2013 trends in VC/PE country attractiveness

Venture capital and private equity funds are increasingly looking to emerging economies for investment opportunities — and not only in the BRICS, but also in fast-growth economies.

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Investors in VC/PE funds continue to look to emerging regions for new, attractive opportunities, especially with the European economy stagnating and the United States growing at a snail's pace.

To help investors identify the best opportunities, IESE's Center for International Finance, in conjunction with Ernst & Young, has published its fourth annual Venture Capital and Private Equity Country Attractiveness Index. The 2013 edition includes two new entrants — Belarus and Cambodia — boosting the total number of countries surveyed to 118.

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

The idea is to determine the relative positioning of particular economies and regions in relation to their attractiveness for investment in VC/PE assets. The index does not compare directly with 2012, but calculates changes over a five-year period (2008-2012) with the enlarged country sample.

As the report states, longer time periods are ideal for examining the shift from traditional, mature markets toward emerging regions.

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Closing the gap

This year's top five remain unchanged from last year, with the United States again topping the ranking, closely trailed by Canada, the United Kingdom, Japan and Singapore. That said, the gap between these and other countries has narrowed considerably compared with previous editions.

All the same, the higher ranked core markets continue to tick more of the key boxes — with the obvious exception of economic activity. The United States, for example, usually ranks far ahead in the capital market.

For a country to have a high rank, it needs to achieve a high score on all of the criteria — something that continues to elude many of the world's emerging economies.

Until the big emerging economies can challenge the United States across the board, they will continue to lag, even as they become more attractive.

Other BRICS in the wall

The index reveals recent strong investor interest not only in the BRICS (Brazil, Russia, India, China and South Africa) but also in other emerging economies such as Turkey, Mexico, Indonesia, Nigeria and the Philippines, suggesting that investors would be well-advised to expand their vision beyond what are often touted as the "hot" markets.

That said, the survey expresses reservations about these emerging markets, most notably in relation to the disequilibrium between exceptional growth opportunities and advanced financial market infrastructure.

This often comes at the high cost of disadvantageous investor protection, corporate governance, human and social environment, and entrepreneurial culture. Deal opportunities are also less developed in general.

Corporate governance levels and investor protection remain concerns, while bribery and corruption levels remain high, and innovation and corporate R&D low. These factors particularly affect Russia, a relative laggard among the BRICS.

Most worrisome, growth and wealth creation in the BRICS are often confined to certain regions and small elites. Until growth benefits are more widespread, the BRICS are unlikely to improve across the board.

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Should growth slow — a clear possibility, with even China experiencing a relative slowdown recently — their VC/PE attractiveness rankings are likely to drop.

As the authors note: "If you are an investor, please enrich the information provided with your own expertise and knowledge about the key driving forces and market conditions in the individual countries to make your allocation decisions."

"If you are a politician, please use our analyses as a demonstration of how investors can evaluate and benchmark countries."

"As we continue to update our index annually, we very much appreciate any critique and comment on our approach and findings."

See Venture Capital and Private Equity Country Attractiveness Index 2013

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