniel Broby, CEO of GEMfonds PLC, a specialist glob-

al emerging and frontier markets investment firm, recently said: "As an emerging market veteran, it's clear to me that frontier markets are similar to what emerging markets were two decades ago. We gain a high degree of visibility from those markets as they industrialize and join the global economy. As a result, it's not going to prove to be some kind of investment fad. We will see above-average growth for some time to come."

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These high rates of economic growth are attractive, but the tricky environment calls for an investor who is extremely experienced in operating internationally. At the same time, a new breed of private equity investors is emerging who are acutely aware that in addition to substantial financial returns, entering these markets also involves huge societal impact.

Private equity investors getting in at the ground floor will have a bigger impact than expected – on both regional economic development and social justice in the lives of local inhabitants. Suddenly, the fund manager's work now goes further than the confines of pure financial returns – it will also provide the catalyst for positive social change.

Taking advantage of these opportunities involves overcoming obstacles such as lack of transparency, human capital issues, political instability and the intrinsic complications of aid programs – notably inefficiencies, politicizing and frequent corruption. Restricted exit strategies also have to be addressed; the majority of exits for frontier market investments are still happening through industry sales rather than through capital markets.

Private equity investors in frontier markets are the new generation of impact players, both socially and economically. The new-generation private equity investment manager delivers social benefit as well as superior financial returns. **BFI**

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