KEYNOTE INTERVIEW

Time to change perceptions of emerging markets

Limited partners are increasingly looking to emerging markets for investment opportunities. Torbjorn Caesar, senior partner at Actis, discusses how perceptions are changing

Emerging markets have historically tended to come in and out of fashion with institutional investors as trends in developed markets and issues such as currency volatility or commodity price fluctuations in emerging markets have shaped perceptions of where they can achieve attractive risk-adjusted returns. The wake of the financial crisis, for example, saw significant capital flow towards emerging markets – in 2010 20 percent, and in 2011 24 percent of capital raised by private markets globally went to emerging markets, according to EMPEA figures.

We are currently seeing renewed interested among investors in many emerging markets. Torbjorn Caesar, senior partner at Actis, discusses how perceptions are changing and why he believes emerging markets make such a compelling investment opportunity.

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Q Your firm has been investing in emerging markets for over seven decades and you now have funds that span energy, infrastructure and real estate as well as private equity. What connects an investment in a Chinese data centre with an affordable housing project in Kenya?

All our investments build on the same fundamental theme – that growth in the world is happening in emerging markets rather than in, say, the US or Europe. This is underpinned by shifts such as rapid urbanisation, the growth of the middle classes and demographics. For some years now, there has been a wave of new consumers entering the markets where we invest. Families are sending their children to school, they are using credit cards, going to restaurants, buying a pair of jeans – they are doing all these things, sometimes for the first time and this is driving economic growth.

Our investment thesis is rooted in this fundamental trend – both through consumer-facing opportunities and through the infrastructure supporting that, such as energy and real estate. There is real dynamism, enthusiasm, pace and activity in our markets that can be easy to miss if you sit in developed markets consuming headlines about Brexit or Donald Trump. And I think the perception of emerging markets is often quite different from the reality on the ground.

Q How would you characterise the perception around emerging markets?

I think there remain a number of misperceptions – and the main one of these is around risk. Let's take energy and renewables as an example. While we're an emerging markets investor, we're actually a world leader in energy and renewables, with 15,000 wind turbines and 5.7 million solar panels constructed just last year across our investments. We are the second largest utility globally.

From a project point of view, you have to ask whether it's harder to build a wind farm in India than it is in Germany. The answer is: no, because you are using the same contractors and technology. The sector risk is not higher; it's actually lower because there is a shortage of electricity in our markets. I'd far rather be in a market where there's a shortage than an over-supply, as there is in some developed markets. Then there's sovereign risk – the events of the past few years suggest that this is no higher in emerging markets than developed ones and with considerable downside protection, for example – you can insure risk through the World Bank. Overall, you can achieve a better risk-return profile through emerging markets exposure than you can in the US and Europe.

I think perceptions are changing, however. I started out as a Swedish engineer for ABB and built a power plant in Egypt in the 1980s. Things were quite different then. Emerging markets were considered pretty niche – these days that's not the case. We certainly see ourselves as a global player as opposed to a frontier investor.

Q And what can you do to help change this perception?

I think it's happening anyway. Emerging markets are now more mainstream and investors are starting to take a more global view. They're asking, what's the risk in Greece vs Morocco or Italy vs Mexico and arriving at answers they may not have previously.

As for what we can do, generating strong returns is clearly vital. But we also have our Macro Forum, a group of investment professionals that feed into every investment committee. Their views are informed not only by our 250 staff across our 17 offices, but also by the 165,000 staff and 600 board members we have in our portfolio. These people sit on the ground and share their experiences so we have a south-South Street view of what's happening. We share these insights in a regular publication that offers a long view of what's happening.

This is quite different from what you might be able to download from, say the World Bank or investment banking research. Most macro views tend to look at the currency markets next week or offer a quarterly or, at most, an annual snapshot. We want to ask the question of what's the outlook over 20 years? These trends are far more important than the headlines of the day.

Q You mentioned your background as an engineer. How does that help you run the firm?

It helps make me, and the firm more generally, more hands-on. I've been an investor for nearly 20 years, but having been an industrialist and an entrepreneur previously means that, when I'm sitting on boards, I have experience of what it's like on the other side and I can bring operational skills, rather than simply buying, leveraging and, a few years down the line, picking up a cheque. I can help draw up development plans around what needs to be done in a business and focus on the right areas that will drive financial value for our investors.

> *"Emerging markets were considered pretty niche – these days that's not the case. Today we certainly see ourselves as a global player as opposed to a frontier investor"*

Q What's your leadership philosophy?

It's focused around people, focus and values, all of which should drive financial performance. How can we attract, retain and develop the right people? We must be focused on areas where we can be the best by deploying replicable strategies, using the networks, contacts and experience we have built up. And we must continue to act in accordance with our philosophy that values drive value – we have to engage with local communities and create well run, sustainable businesses that will ultimately achieve the best price at exit.

On this last point, we're seeing LPs and competitors embrace the idea of sustainability, whereas 10 years ago, this wasn't the case. Many felt that they had to sacrifice an element of returns; now there's a greater appreciation that investing according to a set of values, with the right people on board are key levers for financial performance.

Q You recently acquired some of the Abraaj funds. What was the rationale for this?

This goes back to my point about perceptions. When Abraaj collapsed, there was a view among some that this was "typical emerging markets". It wasn't. It was a manager issue. Yet it tainted emerging markets.

We were approached by a number of Abraaj investors to see if we could help deal with the situation. We could see that if we could arrive at a solution it would help us, but also the wider market. We're 100 days in now, we're working through the assets and creating detailed value creation and exit plans, while also ensuring there is clear and transparent reporting in place.

Q And finally, as more capital is directed at alternatives, what does this mean for the evolution of emerging markets investing?

I believe investors will increasingly consider their portfolios on a global basis as opposed to artificially separating out emerging and developed markets. This is particularly so as investors are being driven more by issues around sustainability – after all, if you create CO_2 in South Africa, it adds to climate change globally.

Over the past few decades, investors have made money in alternatives as stock markets have continued to rise and multiples have increased. They will ask themselves whether this can continue for the next 20 to 30 years. In the parts of the world where we invest, it's much more about underlying growth as opposed to repricing of assets. Investors will take more of a one-world approach to their portfolios.

Emerging markets private markets allocations have so far been a tiny proportion of a small slice of capital. If you think that they will soon be home to 85 percent of the world's people, you can see how capital will shift. You're already seeing products becoming global and investment will be the same. ■