

2014 VC/PE Investor Index: Life begins after 45

The 2014 Venture Capital and Private Equity Country Attractiveness Index suggests PE investments come alive when a country's index score surpasses 45.

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Is there a hurdle rate at which private equity (PE) investments come alive? Is there a point at which countries have a sufficiently developed "PE infrastructure" to create appropriate deal flow?

Using the United States as the benchmark, the authors of the annual Venture Capital and Private Equity Country Attractiveness Index analyzed the socioeconomic data of 118 countries to identify a strong link between their attractiveness scores and actual PE activity. They determined that a country with approximately 45 index points or more seems to mark the turning point when PE activity comes alive.

If they're right, then according to their 2014 ranking, Kazakhstan, Georgia and Kuwait stand at this juncture. It will be worth watching to see whether these countries progress or regress along the six drivers identified by the authors as being key for attracting future investment.

The six key drivers are: economic activity; depth of capital markets; taxation; investor protection and corporate governance; human and social environment; and entrepreneurial culture and deal opportunities, which encompass aspects such as innovation capacity, the ease of doing business and the development of high-tech industries.

The index, now in its fifth edition, is prepared annually by IESE's Center for International Finance, in conjunction with EMLYON Business School, to help investors identify the countries with the most potential for investment.

Small movements at the top

As in previous years, the United States and Canada once again topped the 2014 ranking.

Singapore moved up two places, overtaking the United Kingdom and Japan, which dropped to fourth and sixth places, respectively.

Hong Kong moved into fifth place — demonstrating the ability of yet another city-state to punch above its weight in being an attractive destination for investment.

As the index has been running for several years, investors now have a better basis on which to compare and contrast countries, calculating changes and monitoring positioning trends based on data going back to 2000.

Reading between the headlines

Ukraine's investment prospects have generally improved over the past five years, moving up to 63rd this year from 82nd in 2010.

However, despite its compelling economic growth prospects and the liberalization of the capital market environment, the index indicates that Ukraine's institutional and social/political frameworks are challenging. It remains to be seen how the volatile political situation and Russian saber-rattling of recent weeks will reveal itself in next year's index.

For some investors, such turmoil makes them panic and flee, while others regard it as par for the course when it comes to investing in emerging economies.

Indeed, the BRICs (Brazil, Russia, India and China) continue to experience strong investor attention, in spite of the fact that key drivers related to investor protection, human and social environment, and entrepreneurial culture remain rather poorly developed in these countries.

Russia, for example, though characterized by relatively strong economic activity and capital markets, suffers from perceived bribery and corruption, and innovation and corporate R&D are comparatively weak.

While the BRICs remain the darlings of investors, the emerging economies of Indonesia, Mexico, the Philippines and Turkey show the highest potential for meaningfully increasing PE activity in the near future.

All four countries have gained attractiveness over the past five years, with Turkey and Mexico

ranking even ahead of Brazil and Russia.

Close on their heels are Indonesia and the Philippines, which increased its attractiveness by 22 positions and now stands in 42nd place.

Despite these economies being smaller than those of the BRICs, the real growth perspectives of these four countries are encouraging, owing to their strong economic potential combined with their large populations.

Besides these four, other countries whose medium-term prospects show promising development of PE attractiveness are Malaysia, Finland, Chile, Colombia, Lithuania, Oman, Peru, Morocco and Estonia.

As the authors of the index note: "The landscape of investable emerging markets is enlarging. However, there are also many countries that are probably not yet sufficiently mature to support the PE investment rationale. Our index helps assess the maturity of countries with respect to sustaining the PE business model."

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