Institutional capital must keep flowing into emerging markets

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this article first appeared in Private Equity News

Maintaining the flow of institutional capital into Emerging Markets is neither altruistic nor opportunistic. It's pragmatic.

Economies across the emerging world require fiscal breathing space to fund their response to the acute covid-19 situation. This can involve everything from supporting their economic and humanitarian recovery, to shoring up their fiscal positions in anticipation of an extended, or even further, crisis. With Emerging Markets representing 85% of the world's population, Covid-19 is not over for Developed Markets until it is over for *all* markets.

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Governments, multilaterals and NGOs have responded to the initial urgent need for essential services in the poorest countries, calling upon an unprecedented array of financial instruments, in addition to the work they have already undertaken to catalyse foreign direct investment. With that in place, now is the time for institutional private capital to step forward and drive a complementary, coordinated, and commercially feasible response.

It is hard to escape the conclusion that 2020 will be a challenging year for Emerging Market economies. Not only is the promising growth trajectory of some economies under threat, but fiscal dynamics will be hit hard by lower tax collections and reducing natural resource rents. Some governments will face a protracted struggle to recover the gap generated by big fiscal deficits, heavily financed by non-domestic flows. That does not make the most compelling backdrop for institutional money.

However, one must not forget that first and foremost this is a human crisis. As investors, we are responsible not only for keeping the lights on in the countries, cities, and communities in which we operate, but we have a moral duty to protect the welfare of our portfolio company employees – 120,000 of them in Actis' case. As owner-operators, we are able to make positive and complementary interventions, which mitigate the risk for local communities, while safeguarding the interests of those employees and other stakeholders who have entrusted us with their capital.

But, looking through the immediate crisis, there will likely be a wide-open Emerging Markets door, which can provide a win-win for both providers and consumers of capital.

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It is likely that governments will look to foreign direct investment to bridge fiscal holes. In an environment of tight domestic monetary conditions and reduced cross border flows, the buyers of these assets have considerable advantage. Undervalued currencies and economies have provided excellent subsequent returns for foreign investors. General economic conditions are more volatile as an offset, so that in turn will require a lower price entry point to justify reward for risk.

Those deploying private capital are currently sitting on a staggering US$1.5 trillion of dry powder. A portion of this will be integral to maintaining and expanding hard and soft infrastructure in Emerging Markets, and demand for assets with long duration and stable cash flows closely linked to social stability will be significant. This translates into demand for electrification and social infrastructure to provide employment, economic growth and stability. A prime example is continued investment in low cost, low carbon energy, which is both a fundamental developmental building block, and a key part of expanding capacity and resilience.

Right now, Chief Investment Officers and other investment decision makers will be looking for stable cash flows at low prices without excessive liabilities attached. These asset types will be at the top of a limited list of spending priorities. Buyers with dry powder will be in excellent positions to capitalise on these.

Covid-19 is ravaging economies and savings. Asset owners will struggle for a long time to recover the lost ground. Taking the safe option is understandable while this awful tempest rages, and "getting back to land" as it abates takes skill and entails calculated risks. But, many of the opportunities mentioned in long duration yielding assets are already present or will soon emerge. Institutional investors just need to keep their eyes open to them. The good news is that these opportunities can also simultaneously address the developmental funding gaps in countries that make up most of the world's population and resources – the vital Emerging Markets.