Thesis Report

"Emergence & Scope of Private Equity in the Developing World with the focus on the concerning Issues in Private Equity Regulations in Pakistan"

Submitted to

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Acknowledgement

All praises are for Allah Almighty who has blessed me with power of knowledge and wisdom. I would take this opportunity to thank my parents for their love, appreciation, continuous support and help, without which I wouldn't be here today where I am. I owe my success completely to my parents, especially to my father whose ever encouraging nature has never let me down during any difficulty of life.

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Abstract

Private equity is a product of pure capitalism which has emerged as a major component of the alternative investment options and is now broadly accepted as an established asset class with in many institutional portfolios. Private Equity works on the phenomenon of **"Buy a business, don't rent stocks."** Though PE is highly international but it is a rather new concept in the Middle East region.

The second chapter of the report deals with the rapid growth in the global private equity investment industry, which has played a major role in the emergence of this asset class in the Asian Developing Countries. It focuses how Asian private equity industry has changed profoundly since the last decade. This has been partly the impact of the Asian financial crisis and the bursting of the high tech bubble, which have had a dramatic impact on corporate valuations creating the opportunity to buy good businesses at distressed values and to add value through restructuring. The study further highlights the increased appetite of PE for emerging markets; particularly **China and India** where we saw investors had pour record sums into private equity funds last year. China is a land of private equity opportunity and its private equity market is booming, with remarkable **US$4.96 billion** of private equity investments completed in the **first five months of 2006**, compared to **US$4.04 billion** for all of **2005**. The continuing attraction of the China market is linked in large part to an enormous improvement in returns over the past few years. China's private equity boom has been driven by strong returns and a series of high-profile exits over the past two years. Compared to China though the Indian market is still small from a global perspective, but the **US$2.74billion** raised in **2005** represents a tenfold increase in fundraising in just two years. Success in Indian private equity has been driven fundamentally by the extraordinary growth of the country's large and liberalizing economy.

The third chapter of the report discussed the current economic situation of Pakistan and the scope of Private Equity in Pakistan. In **Pakistan**, there is a huge **mismatch between the growing appetite of institutional and contractual saving institutions for long term investment vehicles and the demand for long gestation mortgage, infrastructure, real estate and project financing**. There is a strong need to establish and strengthen institutions required for competitive and free market economy that fosters to growth and prosperity of Pakistan. Substantial progress had been made in not only reviving over all growth of the economy but Pakistan had also been taking initial steps in reducing internal and external micro-imbalances, bridging public and external debt ratio to sustainable levels and maintaining market determined interest rate and exchange rate leading to upgraded creditworthiness for Pakistan in international capital. This betterment in the financial position has also gained the attention of many foreign investors who are particularly interested in venture deals or pooled equities. **In Pakistan growth in private equity is almost negligent**; perhaps because of the strict rules and regulations implied by the macroeconomic environment of the country.

The fourth chapter analyzed the issues concerning the private equity regulations in Pakistan where the uncertain political and economic situation in Pakistan has reduced the potential for an increase in Private Sector Business Operations (PSB's) in the short to medium term. Loss of investor confidence has reduced the country's ability to raise long term financing for projects, both domestically and internationally, and is one of main challenges the country is facing during the current period**.** The perennial debate within the private equity community and regulators in Pakistan is whether regulations helps or hinders this industry. Some private equity and venture capital associations believe that greater control and increased transparency will attract new investors to this asset class in Pakistan and will result in a higher level of commitment from investors**.** Concerning issue in regulating this sector is to understand the relationship between private control, private benefits and profit maximization.

The findings of the report shows that the contractual savings institutions in Pakistan are highly segmented narrowly focused and making sub-optimal returns on the assets they manage. It is the joint responsibility of the Government, regulators and the industry to mobilize and manage these savings in an optimal and professional manner. As private pension funds, provident funds and endowment funds would be developed and managed in an effective way, the overall domestic savings rate in the country will rise subsequently.

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List of Acronyms

Asian Development Bank	**ADB**
Asian Private Equity Research	**APER**
Asia Private Equity Review	**APER**
Business Process Outsourcing	**BPO**
Centre for Asian Private Equity Research	**APER**
Domestic Ventures Capital Fund	**DVCF**
Emerging Market Private Equity Association	**EMPEA**
European Venture Capital Association	**EVCA**
Freedom of Information Act	**FOIA**
General Partners	**GPs**
Hong Kong Stock Exchange	**HKSE**
Initial Public Offerings	**IPOs**
Internal Rate of Return	**IRR**
Limited Partners	**LPs**
National Association of Securities Dealers Automatic Quotation	**NASDAQ**
New York Stock Exchange	**NYSE**
Securities and Exchange Commission of Pakistan	**SECP**
State Bank of Pakistan	**SBP**
Venture Capital	**VC**

INTRODUCTION

PRIVATE EQUITY IN DEVELOPING COUNTRIES

PRIVATE EQUITY IN PAKISTAN

CONCERNING ISSUES OF PRIVATE EQUITY REGULATIONS IN PAKISTAN

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Chapter 1

Introduction

1.1 Research Topic

"Emergence & Scope of Private Equity in Developing Countries with the focus on the Concerning Issues in Private Equity Regulations in Pakistan"

Private Equity

Private equity is the term applied to privately negotiated instruments which are generally illiquid and thought of as long-term investments. Theoretically; private equity is a product of pure capitalism which has emerged as a major component of the alternative investment options and is now broadly accepted as an established asset class with in many institutional portfolios. ***The Economist*** has lately dubbed private equity funds as *"Capitalism's new kings"*[1], commenting on the astonishing growth in the amount of money managed by these funds.

In general private equity investments may be described as investments in unlisted securities through a negotiated process. They typically involve **transformational, value-added and active strategies that are supported by specialized skill sets** (GCC Private Equity-July 2006). There are many definitions of Private Equity but perhaps the most suitable for this research dissertation is the one defined by the European Venture Capital Association (EVCA) as;

"A process where equity capital is made available to companies not quoted on a stock market. "Private equity," the EVCA's definition continues, ***"can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's balance sheet."***

Traditional investment focus on listed securities such as listed equity shares, debt securities and exchange-traded derivatives[2]. In recent years, private equity investments, that is, investments in unlisted equity shares have become increasingly popular in the asset management industry. Private equity fund is usually a pool of capital contributed by high net worth individuals and institutional investors for making private equity investments, and is managed by a fund manager with certain industrial experience and expertise. Private equity fund manager may also provide management and operation advice to investing businesses, in additional to equity investment.[3]

[1] 27 November 2004, The Economist.
[2] Exchange-traded derivative contracts are the standardized derivative contracts (e.g. futures contracts and options) that are transacted on an organized futures exchange. These contracts can include futures, calls and puts.
[3] Private Equity Investments, *Half Yearly Economic Report 2005*

Private equity investing means putting capital into a business to expand develop new products or fund changes to ownership and management. Private equity investors do more than buy the rights to share in a company's return – they provide working capital. As respected investor Warren Buffett puts it:

"Buy a business, don't rent stocks."

Private equity investors generally provide their capital in exchange for a sizeable stake in the business. They also invest their expertise – in management, finance, marketing, strategic direction and networks. By exercising some control through board seats and management agreements, private equity investors can protect and grow their investment. This alignment of interests and the ability to add value to the business often means that private equity investors can generate higher returns than those available from traditional 'hands-off equity investing'.

A private equity phenomenon is highly international but it is a rather new concept in the Middle East region[4]. In terms of cost of capital, private equities are invariably costlier than public equities and other non-exotic debt instruments. However, their costs and strict conditionalities are generally backed by immense project management expertise provided by private equity houses, which justify the cost versus benefit trade off. Private equity players as opposed to public equities are active investors with several privately negotiated and privileged rights.

Factors that work in favor of Private Equity investments are

- PE firms increasingly help companies to maximize their long-term value by protecting them from stock market pressures.
- PE firms management, industry and financial expertise helps in the business success of the invested companies by sharing in the risks and rewards with practical advice, like a true business partner.
- Improved corporate governance and lessening agency problem.
- Provides a solid, flexible, capital base to meet your future growth and development plans.
- Good for cash flow, as capital repayment, dividend and interest costs (if relevant) are tailored to the company's needs and to what it can afford.
- Exit after creating value in the investment.

Private equity investments are not subject to the same high level of government regulation as stock offerings to the general public. Private equity is also far less liquid than publicly traded stock Therefore, any investor looking to sell his/her stake in a private company has to find a buyer in the absence of a marketplace. *Returns on private equity*

[4] Global Investment House, "Private Equity - The Rise of Desert Capitalism", July 2006

generally occur in three ways: **a merger or strategic sale, an initial public offering, or a recapitalization.**

Classification of Private Equity

Private equity could be classified into a number of categories:

- **Venture Capital:**
  Venture capital is a type of private equity capital typically provided by professional; institutionally-backed outside investors to new, growth businesses. It is a pooled investment vehicle (often a partnership) that primarily invests the financial capital of third-party investors in enterprises that are too risky for the standard capital markets or bank loans.[5]

- **Mezzanine Capital:**
  Mezzanine capital (or mezzanine debt) is a broad financial term that refers to unsecured, high-yield, subordinated debt or preferred stock that represents a claim on a company's assets that is senior only to that of a company's shareholders. (Wikipedia). It is a subordinate debt with equity warrants for financing leverage buyouts is usually provided to profitable business pending for Initial Public Offerings (IPOs).

- **Buyout Capital:**
  A buyout capital is used in gaining a controlling interest of a business and might involve high leverage financial strategy.

Risk and Return in Private Equity

Private equity investments are manifestation of high risk-high return portfolio. Venture capital is the riskiest form of private equity investments but its potential return is also the highest. Generally speaking, private equity funds can reap their return when the investing business successfully initiates its IPO in stock exchanges[6]. Alternative forms of exit include selling the unlisted shares to a larger company and seeking repurchase by the investing business.

Structure of Private Equity

Private equity investors are principally institutional investors such as endowments and pension funds. These investors, called Limited Partners (LPs), commit a certain amount of capital to private equity funds, which are run by General Partners (GPs). GPs search out investments and tend to specialize in either venture capital (VC) investments or

[5] Venture capital renders working funds for young and growing businesses to commercialize their innovations and products. Overseas experiences demonstrate that venture capital could act as catalyst for the development of innovation and creative activities.
[6] Many companies backed with venture capital were listed on the secondary boards (e.g. Nasdaq in U.S.), which have a lower listing requirement on profitability and financial position.

buyout (BO) investments. In general, when a GP identifies an investment opportunity, it "calls" money from its LPs. When the investment is liquidated, the GP distributes the proceeds to its LPs. The timing of these cash flows is typically unknown ex ante. **(Appendix 1)**

1.2 Significance of the Study

The rapid growth in the global private equity investment industry[7] has played a major role in the emergence of this asset class in the Asian Developing Countries. This evolution and growth of private equity investments in the developing economies has been driven by a narrowing in the perceived risk differential between private and public equity portfolios, easier access to private equity funds for investors, better exit opportunities through the financial markets and continued out performance by private equity in terms of returns. There is an increasing public awareness and interest all over the world on the roles of private equity and entrepreneurship in contributing to economic growth through the development of successful business.

Private equity, and more specifically venture capital (a sub set of private equity), is considered an ideal solution for the economic growth and development of the country, by providing the finances with active support of governance and mentoring of the start-up companies. In modern form private equity funds are pool of capital that invests in projects with an expectation of significant returns for the investment risk involved. Private equity is definitely a high risk and high return business.

In Pakistan, there is a huge mismatch between the growing appetite of institutional and contractual saving institutions for long term investment vehicles and the demand for long gestation mortgage, infrastructure, real estate and project financing. Private equity and venture capital funds, private pension and provident funds and insurance companies can play an important role in filling in this market segment. There are institutional investors, who are always very keen to obtain a traditional banking license to exploit the vast potential by setting up these new types of funds which are almost non existent in the country but are badly needed.

There is a strong need to establish and strengthen institutions required for competitive and free market economy that fosters to growth and prosperity of Pakistan. Substantial progress had been made in not only reviving over all growth of the economy but Pakistan had also been taking initial steps in reducing internal and external micro-imbalances, bridging public and external debt ratio to sustainable levels and maintaining market determined interest rate and exchange rate leading to upgraded creditworthiness for Pakistan in international capital. This betterment in the financial position has also gained the attention of many foreign investors who are particularly interested in venture deals or pooled equities.

The need of hour on the part of the Securities and Exchange Commission of Pakistan (SECP) and State Bank of Pakistan (SBP); is that they should render all possible assistance to those who wish to move into the fields of private equity funds, venture capital funds, private pension and provident funds, and similar other vehicles.

[7] Pension funds in the United States and Europe are likely to double their allocation to this asset class i.e; Private Equity Investment, by the year 2010.

1.3 Scope of the Study

Private equity industry is currently on the start up of a boom cycle in the Asian Equity Market, and it has affected the investment of policies of more or less all the Asian countries.

This dissertation attempts to assess the scope and emergence of private equity[8] in the developing world, broadly in Asia and specifically focusing on the emergence of Private equity in the neighboring countries; China and India. Conclusions have been drawn by taking evidences from the current economic situation of China and India, and analyzing the assets they have in the investment market that helps them catching the eye of the foreign investors. The study further analyzes what are the main strengths that these countries are encashing upon for the growth and development of the private equity market in the country.

The research also analyzes the current position of private equity investments in Pakistan, their scope and role in the development of country. Furthermore it identifies the industries which are more suitable for the private equity investments in the country. The study discusses various issues concerning private equity regulations in Pakistan and to find out the causes and sources of theses issues. The conclusion is drawn by highlighting what are the steps needed to be taken by the Securities and Exchange Commission of Pakistan, to regulate the private equity investments in the country.

[8] The term Private Equity in this research work covers also the investments in Venture Capital and Management Buyouts.

1.4 Research Methodology

Significant work is done on the analysis and scope of Private Equity Investments in Asia and the data of most of them is available publicly also. Qualitative research methods are used for conducting the research work, which includes observational research through case studies and daily newspaper articles. For the study of emergence and scope of private equity in the developing market, most of the research material is drawn from the **research publications done by the renowned authors of the financial market**, Internet research about the data available on the economic conditions of the developing countries and the amount and number of private equity investments in the region. In addition, books and **case studies** have also been consulted to draw the conclusions for the feasibility of private equity investments in the developing economies.

For the scope and initialization of private equity investments in Pakistan, there is no much data or research material available to the public as the medium of investment is fairly new in the country and till now only one major deal[9] has been done in this respect. The research in this area is mainly relying on **the interviews being taken by SECP and Ministry of Finance personnel**, about the current position as well as the future of Private Equity Investments in the country as well as the concerning issues in the regulations of private equity investments in Pakistan.

Further research methods include:

- Internet Search
- Books and Magazines
- Research Publications

[9] **Abraaj Capital**, the Dubai-based private equity firm, has made its first investment in Pakistan with the acquisition of a 50 percent stake in BMA Capital Management, which is the Pakistani financial securities sector adviser and manager, and is a member of the Karachi Stock Exchange.

1.5 Literature Review

Financial economists generally believe that private equity and venture capital funds exist to address the substantial information gaps between investors and entrepreneurs, especially those in rapidly growing and restructuring firms. By carefully structuring the initial transaction and intensively monitoring the firm after the private equity investments, entrepreneurs as well as investors can avoid many of the problems that deter banks and other financiers from investing in these settings. Theorists from **Chan (1983)** to **Cornelli and Yosha (2003)** have argued that many of the features of private equity investments, such as the use of convertible preferred securities, makes these investments more suitable and convenient for the businesses.

There is a growing literature studying the economics of the private equity industry in the emerging economies. Most of those studies have focused either on aggregate trends in private equity or on the relation between GPs and entrepreneurs. This restriction is mainly due to the difficulty of obtaining information on individual fund performance. Two recent exceptions are **Jones and Rhodes-Kropf (2003)** and **Ljungqvist and Richardson (2002)** who study private equity returns at the fund level.

Papers that focus on the relation between GPs and entrepreneurs, and the amount and disclosure of critical information from the investment point of view, include **Kaplan and Strömberg (2003)**, who document the structure of transactions between the private equity investors and entrepreneurs. **Gompers and Lerner (2000)** looked at aggregate performance of the economy and capital flows in the country and suggested that the valuation of individual deals is affected by overall macroeconomic conditions and the degree of competition in the private equity industry.[10] They analyzed that the changing in macroeconomic factors, such as past industry performance and overall economic performance as well as changes in the capital gains tax or provisions, have a great affect on the capital flows into private equity.

Another research conducted by **Josh Lerner and Antoinette Schoar** about the Private Equity in the Developing World, they focused on the determinants of transaction structures in private equity industry. **Cummings and MacIntosh (2002)** conducted their research about the how the legal and political regulations affect the types of investments selected, and the way in which the private equity groups exit their holdings. They focused on examining the types of transactions funded and exit routes employed in 12 Asian nations.

Lerner and Schoar (2004) highlight that in developing countries the bulk of financing is through private equity. In a study of **210 private transactions** they find that the structure of a country's financial regulatory system greatly affects the private contract that arises, which cannot always be avoided through private solutions.

[10] "The Journal of The American Finance Association," Volume 60 - August 2005

In a study by **Levitt** in **1998** highlighted the fact that in order for a market to function efficiently and attract investor interest, there needs to be effective enforcement of rules that regulate transparency and disclosure. Equity market regulation is justified as a tool to guarantee investors a level-playing field. A cross-sectional study on the effect of securities market regulation and cost of capital finds that stricter regulation (in the form of high disclosure requirements set by the exchange or government) and strong enforcement is associated with lower cost of capital **(Hail and Luez 2003).**

In a preliminary and incomplete research work done by the **Securities and Exchange Commission of Pakistan (2004)** on "The Concerning Issues in Private Equity Regulations in Pakistan", the researchers has tried to analyze the factors that are responsible for the growth of this industry in the country. Their attention was focused on the concerning issues in the regulations of private equity investments in Pakistan, that are a major obstacle in the growth of this industry. After that, the report also suggests some steps to be taken by the SECP in this regard to provide a more conducive and competent environment for the private equity investors to invest in this country.

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Chapter 2

Emergence & Scope of Private Equity in Developing Countries

"As emerging markets private equity becomes a more widely accepted allocation strategy among investors, we should continue to see growth, albeit at a more sustainable pace than the break neck growth we saw in 2004–2005."

EMPEA[11] president Sarah Alexander

2.1 Fund Raising in Emerging Economies

Private equity funds in the developing countries[12] have been flourishing in the past 10 years. Private equity activities are expected to continue to grow rapidly in the **Asia-Pacific region, the brightest emerging market**. **(Appendix 2)** An increased appetite for emerging markets; particularly **China and India** saw investors pour record sums into private equity funds targeting this region last year. Several large-scale management buyouts in South Korea, Japan, China and India, in recent years demonstrated that private equity funds could make decent returns in the region.

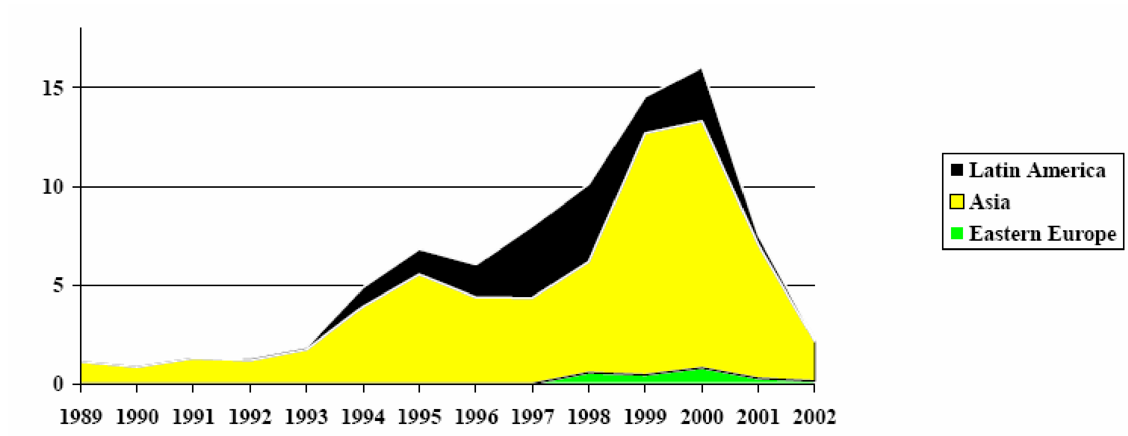


Fig 2.1: Developing nation private equity fundraising by year, 1989-2002

The figure shows the developing nation private equity fund raising form year 1989 to 2002. It is very clear from the figure that a major portion of private equity fund has been raised by Asia during the 14-year time period. This shows that there is a lot of growth and scope for private equity investment in this region and there is a huge appetite for emerging economies for this investment class.

[11]Emerging Market Private Equity Association (EMPEA)

[12] According to the **World Bank**, developing nations are those countries that have either low- or middle-level per capita incomes; have underdeveloped capital markets; and/or are not industrialized.

Developing country economies in Asia Pacific grew at an average of **8.0 % in 2005 and 2006**, boosted by strong growth in China, Indonesia and India. China is receiving roughly **$50 billion** in foreign direct investment annually, and Asia-Pacific as a whole is enjoying flows of well over **$100 billion**[13]**.**

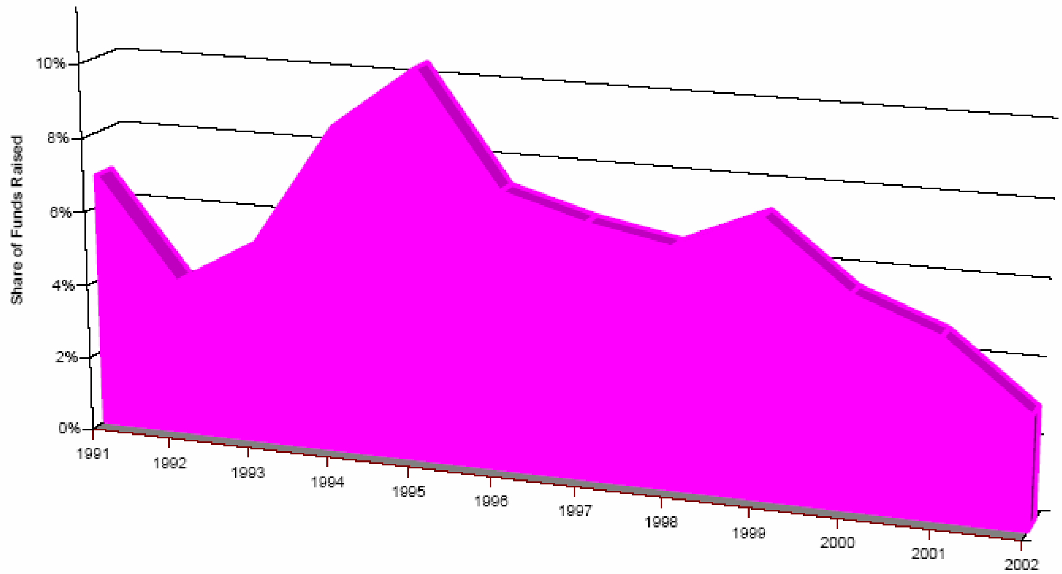


Fig 2.2: Developing countries' share of global private equity fundraising, 1991-2002

Private equity funds targeting emerging markets raised more than **$33 billion (€25 billion) in 2006**, **29 % more** than the previous year[14] and were **US$101,100 million** in the first-half of **2004**, from **US$30,950 million** a **decade earlier**. This represented an **average annual growth rate of 13%**[15]. These increasing figures are a sign of escalating investor appetite for emerging markets. The figure below represents the figures of 2005, where the fund managers raised over **US$22bn for the asset class, more than triple then the amount in 2004.** Although, all regions have posted a remarkable increase in fund raising of emerging markets but Asia led the way with a remarkable burst to **US$15.4bn**. Central & Eastern Europe and Russia were second with US$2.7bn raised.[16]

[13] International Finance Corporation, World Bank Group, "The Future of Asia's Emerging Market"
[14] Emerging Markets Private Equity Association, March 2007
[15] The total represents a **29% increase on 2005**, when **$25.8 billion** was raised, and is more than five times the **$6.5 billion raised in 2004**.
[16] EMPEA Releases 2nd LP Survey

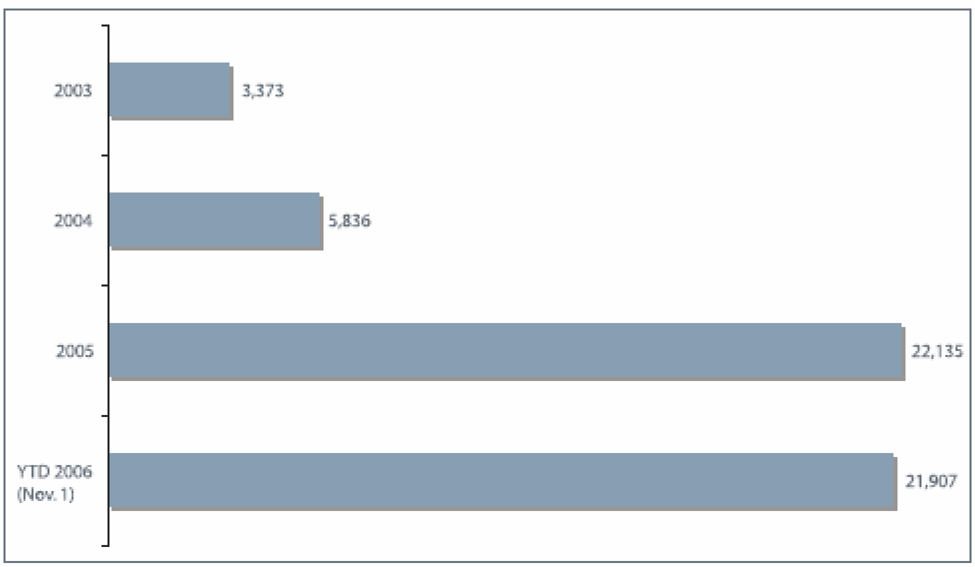
EM FUNDRAISING 2003 - 2005 (US$m)				
	2003	2004	2005	% Chg '04-'05
Asia (ex Jap / ANZ)[1]	2,200	2,800	15,446	552%
CEE & Russia[2]	406	1,777	2,711	53%
Latin America[3]	400	1,020	2,067	103%
Africa & Middle East	350	545	962	77%
EM Total	3,356	6,142	21,186	245%

1 Excluding Japan, Australia, New Zealand
2 CEE & Russia: 2003 data does not include Russia or non-EU accession states
3 Latin America data includes real estate funds; other regions do not. Non-real estate PE fundraising for 2005 in Latin America was about $750 million

Source: *EMPE, Quarterly Review, Volume II, Issue 1, Q1 2006*

Table: 2.1: Emerging Market Fund Raising 2003-2005

The figure below shows the fund raising for emerging markets private equity from the year 2003 to November, 2006. There is a **significant increase** in the amount raised for the emerging market private equity investment from 2003 to 2006. The figure clearly



Source: *EMPEA Estimates*

Fig 2.3: Emerging Markets Private Equity Fund Raising 2003 – 2006

shows the figures for November, 2006, likely to beat the figures for the year 2005, which were a record last year for the private equity fund raising. In 2005, fundraising topped **$22 billion**, almost four times the **$5.8 billion raised in 2004**. For 2006 year through November 1, estimates shows that $21.9 billion has been raised already.

2.2 Rationales for Private Equity in Developing Countries

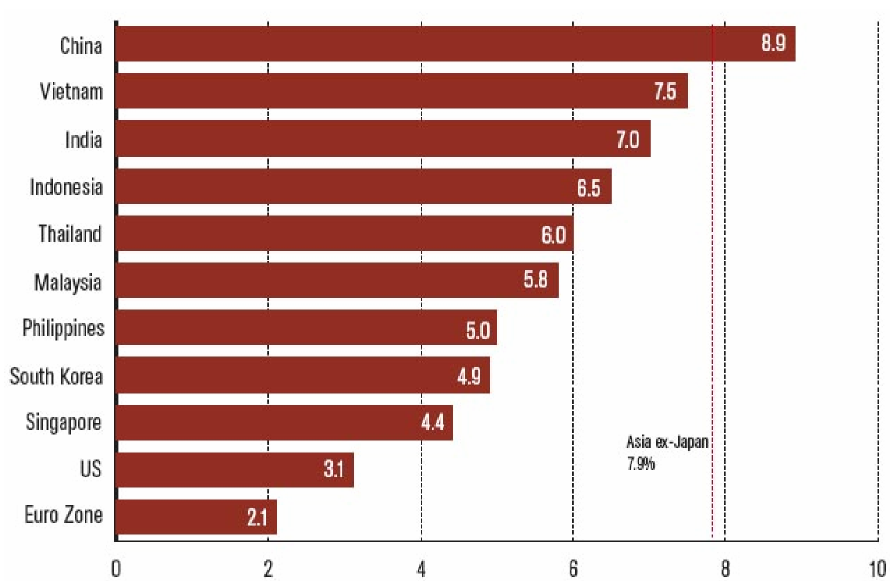
In a study by **Carter, Barger, and Kuczynski (1996)** and **Sagari and Guidotti (1992),** they explained that there are two sets of rationale for the interest in private equity activity in the developing world during recent decades, which are;

2.2.1 Changes in the Developing Nations

The macroeconomic situation of a country has a major impact on the investments made in the country, by the foreign investors. Any change in the macroeconomic and investment policy, such as the **reduction of trade barriers and enhancement of intellectual property protection** can result in the percentage increase of the investment. Evidences show how China and India gained the attention of foreign investors by giving them leverage in investment policies and providing them a suitable environment for the investment. External changes e.g., **technological innovations in transportation of goods** have also accelerated the integration of developing nations into the world economy.

2.2.2 Changing Conditions in the Developing Nations

The second set relates to the changing conditions in the developed nations. Many institutional investors have been skeptical that the attractive returns characterizing venture capital and leveraged buy-out funds in many developed nations could be sustained, and looked for new arenas in which to invest. However, in a research conducted by **International Monetary Fund in 2001,** it concluded that the emerging market economies grew at **5.8%**, and is considered very attractive place for investments.



Source: *Asian Development Bank*

Fig 2.4: 2007 GDP Growth Forecast of Developing vs Developed Countries

2.3 Private Equity Fund Structure in Developing Countries

The macroeconomic environmental factors greatly affect the size and nature of available financing opportunities, as well as the subset that are attractive to professional private equity investors. These factors include **extent of economic development in the nation, the nature of the opportunities faced by the private equity investors**, (which may differ substantially with the degree of development of the nation), which will in turn be a function of its initial resources and many other considerations. Although, the private equity funds are structured on the same guide lines all over the world, however there are some differences in its implementation, in developed and developing countries.

2.3.1 Fund structure

The fund structure standard in developed countries is the limited partnership. The general partners are the individual venture capitalists (or an investment management firm controlled by these individuals). The general partners are in charge of raising, making, monitoring, and exiting the investments. In return they are paid a management fee plus a share of the profits. The limited partners are prohibited from playing an active role in managing the investments and usually enjoy tax benefits. But in many portions of the developing world, particularly in Asia, there has been a general lack of legal structures that allow the establishment of limited partnerships. In these regions, many funds have been structured as corporations, which often do not have the forced liquidation feature of limited partnerships.

2.3.2 Funding sources

Many of the sources of capital for private equity funds for private equity funds in developing countries are similar: e.g., pension funds and university endowments typically based in the developed world. Several additional parties, however, have played an important role in the raising of private equity funds in developing nations. These have included foreign aid organizations like the U.S. Agency for International Development, quasi-governmental corporations like the Overseas Private Investment Corporation, and multilateral financial institutions like the International Finance Corporation.

2.3.3 Types of investments

Private equity funds in developing nations undertake transactions familiar in the United States, including leveraged buyouts, consolidations of fragmented industries, and venture capital investments. But they also undertake several types of transactions less common in the U.S. setting, including investments in privatizations, infrastructure projects such as highways and shipyards, and strategic alliances.

2.3.4 Exiting

Perhaps the most vexing aspect of private equity investing in developing nations has been the difficulty of exit. The fortunes of private equity investors in the developed world have been largely linked to those of the market for initial public offerings (IPOs). Private equity investors in developing countries cannot rely on these offerings. Even in “hot markets” where large foreign capital inflows are occurring, institutional funds are usually concentrated in a few of the largest corporations. Smaller and new firms typically do not attract significant institutional holdings, and have much less liquidity. Consequently, private equity investors in developing countries have tended to rely on the sale to portfolio firms to strategic investors. This can be problematic, however, when the number of potential buyers is small. The purchaser can exploit the private equity investor's need to exit the investment, and acquire the company for below its fair value.

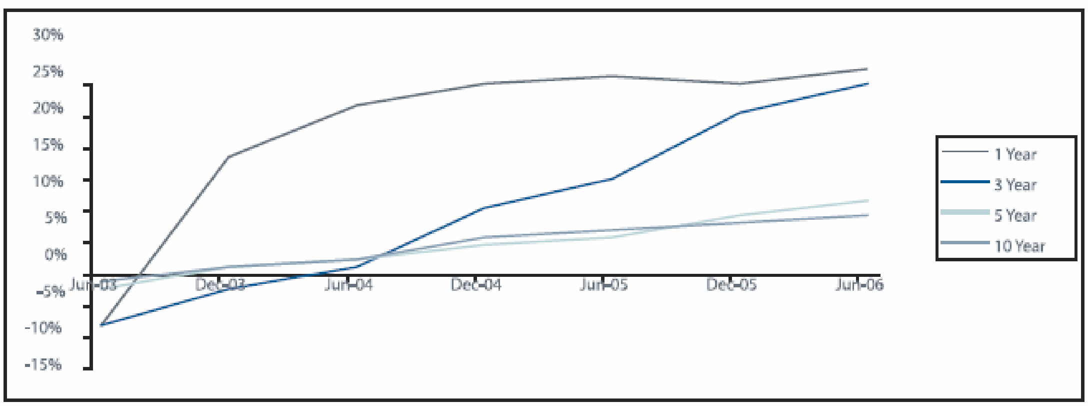
2.4 Rate of Returns on PE in Emerging Markets

Research shows that average return on private equity is similar to that of public equity market index[17], although investing in a private company is much riskier than investing in the public stock.

2.4.1 Expanded Exit Options

Asian private equity managers have now established a strong track record for their ability to exit investments and return capital to their investors. This partly reflects a strong public equity environment creating strong demand for Initial Public Offers (IPOs); but effective exits have also been made through recapitalizations, trade sales and secondary buyouts. Exits are no longer dependent on the IPO cycle. In fact, all the exit options available in the "mature" private equity markets of the US and EU can now be executed in Asia, and this has further encouraged experienced private equity investors to increase weightings in the region.

The figure below shows that since June 2003, 1, 3, 5, and 10-year returns on private equity in emerging markets have been improving steadily.



Source: *Cambridge Associates LLC Proprietary Index: pooled end to end returns, net of fee, expenses and carried interest*

Fig 2.5: Trends in Emerging Markets Private Equity and Venture Capital Returns (as of June 30, 2006)

[17] Research work by Tobias. J. Moskowitz and Annette Vissing Jorgensen, published in *The American Review* in September 2002, used data for all private equity from both the survey of consumer finance (SCF) and the flow of fund accounts and the national income and product accounts (FFA/NIPA) over the period 1989 to 1998 as well as proprietor and partnership data from the FFA/NIPA for a longer period i.e. 1952 to 1999.

The 1-year return has exceeded **20% over the last 2.5 years**. The 3-year return has gone from **9.5% in June 2003 to 22.6% as of June 30, 2006**. This increase reflects the strong cash flows to LPs that have been driven by a significantly improved exit environment over the past few years.

2.5 Private Equity Funds in Asia Pacific Region

Asian private equity industry has changed profoundly since the last decade. This has been partly the impact of the Asian financial crisis and the bursting of the high tech bubble, which have had a dramatic impact on corporate valuations creating the opportunity to buy good businesses at distressed values and to add value through restructuring **(Appendix 3)**. In addition, Asian private equity is growing as an asset class because it meets a number of investors' needs i.e.

- to increase investments in alternative strategies,
- to increase exposure to the Asian region,
- to gain exposure to profitable, high-growth private companies.

2.5.1 Going Ahead on the Curve

Asia's private equity market is beginning to mirror that of the US and Europe, as deals begin to hit the **$1 billion (€757 million)** range and international growth strategies are sought. A sharp rise in fundraising figures for the **Asian Private Equity Market** has generated a growing interest in the asset class among political and industrial leaders in this region. The investors are paying particular attention on how to effectively and efficiently manage private equity firms in the region while coping with demanding regulatory changes and increasing levels of global attention. Private equity in Asia is developing more in terms of a traditional buyout market, where investors focus on operational improvement and long-term investment. Further growth is expected in Asia's private equity market, as larger transactions and international expansions become more common place.

There has also been an acceleration of secular trends, which benefit the private equity investor. Deregulation in this region, has lead to the reduction of influence of entrenched vested interests and increased transparency. This has created an environment in which innovative businesses and meritocratic management can thrive. Another major reason which is well-established in the US and Europe; for the growth of this investment class is that when large conglomerates face growing shareholder pressure to sell divisions or subsidiaries not considered core parts of the business, private equity firms acquire them. Many countries in the region (e.g., China, Japan, and India) are trying to implement the application of international standards of investment, to attract foreign institutional investment. **(Appendix 4 & 5)**

2.6 Private Equity in China

China is a land of private equity opportunity and its private equity market is booming, with remarkable **US$4.96 billion** of private equity investments completed in the **first five months of 2006**, compared to **US$4.04 billion** for all of **2005**. The continuing attraction of the China market is linked in large part to an enormous improvement in returns over the past few years. Much of the China opportunity stems from the government's strong commitment to privatization.[18]

China Private Equity at a glance	
PE Funds Raised 2005	US$2.24 billion
PE Investments 2005	US$4.04 billion
PE Investments 2005 (As % of GDP)	0.18%
No. of Exits 2005	48
Returns to LPs 2005	US$1.86 billion

Source: *Asia Private Equity Review, 2005*

Table 2.2: China Private Equity at a glance (Year 2005)

According to a study by **Dow Jones Venture One and Ernst & Young,** in **2006**, Private Equity investments in mainland China reached its highest point in three years and the scope of non-technology investments have also broadened. Venture capital investments in mainland China reached its highest point in three years with **214 deals** and **US$1.89 billion** deployed, according to China ***Quarterly Venture Capital report*** by **Dow Jones VentureOne and Ernst & Young**. The latest statistics show a **37%** rise in deal flow and a **55%** jump in capital from **2005** levels.

The **HKSE** has proven to be a preferred destination for Chinese IPOs, with businesses from mainland China now accounting for half the market value on the exchange. **NASDAQ** and the **NYSE** are also favored IPO destinations, and it is noteworthy that in **May 2006** the **Singapore Exchange** listed its 100th Chinese company.

[18] Twenty five years ago, 85% of the Chinese economy was dominated by state-owned enterprises (SOEs), while today SOEs account for only 40% of economic activity. The Chinese government's commitment to a thriving private sector has attracted strong growth in foreign direct investment by US and European corporates and has also created space for a viable SME sector. Companies with less than US$40 million of revenue now contribute 55% of Chinese GDP, and approximately 80% of these companies are reportedly profitable.

2.6.1 The Booming China Private Equity Market

China's private equity boom has been driven by strong returns and a series of high-profile exits over the past two years. The **Asia Private Equity Review (APER)** reports that **US$1.86 billion** was returned to LPs in **2005** through **48 exits**, including high profile transactions[19]. According to APER, almost half of the 2005 exits had **IRRs** of more than **200%**. Driven by these staggering returns, private equity investments are expected to surpass **US$6 billion in 2006**, which may push China past Japan in terms of invested private equity capital.

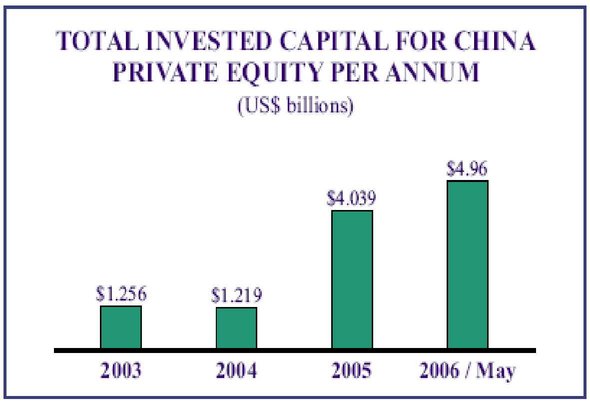
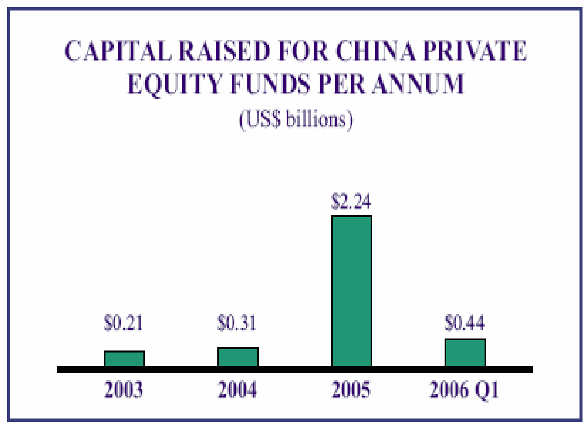


Fig 2.6: Total Invested Capital for China PE per Annum



Source: *Asia Private Equity Review (APER)*

Fig 2.7: Total Capital Raised for China PE per Annum

Figure 2.6 shows the total invested capital for China PE per annum, is continuously increasing every year. The graph shows an abrupt increase from the **US$1.219** in **2004** to **US$4.039** in **2005**, which is almost four times the capital invested in the year 2004. Further growth in investments in China's PE can be seen by observing that the invested capital in this market till **May 2006** is **US$4.96**, which is more than all year 2005 invested capital. This shows that till the year end the invested capital in 2006 will be more than double of 2005. These ever increasing figures depicts that there is huge market growth for the private equity investments in this geographic area.

[19] Baidu's listing on NASDAQ, which gained 354% on its first day of trading, and China Construction Bank's debut on the Hong Kong Stock Exchange (HKSE), which raised US$8 billion

In figure 2.7, total capital raised for China private equity funds per annum is shown where it is very evident that each year the amount raised for private equity fund is increasing at a continuous pace. There is a rapid increase in the capital raised from the year 2004 to the year 2005, which is explained in the figure 2.6 where invested capital has also increased from 2004 to 2005. All this explains that PE industry in China is emerging to be the most opportunistic investment option for the international investors.

2.6.2 The Importance of Growth Equity in China

The growth equity market segment, a sub class of private equity investment, is getting a lot of dominance and popularity in China. China market is elevating the category of growth equity investing to center stage, and this will impact the portfolios of LPs around the world. The country is becoming the meeting point for International and Chinese players from all market segments. VC and traditional growth equity firms are meeting over companies that may be early stage, but already have positive revenues. Growth equity and buyout players are meeting in larger deals where only minority stakes are available.

2.6.3 Companies Investing in Private Equity in China

There are many domestic as well as international players which are investing in Private equity Investments in China. In **November 2005**, ***Carlyle and Prudential Financial*** took a controlling **25% stake in China Pacific Life Insurance for US$409 million**.

REPRESENTATIVE CHINA PE AND VC DEALS

Portfolio Company Name	Lead PE Firm	Other PE Investors in the Transaction	Capital Invested	Stake	Deal Date
Fangtek Electronics Co.	Qiming Venture Partners	DFJ ePlanet Ventures, IDG Technology, New Frontier, Kibo Technology	US$12m		Jun 2006
Gum	Warburg Pincus		US$100m	takeover	May 2006
Shandong Chenming Paper	CVC Asia Pacific		US$623m	30%	May 2006
Worksoft Creative Software Technology	Sequoia Capital		US$30m		May 2006
Toodou.com	Granite Global Ventures	Jafco Asia, IDG Technology	US$8.5m		May 2006
China Worldbest Pharmaceutical Co.	CDH Investment	China Resource Enterprise	US$341m (est.)		Apr 2006
Henan Luohe Shuanghui	Goldman Sachs	CDH Investment	US$250m	25%	Apr 2006
Oak Pacific Interactives	General Atlantic	Doll Capital Management, Technology Crossover Ventures, Accel Partners, Legend Capital	US$48m		Mar 2006
Bank of China	Temasek		US$1,550m	5%	Feb 2006
GOME Electrical Appliances Holdings	Warburg Pincus		US$150m	10%	Feb 2006
Goodbaby Group	Pacific Alliance Group		US$122.5m	takeover	Jan 2006
Industrial & Commerical Bank of China	Goldman Sachs		US$2,580m	7%	Jan 2006
China Pacific Life Insurance Co.	Carlyle Group	Prudential Financial Inc.	US$409m	25%	Dec 2005
Lenovo	General Atlantic	LLC, Texas Pacific, Newbridge Capital	US$350m	10%	Mar 2005

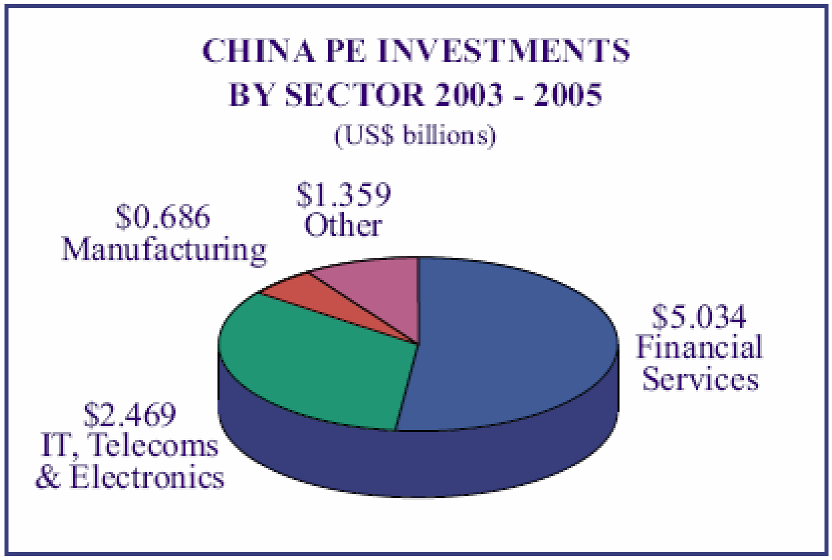
Source: *Cambridge Associates' Emerging Markets data*

Table 2.3: Companies Investing in China's PE

In **January 2006**, ***Pacific Alliance Group*** **took over Goodbaby Group for US$122 million.** In **May 2006**, ***CVC Asia Pacific*** **paid US$623 million for a controlling stake in Shandong Chenming Paper**, one of China's biggest paper companies, and ***Warburg Pincus*** **paid US$100 million for control of Gum**, a food additive producer. The most significant threshold was passed in **February 2006** when **China-based *Legend Hony Capital*** succeeded in acquiring control of the **Chinese glass market** executed through a vehicle called China Glass Holdings in multiple transactions, to control 70% of China glass market.

2.6.4 Sector wise PE investments in China

The figure 2.8 shows the sector wise private equity investments in China. It shows that more than 50% investments are made in financial sector, where larger growth equity transactions took place. Key investments in the financial sector include **Temasek's US$1.5 billion** investment in **February 2006 in Bank of China** and **Goldman Sachs' US$2.6 billion** stake in **the Industrial and Commercial Bank of China**.



Source: *Price Waterhouse Coopers*

Fig 2.8: China PE Investments by Sectors (2003 – 2005)

Information Technology and Telecom sector accounts for almost more than **25%** of private equity investments. In **2006**, **131** information technology companies received **US$920.7 million**, **34%** more capital compared to **2005**. Internet-dominated information services segment proved to be the most popular sub-segment, attracting **US$464.6 million** for **73 deals.**

The manufacturing and other business sector comprised of **8%** and **17%** of private equity investments, respectively. In the other business, comprising consumer and retail industries, there were **57 deals** and **US$613.3 million** invested in **2006**, which is **20 deals more** and **40%** increased capital from **2005**, the study showed. In healthcare, there were **10 deals** and **US$47.5 million** invested, up from **6 deals** and **US$5.8 million** in **2005**. In the energy segment, there was a **tenfold increase** in number of deals from a low base of only **one deal in 2005**.

2.6.5 Issues in Regulation of PE in China

While Chinese private equity is booming, Chinese regulators remain skittish about foreign control in key sectors, such as finance and heavy manufacturing. **Carlyle's** troubled attempt to take over **Xugong Construction Company** is representative of some of the regulatory challenges that still exist for doing business in China.

Three other large buyout deals that have received the most press because they have either been blocked by the government or are in limbo due to staled negotiations between counterparties are **Citigroup's Guangdong Development deal, Warburg's Harbin Pharmaceutical deal** and **Newbridge Capital's Shenzhen Development Bank deal**. The challenges related to closing buyout deals in China are also forcing players like Carlyle to focus equally, if not more so, on the booming growth capital sector[20].

CONTROL DEALS - BLOCKED OR IN LIMBO						
Portfolio Company Name	**Lead PE Firm**	**Other PE Investors in the Transaction**	**Proposed Capital Invested**	**Proposed Stake**	**Deal Date**	**Status**
Guandong Development Bank	Citigroup	Carlyle Group	US$3,000m	85%	Jan 2006	May 2006 China Bank Regulatory Commission blocked deal on regulatory grounds. Parties considering restructuring bid.
Xugong Construction Machinery Co.	Carlyle Group		US$375m	85%	Oct 2005	Jun 2006 Authorities continue to withhold final approval of deal.
Harbin Pharmaceutical Group Holdings	Warburg Pincus	CITIC Capital	US$245m	45%	Jan 2005	Apr 2006 Securities laws altered mid-auction and counterparties back out. Deal appears to be dead.
Shenzhen Development Bank	Newbridge Capital		US$170m	20%		May 2006 Shenzhen Development Bank announced withdrawal from deal, legal action pending.

Source: *Cambridge Associates' Emerging Markets data*

Table 2.4: Controlled Deals in China's PE

Although, China's large and rapidly growing economy is liberalizing fast and a wide range of state-owned companies are looking for strategic foreign investors in the coming years. Despite the size of the market, however, opportunities are limited by underdeveloped management quality and a relatively restricted supply of high-end labor. But, the due diligence and valuation processes in China are often hampered by an absence of verifiable data. Legislation governing foreign investment can be bewildering and arbitrary, especially as authorities' toy with new regulations.

China	Rank
Overall environment for private enterprise	32
Financing environment	26
Market opportunities	30
Legal and policy environment	33
Entrepreneurial environment	29

Source: *Private Equity Environmental Ranking, Country Profile*

Table 2.5: China's PE Environmental Ranking

[20] Carlyle recently announced the closing of a US$668 million Asia growth fund, which has already committed over US$50 million to two Chinese firms.

2.7 Private Equity in India

The Indian market is still small from a global perspective, but the **US$2.74billion** raised in **2005** represents a tenfold increase in fundraising in just two years. This rapid growth is particularly striking given the fact that, as recently as the late 1990s, Indian private equity was known mostly for a poor track record and several high profile failures.

India Private Equity at a glance	
PE Funds under management	US$4.00billion
PE Fund raising 2005	US$2.7 billion
PE Investments 2005 (As % of GDP)	0.36%
No. of Exits 2005	49

Source: *Asia Private Equity Review, 2005*

Table 2.6: India Private Equity at a glance (Year 2005)

2.7.1 Growth in India Private Equity Market

Success in Indian private equity has been driven fundamentally by the extraordinary growth of the country's large and liberalizing economy, which has enjoyed a **6.6%** compound annual growth rate over the last five years. The leading edge of the Indian economy is growing at a much higher rate; according to APER, the BPO sector, for example**, tripled between 2002 and 2005**. Many analysts expect growth in the future also to be strong in manufacturing and consumer related sectors, areas that private equity investors are moving into aggressively. The table below shows the expectations of the investment bank ICICI for exceptional growth in the leading sectors:

PROJECTED EPS* GROWTH FOR INDIAN LISTED COMPANIES 2005-2007	
Consumer goods	147 %
Construction	95%
Life sciences	84%
Retail	86%
Engineering	86%
IT	73%
Auto parts	57%

Source: *ICICI 2005*

Fig 2.9: Projected Growth for Indian Listed companies

In India, many of the industries highlighted in the table above are highly fragmented, creating the potential for private equity investors to gain from both secular growth and consolidation. **Veronica John** of the **Asian Development Bank**, an LP in a number of Indian private equity funds, cites the example of the **pharmaceutical industry**, where an astonishing **50,000 companies** compete in India, and where the **top 20** combined hold less than a **20% market share**

Rapid growth in private equity can be a double-edged sword: on the one side, ***driving additional opportunities and strengthening the supporting business ecosystem***; and on the other side, ***building the risk of price bubbles and capital overhang***. Both phenomena are in evidence in India today. The achievements of private-equity backed companies have given India's leading fund managers a very high profile in the country and the reputation of being desirable partners.

In India, there seems to be little of the wariness toward partnering with private equity investors. Fund managers are enjoying increasing support from the rapidly growing infrastructure of investment banks, law firms and accountancies that support private equity and that are an important source of deal flow. Most importantly, the success of private equity in India seems to be part of an awakening of Indian ambition to develop companies capable of global competition. Ashok Wadhawa of Ambit Corporate Finance, an investment bank in India, says;

"Indian entrepreneurs didn't think that they could aspire for more than building a company to the level of US$30m or US$40m; now, private equity players are helping to redefine those aspirations toward the global level.

2.7.2 Factors involved in Growth of PE in India

The key factors are involved in the rapid growth of the India private equity market are;

2.7.1.1 Number of exits

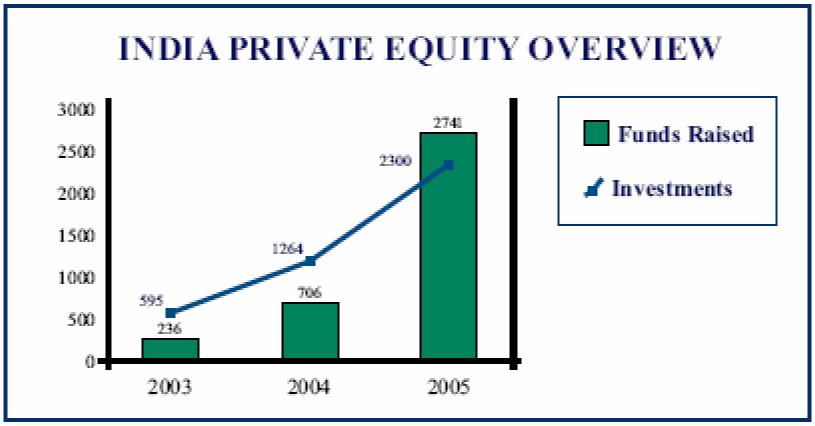
A large number of high-multiple exits, driven in part by the growth of India's stock markets, have demonstrated that money can be made in private equity in India. According to the ***Centre for Asian Private Equity Research (APER)***, the median return of the **57 exits** since **2002** was a very healthy **30%**.

2.7.1.2 Expansion of PE

The second factor involved in its growth is that Indian private equity is expanding beyond its relatively narrow concentration on technology and BPO to take advantage of opportunities offered by the rapid growth in consumer spending and the country's large pool of skilled workers.

2.7.1.3 Vibrant Capital Market

India's vibrant capital markets are another important driver of growth in private equity. India boasts one of the largest, oldest and most liquid stock markets in all of the emerging markets, with more than **7,000 companies** listed. Listing requirements are relatively manageable, and recently there has been significant appetite for new issues. In **2005**, for example, there were **25 private equity-backed IPOs** in India.



Source: *Centre for Asia Private Equity Research, Venture Intelligence India for 2005 Investments*

Fig 2.10: Indian Private Equity Overview

At the same time, a tenfold increase in fundraising in two years inevitably raises concerns that Indian private equity is overheating. Figure 2.10 shows abrupt increases in the funds raised for private equity investments from the year 2003 to 2005. The amount raised in 2005 is more than three times that of 2004. **Kathleen Ng** of the **Centre for Asian Private Equity Research (APER)** believes there is a capital overhang in the market of approximately **US$2.2billion**, stemming from the rapid increase in fundraising within India coupled with the increasing presence of money from global players such as **Warburg Pincus** and **Blackstone**. Ng calculates that the **average deal size** has remained constant at **approximately US$17million** while the average fund has doubled from **US$79million** in **2003** to **US$171million** in **2005**. More money chasing deals leads to higher prices, and most PE managers seem to agree that valuations are getting much higher.

2.7.3 Companies Investing in Private Equity in India

The Indian market has recorded some quite sizeable block trades in **2005**, most notably the **US$560million** sale of stock in **Bharti Tele-Ventures** by **Warburg Pincus**. Till now, Warburg has generated a return of roughly **six times on its $300million** investment into Bharti Tele Ventures, making this well publicized deal a kind of confirmation of the opportunity in Indian private equity.

In **2006**, Newbridge invested **US$100million** with the goal of growing the company to a dominant player across Asia.

FUNDS	INVESTED CAPITAL IN	REALISED OR REALIABLE AT CURRENT MARKET PRICES	MULTIPLE
INDIAN FUNDS			
Citibank	100	362	3.6
Electra	35	109	3.1
ING Barings	30	90	3.0
Draper	28	70	2.5
BankAm	130	210	1.6
ICICI	55	83	1.5
Chrysalis	60	80	1.3
GE	60	66	1.1
Indus	45	45	1.0
Walden	30	22	0.7
HSBC PE	60	28	0.5
Oppenheimer	40	8	0.2
Chase I	45	9	0.2
Sub-total	718	1,182	1.6
REGIONAL FUNDS			
Chase II	150	250	1.7
CDC	175	247	1.4
Warburg Pincus	693	784	1.1
AIG	450	405	0.9
Schroders	125	119	0.9
Sub-total	1,593	1,805	1.13
Grand total	2,311	2,987	1.3

Source: *VW Research, Venture Fund Source*

Table 2.7: Performance of Private Equity Investors in India

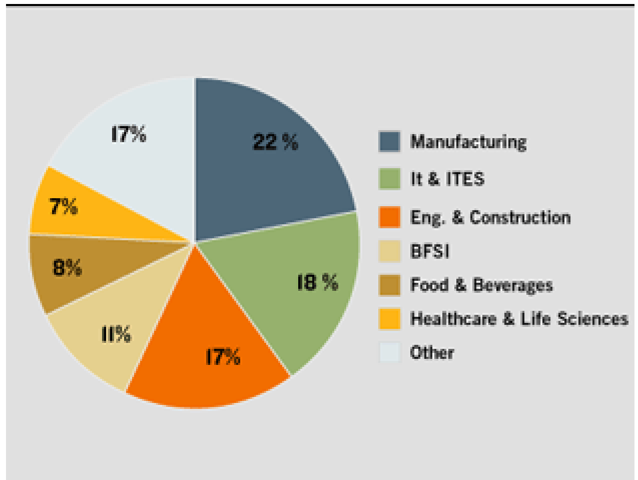
At the end of year **2006**, **Sequoia Capital and Battery Ventures** invested a combined **US$15million** into Travelguru, the Indian online travel portal, in what was billed as ***"the largest investment in one single round in the consumer internet space in India"***.

The government of India, these days is focusing more on the development of the country's infrastructure in terms of airports, railways tracks and roads. Government is emphasizing a private sector approach, and, as a result, a significant increase in toll road construction and airport privatization is taking place. One such project receiving private equity capital is the **US$1billion** modernization of the New Delhi airport, to be undertaken by a **consortium including IDFC Private Equity**, one of India's leading infrastructure fund managers. Other players, including Infrastructure Leasing and Financial Services Limited (ILFS) and Macquarie Bank, will likely take the assets raised for Indian infrastructure over **US$1billion** by **2006** or **2007.**

In buyouts, a class of private equity investment, there were five deals in **2005** in India, for a total value of **US$185million**. The two firms that have successfully pioneered buyouts in India are **ICICI Venture** and **Actis India**.

2.7.4 Sector wise PE investments in India

Figure 2.11 shows the sector wise private equity investments in India. It shows that 22% investments are made in manufacturing sector, where larger growth equity transactions took place.[21] The opportunity in skilled manufacturing is driven by India's huge talent base in engineering and sciences, which gives the country a potential competitive advantage in many sectors, such as pharmaceuticals and auto components that are poised for global growth. A study by the **International Institute for Management Development** cited India as having the second largest pool of scientific talent in the world. As this talent links with entrepreneurs and capital, India should be able to increase its relatively low share in manufactured exports.



Source: *Venture Intelligence*

Fig 2.11: Private Equity Investments by Industries

IT and telecom sector is the second growing sector of India which is getting the most of private equity investments, where **Sequoia Capital and Battery Ventures** invested a combined **US$15million** into Travelguru, the Indian online travel portal, in what was billed as ***"the largest investment in one single round in the consumer internet space in India."***

Currently there is a huge appetite for the private equity investors in the India construction industry as the government has an increased focus towards the development of the country's infrastructure. The sector is currently composed of **17%** of the private equity investments.

[21] Although, In terms of consumer spending, average per capita income in India is still very low (US$621 at market rates), but an urban middle class is emerging that is hungry for the goods and services of a consumer lifestyle. For India's 400 million urban residents, average per capita income in PPP terms has reached roughly US$3,400, prompting the Indian investment bank Edelweiss Capital to predict a tripling of the "lifestyle sector" (leisure, convenience and entertainment) to US$50bn by 2010.

2.7.5 Issues in Regulation of PE in India

With the flow of private equity in India having increased significantly since **2000**, aided by targeted reforms by the government since 1999, one might expect early-stage companies in India to have seen a notable increase in investor interest in the past six years. But a new study[22] unveiled recently in **Mumbai** shows that despite the increase in PE in India, Indian start-ups are actually receiving far less investment than their counterparts in other countries. According to the study, ***"A lot of government funding is there, but there are some other challenges,"*** says **Asawari Desai, director of TiE Global** and an author of the study. ***"People don't have the knowledge about where to go to find the money."*** The Indian economy is still largely the domain of family owners, who typically are open to outside minority investors but reluctant to cede control.

The study focused on the fact that the fault for the low level of investment lies both with the entrepreneurs and with the VCs. According to her, the domestic VCs lack the technical skills and market awareness necessary for identifying promising start-ups. This makes them hesitant and risk-averse. She adds that early-stage entrepreneurs, though skilled at cost control and technology, lack market awareness and product development skills. She also says one of the bigger problems is that Indian entrepreneurs often rely on a few personal connections and brokers rather than a wider network of "weak ties" like professional associates and financiers, as exists in Silicon Valley. The study, which was conducted with **175 capital providers** between **October 2005** and **March 2006**, was unveiled at the **TiE Entrepreneurial Summit 2006** in **Mumbai**.

Another hurdle in the private equity investments is the 25 % limit on corpus investable in a single firm by **Domestic Ventures Capital Fund (DVCF)** and increasing the tenure of convertible securities of listed companies beyond 18 months.

A big challenge, Indian private equity industry is facing is the command in the **buoyant Indian IPO market**, which now represents a significant form of competition for private equity investors. **"25% of the competition for deals is the alternative of going public,"** says **Shujaat Khan** of **Blue River Capital**[23].

Although, India's large pool of inexpensive and skilled labor has helped create strong export-driven services sectors in information technology (IT) and business process outsourcing. The country's population of more than 1billion people is the main attraction: the recent surge in car sales demonstrates the increasing purchasing power of India's urban middle class. However, Setting up a new business can be a slow and difficult

[22] The study, conducted by Stanford University and Talent Ideas and Enterprise (TiE), shows that only 12% of the venture capital invested in India goes to early-stage innovative start-up firms. This compares to 29% in the European Union, 50% in Israel and, most interestingly, 41% in China.
[23] Shujaat Khan is concerned that Investment bankers in India are taking companies public, with promises of high valuations, at a stage "when just keeping up with the growth should be the company's priority."

process. The restrictiveness of Indian labor laws remains a major deterrent to investment. There are also strict controls on foreign investment.

India	Rank
Overall environment for private enterprise	30
Financing environment	29
Market opportunities	33
Legal and policy environment	26
Entrepreneurial environment	28

Environmental Ranking, Country Profile

Table 2.8: India's PE Environmental Ranking

Chapter 3

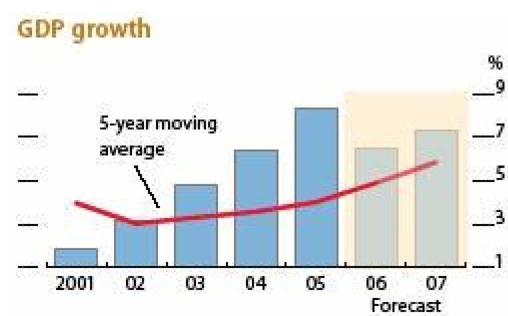
Private Equity in Pakistan

3.1 A brief about Pakistan Economy

Pakistan has emerged as the second fastest growing economy in Asia (after China), registering **real GDP growth of 8.4% in 2005** and further growth expected to be **7-8% through 2010**. This has outpaced some of Asia's leading economies such as India and the UAE. In addition, growth was achieved with significantly less of the debt capital (as of % of GDP) used in these economies. There is significant upside potential in economic growth as lending rates are low and financing becomes increasingly available.

Economic growth has been underpinned by solid fundamentals. Pakistan has seen foreign exchange reserves grow at a **CAGR of 55% since 2000**, with reserves reaching **US$ 12.6 billion in 2005**. The Pakistani rupee (PKR) has remained relatively stable against the US dollar over the past five years. Inflation has remained under control through a strong monetary policy despite high levels of historical economic growth and higher fuel and energy prices in 2004-2005.

Economic expansion has been bolstered by increased local demand as opposed to the "export driven" model of China. Strong growth in manufacturing and service industries is reducing economic reliance on less predictable agricultural industries **(Appendix 6).** By **2010**, Pakistan's nominal **GDP is expected to approach the US$ 200 billion** mark.[24]



Source: *Federal Bureau of Statistics*

Fig 3.1: GDP Growth of Pakistan (2001 – 2007)

Availability of necessary resources is critically dependant on significantly increasing the tax to GDP ratio and promoting a just and non regressive regime of taxation.[25] The Pakistan financial system displays all the classic characteristics of an emerging market; **market capitalization** amounts to only **5.5% of GNP**; **less than 0.3%** of the populations

[24] Pakistan ministry of finance, economist intelligence unit
[25] Approach Paper, Strategic Directions to Achieve Vision 2030, Government of Pakistan Planning Commission Islamabad

are shareholders, resources mobilized through the capital market are insignificant compared to that through the banking system, and equities account for about **4%** of the assets of the financial system.

Improvements in macroeconomic fundamentals, as well as recovery in the economy, were consolidated in **FY2003**. GDP growth in FY2003 strengthened to **5.1%** from **3.4%** in FY2002. Given continued buoyancy in both domestic and external sectors in the first half of **FY2004**, GDP growth exceeded the government target of **5.2%** for the **FY2004** and **5.8%** for the **FY 2005.**

In Pakistan corporate governance reform initiated during the last few years, by the Securities and Exchange Commission of Pakistan (SECP), is argued to be an important component of the Government of Pakistan's (GoP) **Growth Revival Strategy**. The Government of Pakistan is deregulating markets as well as improving supervision and regulation of markets to ensure greater competition. The economic management and first generation reforms have made the country's economy grow at an average rate of almost **7%** during the last four years. In addition, **investment as a percentage of GDP** has **grown to 20%** - the highest ever in the last two decades.

Pakistan's economy has yet to reach its full potential and various factors may result in even higher growth than the impressive rates currently projected. The country's investment policies are generally recognized as some of the most favorable in the region. The capital markets in Pakistan are reforming and growing with increase in corporate earnings as well as heightened interest from domestic and international investors. Pakistani equity markets have been some of the best performing in Asia. Unlike many of the regional equity marketplaces, the growth in the Pakistani equities market has largely been fuelled by strong fundamentals in the form of solid corporate earnings.

3.1.1 Investment Policy

Pakistan's Investment Policy has been formulated to create an investor-friendly environment, with a focus on further opening up the economy and marketing the potential for direct foreign investment. Various incentives have been offered to attract foreign investments including full repatriation of capital, capital gains, dividend and profit. Previously, only the manufacturing sector was open to foreign investment. Now, the Policy Regime is much more liberal with most other economic sectors also open for foreign investment and with significant efforts at mobilizing domestic financial resources towards long term investment.

International investors have begun to take notice of the abrupt growth in Pakistan economy. The country has seen FDI inflows grow at a CAGR of **47% since 2001**; although these inflows account for only **1.4% of GDP** – far below regional levels. FDI in Pakistan is expected to almost double in 2007 reaching an estimated **US$ 3 billion.** Due to economic and financial reforms taken by the government of Pakistan, the investment by the local and foreign investors has increased and in the first six months of the current financial year, Pakistan has received over **3.5 billion dollars Foreign Direct Investment**, which is a record.

3.1.2 Key Factors driving Economic Growth

Factors playing a key role in the economic growth of the country include:

- Reform-oriented political environment
- Fiscal discipline
- Favorable demographics
- Stable and increasingly business friendly framework leading to increased Foreign Direct Investment (FDI)

3.2 Private Equity in Pakistan

These opportunities are supported by very favorable and rapidly improving conditions in the marketplace. Private equity funds have played an extremely useful role in several developing countries in efficiently mobilizing private funds, placing them in undercapitalized companies making them highly profitable and either taking them public or exiting from the scene after reaping handsome returns Pakistan presents a number of investment opportunities especially applicable to private equity as an asset class[26]. Private equity investments can play a major role in the development of Pakistan economy in that; Private equity, and more specifically venture capital (a sub set of private equity), is considered an ideal solution for the funding to the start ups and small and medium enterprises.

The Securities and Exchange Commission of Pakistan (SECP) has been actively pursuing a reform roadmap to develop an efficient corporate sector and capital market, based on sound regulatory principles. In doing so, security to minority shareholders is ensured and efforts are made to bring transparency and better management and governance structures in the private sector.

3.2.1 Seizing the Opportunity

Private equity is poised to serve as a catalyst for growth in Pakistan. The investment opportunities such as a need for expansion capital, consolidation and privatization lend themselves to this asset class. Socioeconomic and political tides are turning to welcome Foreign Direct Investment and the foundations of the current growth are sound. The stage is set to target investments in Pakistan focused on acquiring controlling or significant interests in mature and well-managed businesses and creating value through operational and financial improvements, management incentives and the use of leverage. **(Appendix 7)**

[26] State Bank of Pakistan, "Vision for Pakistan's financial service industry by Dr. Ishrat Husain"

3.2.2 Private Equity and Venture Capital Fund Scheme

"Private Equity and Venture Capital Fund Scheme" means a scheme that provides for the management, vesting and investing of the funds of, as well as all other matters generally arising out of or in relation to a Private Equity and Venture Capital Fund consistent with these rules. Private groups in Pakistan have become increasingly involved in merger and acquisition activity to consolidate and rebalance their business portfolios. The increasing maturity and depth of the capital markets and the rapid growth in liquidity has resulted in better exit opportunities.

3.3 Opportunities for Private Equity Investments

Due to growth in the economy and improving profitability many medium-sized companies have to grow and can tap venture capital and private equity markets to improve their capitalization and hence be able to grow to meet the expanding market. Investment opportunities exist in **engineering goods, IT & telecommunication, real estate & leisure business** and **construction & construction material** as well as several other areas. Driven by the government's commitment to economic liberalization, Pakistan is forecast to continue growing at around **7% per annum**, exceeding the Asian average. With one of the world's most successful privatization programmes, a pivotal geographic position in a fast-growing region and sustainable comparative cost advantages in key sectors, Pakistan offers many exciting opportunities to invest profitably.

The present government has undertaken numerous reforms which are continuing to improve the investment climate and overall corporate governance standards in the country and is trying to streamline procedures, minimize delays and expedite approvals where needed. Opportunities for the private equity investors exist in the areas mentioned below:

3.3.1 Expansion Capital

98% of registered companies are private limited companies with no access to the equity capital markets. Many sectors are operating at or above full capacity and are in need of expansion capital. Such sectors include but are not limited to **cement, refining, chemicals, fertilizers, electronics, and paper**.

3.3.2 Privatizations

The government completed **US$4.3billion** worth of privatizations during **2003-05**, with the current pipeline worth in excess of **US$10 billion.** This area can be a major focal point of the private equity investors with the pace of privatizations rapidly increasing.

3.3.3 Consolidation

Opportunities exist in many fragmented industries such as **insurance, banking, basic materials, power, automotive parts, telecoms** and **textiles** among others.

3.4 Companies Investing In Private Equity in Pakistan

In Pakistan private equity in truest sense is almost non-existent. A few multinational private equity houses like **Actis**, **IFC**, **Norfun**d etc. are currently active in true venture capital investing, along with some national players including **AKD, JSIC**, and **TRG** etc.

Many international investors are also planning to make huge private equity investments in Pakistan. A recent visit of **James Caan**, **Executive Chairman of Hamilton Bradshaw**, a major private equity company of the UK, said that his company has looked at several opportunities and believe the time is appropriate for Pakistan to attract investment from foreign private equity, hedge fund and other institutional investors so that they can benefit from the growth potential of the country.

David Robenstein CEO of Carlyle Group, a leading private equity management firm, after visiting Pakistan at the start of year 2007, showed a great interest setting up a fund for investment in Pakistan and Middle East through opening its offices in Pakistan.

A local Financial Investment group, JS Group has a successful, long-term track record of private equity investment in Pakistan and, in **2006**, launched Pakistan's first private equity fund targeting high-quality expansion capital and buyout opportunities within sector-leading companies in Pakistan.

A major private equity investment deal in the **September 2006**, took place when **Abraaj Capital**, one of the leading private equity firms in the Middle East, North Africa and South Asian region and **BMA Capital**, one of the most prominent investment firms in Pakistan's financial markets launched a **US$ 300 million Abraaj BMA Pakistan Buyout Fund L.P**. It is the largest Private Equity fund targeted to investments in Pakistan. The Joint Venture between BMA Capital and Abraaj Capital could not have come at a more favorable time given the kind of opportunities that are now available in Pakistan's market. While Abraaj's investment is strategically structured as a capital injection in BMA, what is equally important is the knowledge, expertise and strategic input of Abraaj Capital in BMA Capital's future growth plans in Pakistan and the region.

Chapter 4

Concerning Issues of Private Equity Regulations in Pakistan

A cross-sectional study on the effect of securities market regulation and cost of capital finds that stricter regulation (in the form of high disclosure requirements set by the exchange or government) and strong enforcement is associated with lower cost of capital **(Hail and Luez 2003).** However, most securities and exchange commissions are unable or unwilling to enforce these standards. In emerging markets, most legislation remains on the books and are hardly put into practice. Incomplete regulation is almost always worse than no regulation at all, as investors do not have a confidence in the quality of disclosure, the transparency of the market or effectiveness of regulation. In Pakistan growth in private equity is almost negligent; this is because of the strict rules and regulations implied by the macroeconomic environment of the country. Regulation of private equity is inevitable, although it varies in its extent from country to country. A few concerning issues of private equity regulations in Pakistan are discussed below:

4.1 Slack development in the Private Sector

Private sector development is the key to economic growth and development in any country and private sector growth in itself depends on easy access to finance which is backed by strong mentoring and management support system. The favorable macro environment, physical and social infrastructure and rule of law are the foundations for the private sector advancement.

4.1.1 Uncertain Political and Economic situation

The uncertain political and economic situation in Pakistan has reduced the potential for an increase in Private Sector Business Operations (PSB's) in the short to medium term. Loss of investor confidence has reduced the country's ability to raise long term financing for projects, both domestically and internationally, and is one of main challenges the country is facing during the current period[27]. Despite the clear need for new infrastructure development, the current political and macroeconomic situation is not conducive to privately-led infrastructure activity of any significance. There are a few exceptions, such as the telecommunications sector, but the immediate outlook for the support of private sector infrastructure pipeline in Pakistan is not encouraging.

[27] Source: Asian Development Bank, "Country Assistance Plans-Pakistan – III Sector Strategies, Private Sector Development"

4.2 Sensitivity to Critical Information

As a general matter, private equity funds seek to keep information regarding their partnership terms and financial results private for primarily competitive reasons. Typically, under the terms of private equity fund partnership agreements, both the sponsors and general partners of the funds and their limited partners agree to keep the details of their relationship confidential through the use of confidentiality or non-disclosure provisions or agreements. These provisions also usually seek to safeguard sensitive portfolio company information. There are conflicting views for the dissemination of critical information to the private equity investors. Some argue that information should be public regardless of its authenticity or relevance. Others say that critical information should not be leaked for the competitive reasons.

Some GPs argue that the information requested under the **state FOIA**, laws falls within certain categories that are specifically exempted from disclosure. One argument favored by many GPs is that **information regarding private equity funds is subject to trade secret[28] protection**.

4.2.1 Disclosure to Information

Increased disclosures will provide access to more information regarding the performance of private equity funds, which will allow for better-informed investment choices. If future retirement income is affected by the performance of the private equity funds in which public pension plan monies are invested, it is arguably within the public's rights to know how these funds are performing. While a large pension fund investor may understand that greater risk in certain pension fund investments may yield greater reward, individual contributors may prefer more conservative investments.

Lending support to these arguments, some private equity professionals believe that the concerns regarding disclosure have been overstated, and that experience shows that they have not been harmed by it. For example, **Gerry Langeler**, a partner at **CVP Venture Partners**, has pointed out that certain major public LPs have been disclosing performance data for over a decade, with no visible harm to the funds in which they invest, and furthermore, that the slippery slope leading to disclosure of portfolio company

[28] In the fund context, trade secrets are typically found to consist of information relating to the proprietary operations of the investment managers, which may be interpreted to include costs, fees and carry provisions. Some factors that have been used in determining whether information qualifies as a trade secret include:
(i) the extent to which the information is known outside of the company, or by employees and others involved in [the company's] business;
(ii) the measures taken by [the company] to guard the secrecy of the information;
(iii) the value of the information to [the company] and to its competitors;
(iv) the amount of effort or money expended by the company in developing this information; and
(v) the ease or difficulty with which the information could be acquired or duplicated by others.

information (as opposed to fund-level information) could be avoided by not providing such information to LPs.

4.2.2 Non-disclosure to Information

A contrasting view of Private equity fund managers is that the disclosure of the critical information could cause the dissemination of inaccurate, misleading and premature information. For instance, because of the long-term nature of its investment strategy, a fund's true IRR is not determinable until the end of its life. Therefore, circulating such information prematurely provides only a "partial" picture of the fund's performance. Also, without access to information on private equity fund returns, proponents of disclosure argue that contributors to public pension plans are less capable of evaluating the investment decisions of their pension fund managers.

In addition to trade secret protection, disclosure of information relating to private equity funds will generally not be required if the party opposing disclosure can prove dissemination of the information would cause irreparable competitive harm. The argument from the GPs' perspective is that disclosure of information, even if limited, could indirectly reveal underlying information regarding the practices and strategies of the individual fund managers. Moreover, disclosure could enable a potential buyer of fund investments to determine the cost or current valuation of the target investment, potentially driving down the purchase price and ultimately resulting in lower returns to the fund's investors. Additionally, despite the intended purpose of informing pensioners and the public regarding the investments made using their pension funds, competitors of fund portfolio companies could use the information to their advantage. Finally, investors in private equity funds also argue that disclosure of certain negotiated terms, such as management fees, could harm them by eliminating their bargaining power in negotiating with other GPs. Therefore, disclosure of information relating to current investments may affect the ability of the LPs themselves to reach favorable terms in future investments.

4.3 Questionable Role of Regulations in Private Equity Industry

The perennial debate within the private equity community and regulators in Pakistan is whether regulations helps or hinders this industry. Some argue that regulation provides a badge of respectability which confirms its status as a serious asset class, and give useful comfort to investors and policy makers. Other says it creates unnecessary bureaucracy, and drives up costs that reduce competitiveness. Some private equity and venture capital associations even believe that greater control and increased transparency will attract new investors to this asset class in Pakistan and will result in a higher level of commitment from investors

4.4 Relationship between private control, private benefits and profit maximization

The most important issue in regulating this sector is to understand the relationship between private control, private benefits and profit maximization. While, it is true that excessive and opaque control by private equity players over companies will dampen capital market reforms, nonetheless, it should be appreciated that private benefits, which result from concentrated control, set strong incentives for these players to maximize the generation of operating surpluses. This is an extremely important issue that requires some analytical clarification.

Separation of ownership from control in a private equity invested company implies that the controller (an owner manager in the Pakistani case) retains effective decision-making control over capital that has been invested by external investors. This allows the controller considerable discretion over the use and allocation of the external investors' capital. In Pakistan this discretion is strengthened by weak disclosures and a poorly regulated auditing infrastructure that continues to plague the economy. Among other things, this discretion allows the family controller to seek private benefits, which are attained by tunneling external investors' capital to associated companies and businesses and by allocating profits to expenditures that benefit the controller. Understandably, the concern for external investors is that excessive private benefit seeking by controllers often comes at the expense of their profits.

The dilution of private control and ownership tends to dampen these incentives and this may weaken profit-maximizing effort in companies. Unless the loss in private monitoring effort is substituted by significant monitoring effort from external equity holders corporate inefficiency may grow.

4.4.1 Minority Shareholders protection

The concern is that reforms whose main objective is minority shareholder protection may dampen profit-maximizing incentives for private equity players without providing offsetting benefits in the form of equally efficient monitoring by minority shareholders. If this happens the reform may end up creating sub optimal incentives for profit maximization by private equity players.

4.4.2 Optimization of Dual Objectives

An important challenge confronting all stakeholders is to optimize the dual objectives of minority shareholder protection and the preservation of profit-maximizing incentives for family controlled private equities.

4.5 Need for a Corporate Governance System

Securities and Exchange Commission of Pakistan (SECP) recognizes that growth creation in global capitalism requires a corporate governance system that has the ability to efficiently raise external equity capital, to increase corporate competitiveness and to stimulate corporate growth. Pakistan's present CG system is in all likelihood incompatible with the objective of raising external equity capital through capital markets and may seriously undermine capital market reforms (Ali Cheema, June 2003)

4.5.1 Need for Transparency

Several key cases, have stirred the public debate over the level of transparency necessary or desirable when public funds are invested. One of the main arguments in favor of corporate governance and disclosure regime is that **transparency increases the level of accountability of the fund managers with respect to public investors**. While it is acknowledged that disclosure alone may not lead to better investments, proponents of disclosure point out that lack of disclosure provides an opportunity to hide bad investments. Some even view opposition to disclosure as an effort to hide poor performance; information that should be kept hidden from those who contribute to the fund. Because so many individuals can become indirect investors in private equity funds through their participation in pension funds, some in favor of greater transparency believe that private equity may become an issue of public interest generally.

In addition, opponents insist that demands for transparency are short-sighted: they say it is actually in the best interest of the state and municipal pension funds (and pensioners) and public universities not to submit to disclosure requests or require GPs to permit them to fully disclose information since as a result those GPs may choose to exclude those investors from investing in top performing funds[29].

4.6 The Release of Performance Data of PE Fund

Another major concern is the release of performance data of private equity funds, where the data may, more often than not, be misleading since it is often not finalized. Interim valuations could be quite different than the eventual valuations based on realized returns. Furthermore, since there is **no single methodology for valuations of portfolio investments**, less sophisticated investors may be incapable of accounting for those differences and may therefore misinterpret the data. Moreover, measuring funds against one another before their investments mature is often inaccurate since the performance of

[29] Private funds may determine that it is not worth it to them to accept investors who bring with them potentially damaging disclosure requirements. Thus, despite the large amounts of capital that state pension funds have to invest, top private equity funds may choose to bypass them, ultimately preventing state pension funds from reaping lucrative returns.

a fund could be altered drastically (either positively or negatively) by a single strong investment.

Private equity funds also show concerns that the release of inaccurate return data of their portfolio investments could damage a portfolio company's performance from a competitive standpoint. An under-performing portfolio company's ability to compete in its particular industry may be compromised by a poor (and likely inaccurate) interim valuation.

4.7 Compliance with Regulatory Authorities

Private equity funds are typically structured in order to avail themselves of the various regulatory safe harbors from registration under the **Securities Act of 1933**, as amended, and **Sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940**, as amended, primarily in order to avoid registration of their securities offerings, registration as an Investment Company and/or as an Investment Adviser, and all disclosure that would otherwise result (such as the filing of periodic or other reports with the Securities and Exchange Commission). Therefore, having gone to significant lengths and incurred substantial cost to ensure compliance with these regulatory safe harbors so as to avoid these disclosure requirements, including not permitting certain types of investors to participate and thereby limiting access to available capital, GPs argue that the results of private funds and of their private portfolio companies should continue to remain private.

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Chapter 5

Recommendations & Conclusion

Even with the fastest growth of this sector in developing countries, penetration of private equity investment is still very nascent. Private equity investments in **2006** represented **one-fifth** of **1% of GDP in China**, and **one-half of 1% of GDP in India.** Long-term growth and success in private equity requires fundamental reform in private equity structures and incentives. Making this structure work effectively demands a strong commitment to **transparency, open communication and the careful structuring of incentive compensation to align the interests of the manager and investor**. Emerging markets still represent only **9%** of the **estimated US$400 billion** raised by private equity fund managers worldwide in **2006**.

The lure of the China private equity market coupled with the strong string of successes is drawing interest from other international buyout firms such as **Bain Capital and KKR**. However, how the buyout market will fair in China is an open question, especially given US concerns over Chinese investment in key national US assets, but the increasing attention of major private equity and buyout players seems to suggest a **bullish market for the coming year**. Between **2004 and 2005**, **the buyout market in China represented only 11% of the total value of private equity transactions**, and, like Carlyle, players more closely associated with buyouts in other global markets have been making large growth equity deals in China. Despite the hype, there is still a long way to go for the vast majority of the emerging economies in developing local and regional markets for private equity. There remains a tremendous need for access to capital for middle market companies in most emerging markets, and local institutional investors (e.g., pension funds) in many markets are just beginning to view private equity as a credible option.

The key to the success of economic policies needs continuity and consistency. After a long time in Pakistan's economic history a policy framework developed six years ago has remained on track in terms of its direction and thrust. Although, the present government has carried this process forward, **discrepancies between the macro economic environment and the amount of investments are still there**. The government is trying to liberalize, deregulate and privatize the economic regime in the country. An increasingly greater space is being provided to the private sector to shoulder the burden of economic development. The hour of need is that the government should focus its attention on strengthening the regulatory functions to give more leverage to the private equity investors to invest in the country. Here, the need is for building **"a more capable and transparent government"** in the interest of economy. As according to the **La Porta, Lopez-de-Silanes, Shleifer, and Vishny's (1998)** study of public shareholders, it is clearly concluded that in nations where the rule of law is weaker, private equity-holders display a greater reliance on concentrated equity holdings.

High standards and practices of corporate governance should be observed by all players in the industry so that the confidence of small and minority shareholders is restored and maintained. This can be achieved by focusing on:

- Developing, attracting, retaining and motivating high quality skills who can carryout world-class professional work relating to technical, marketing and management of these equity investments in the country.
- Acquiring core competencies which are needed to compete in an integrated and globalized financial market.
- Focusing on business areas and niches which allow a competitive edge to our exporters of financial services.
- Concentrating on innovation, speed, responsiveness and tailoring to meet the specific customer needs in credit delivery.
- Using technology as an enabler to digitally secure product access and service delivery,
- Reducing transaction costs and providing convenience to customers.
- Introducing control mechanism for cost structure and operational efficiency.
- Building high quality research, market information gathering and analysis capacity to keep in continuous touch with the changing trends and demand patterns.

5.1 Role to be played by SECP

The contractual savings institutions in Pakistan are highly segmented, narrowly focused and making sub-optimal returns on the assets they manage. It is the joint responsibility of the Government, regulators and the industry to mobilize and manage these savings in an optimal and professional manner. As private pension funds, provident funds and endowment funds would be developed and managed in an effective way, the overall domestic savings rate in the country will rise subsequently.

Considering the historic small size of the private equity segment in Pakistan, it was not on the radar of SECP governance objectives, however acknowledging the recent on-going interest in this asset class, timing is right to intervene at the early stage. This would require joint effort on part of all stake holders to not only first understand the dynamics of this segment to productively regulate it, but also educate the public in this asset class and provide comfort of regulatory protection.

SECP has placed considerable emphasis on the reform of capital markets. An important component of this reform is the **improvement in Pakistan's Corporate Governance (CG) system**. The objective of CG reform is to increase the depth and efficiency of capital markets with an aim to mobilize domestic savings and foreign portfolio investment. The measures proposed to fulfill these objectives include:

- protection of minority shareholders rights,
- dilution of family control over the board of directors (BOD)

- better regulation of auditing activity

SECP recognizes that growth creation in global capitalism requires a corporate governance system that has the ability to efficiently raise external equity capital, to increase corporate competitiveness and to stimulate corporate growth.

There is a need for progressive corporate to take a lead in the CG reform effort, as has been the case in India, to help lay a solid foundation for capital market development, which will benefit them and society alike

Legal framework for the investment in Pakistan is also changing; venture capital financing and investment banking both are governed under the **Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003** whereby a NBFC is entitled to engage in the businesses of venture capital investment and investment finance services, subject to necessary licensing by the SECP. The SECP considers it expedient to encourage both forms of private equity in the country. It is also in the process of revising the NBFC Rules in order to provide a more comprehensive legal framework for NBFCs. A summary of current regulatory framework for venture capital form of private equity is given in **Appendix 8**

I conclude my research work by saying that the strong growth of private equity in emerging markets is doable and not implausible. The road ahead is long and arduous but in order to encourage private equity and venture capital investments, governments need to reduce barriers by developing legislation that supports business activity. The financial sectors should adjust to the changing trends to meet the challenges posed by globalization. Furthermore, there may be a role for the Bank to assist in the restructuring of provident funds which have not been mobilized for SME finance. It is also important to design a regulatory environment that allows for greater investment in indigenous companies through collective investment schemes.

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Appendix 1

Structure & Composition of Private Equity

Private equity provides long-term, committed share capital, to help unquoted companies grow and succeed. Private equity investments help business to start up, expand, buy another business, buy out a division of parent company, turnaround or revitalize a company. Obtaining private equity is very different from raising debt or a loan from a lender, such as a bank. Lenders have a legal right to interest on a loan and repayment of the capital, irrespective of the success or failure. Private equity, on the other hand, is invested in exchange for a stake in the invested business and, as shareholders; the investors' returns are dependent on the growth and profitability of business.

Advantages of Private Equity

Private equity investors are mostly interested in companies with high growth prospects, which are managed by experienced and ambitious teams who are capable of turning their business plan into reality. However, provided there is real growth potential the private equity industry is interested in all stages, from start-up to buy-outs. There are many advantages of private equity which makes it a more suitable and convenient form of financing then debt, for the businesses;

- Private equity backed companies have been shown to grow faster than other types of companies. This is made possible by the provision of a combination of capital and experienced personal input from private equity executives, which sets it apart from other forms of finance.
- Private equity can help businesses achieve their targets and goals, and provide a stable base for strategic decision making.
- The private equity firms seek to increase a company's value to its owners, without taking day-to-day management control.
- Private equity firms often work in conjunction with other providers of finance and may be able to help you to put a total funding package together for your business.
- One of a major advantage of private equity is that it is not secured on any assets, though part of the non-equity funding package provided by the private equity firm may seek some security. The private equity firm, therefore, often faces the risk of failure just like the other shareholders. The private equity firm is an equity business partner and is rewarded by the company's success, generally achieving its principle return through realizing a capital gain through an "exit" which may include;

    - Selling their shares back to the management.
    - Selling the shares to another investor (such as another private equity firm).
    - A trade sale (the sale of company shares to another).
    - The company achieving a stock market listing.

The Private Equity investment process

STAGE	ENTREPRENEUR	ENTREPRENEUR AND PRIVATE EQUITY FIRM	PRIVATE EQUITY FIRM	REPORTS
Approaching the private equity firm/ evaluating the business plan	• Appoint advisers • Prepare business plan • Contact private equity firms		• Review business plan	BUSINESS PLAN
Initial enquiries and negotiation	• Provide additional information	• Meet to discuss business plan • Build relationship • Negotiate outline terms	• Conduct initial enquiries • Value the business • Consider financing structure	OFFER LETTER
Due diligence		• Liaise with accountants • Liaise with other external consultants	• Initiate external due diligence	CONSULTANTS' REPORTS ACCOUNTANTS' REPORTS
Final negotiation and completion	• Disclose all relevant business information	• Negotiate final terms • Document constitution and voting rights	• Draw up completion documentation	DISCLOSURE LETTER WARRANTIES AND INDEMNITIES MEMORANDUM AND ARTICLES OF ASSOCIATION SHARE-HOLDERS AGREEMENT
Monitoring EXIT	• Provide periodic management accounts • Communicate regularly with investor/s		• Seat on Board? • Monitor investment • Constructive input • Involvement in major decisions	MANAGEMENT ACCOUNTS MINUTES OF BOARD AND OTHER KEY MEETINGS

Source: Guide to Private Equity

Figure 1: The Private Equity Investment Process

Stages of Private Equity Investment

Private Equity - Different Investment Stages

SEED
Relatively small amount of capital provided to an entrepreneur to prove a concept.

START-UP
Financing provided to companies for use in product development and initial marketing.

FIRST STAGE
Financing provided to launch the first product/service in market, build distribution channels and start selling.

SECOND STAGE
Working capital to stabilize and develop market potential.

THIRD STAGE
Funds provided for a company whose sales are increasing and that is breaking even or profitable.

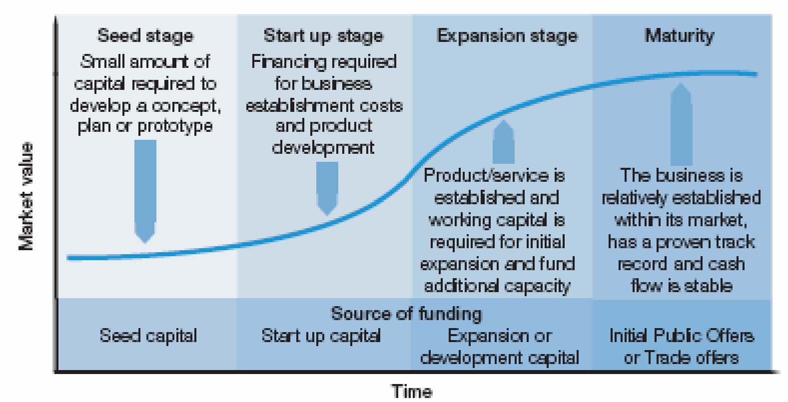
BRIDGE FINANCING
Financing continued growth with a clear view to harvest for a company expecting to go public with in six to eighteen months

BUY-OUT
Funds provided to enable operating management to acquire an established product line or business

WORK-OUT
Financing provided to a company at a time of operational or financial difficulty with the intention of turning the company around.

Source: BVCA Report on Investment Activities 2004

Stages for Investment in the Life Cycle of Business



Source: Macquarie

Figure 2: Stages for Investment in the Life Cycle of Business

Structure of Private Equity Funds

Private Equity funds are typically structured as limited liability partnerships in which a specialized Private Equity firm serves as the general partner (GP) and institutional investors or high-net-worth individuals provide the majority of capital as limited partners (LP). Most Private Equity funds are closed-end funds with a finite life of 10 or 12 years, which may be extended with the consent of the majority of the shareholders[1]. During this period, the GP undertakes investments of various types (e.g. venture capital[2], bridge financing[3], expansion capital[4], leveraged buyouts[5]), with the obligation to liquidate all investments and return the proceeds to the investors by the end of the fund's life, except the **"evergreen"** funds (which have an infinite life and no obligation to liquidate their positions). At the time of the fund's inception, LPs commit to a percentage of total fund size.

In the first years of the fund life (typically the six first years), the GP makes capital calls (or take-downs) to LPs whenever it finds an investment opportunity. Typically, within two weeks, LPs have to provide the corresponding cash. The total amount of such "capital calls" can exceed the capital committed at the fund's birth, but this is relatively

[1] Gompers and Lerner, 1999

[2] **Venture capital** is a type of private equity capital typically provided by professional; institutionally-backed outside investors to new, growth businesses. It is a pooled investment vehicle (often a partnership) that primarily invests the financial capital of third-party investors in enterprises that are too risky for the standard capital markets or bank loans.

[3] **Bridge financing** is a method of financing, used to maintain liquidity while waiting for an anticipated and reasonably expected inflow of cash

[4] **Expansion capital** is the investment needed for the expansion and growth of the business operations.

[5] A **leveraged buyout** (or LBO, or highly-leveraged transaction (HLT), or "bootstrap" transaction) occurs when a financial sponsor gains control of a majority of a target company's equity through the use of borrowed money or debt

rare. In fact, it is more common for a fund to liquidate without having invested all the capital committed. Whenever a fund receives returns on its investments, proceeds are proportionally distributed to LPs, net of fees and so-called "carried interest". These distributions can be in form of cash or shares (common, preferred, or convertibles). GP receives compensation in varying forms. A fixed component, a yearly management fee (between 1% and 3%) of the total committed capital is charged to LPs. In addition, GPs can receive fees for each transaction performed (fixed or as a percentage of deal value) and participates in the fund returns through "carried interest" which often specifies that 20% of all net gains (or gains beyond a certain "hurdle rate") accrue to the GP whilst the rest is distributed among LPs.

PE firms often manage several funds, raising a new fund three to five years after the closing of the fundraising process for the previous fund. However, some PE funds are structured as non-partnership captive[6] or semi-captive[7] vehicles with one dominant (or exclusive) LP. This is mainly the case with funds that are managed by subsidiaries of large insurance companies or banks that invest the parent company's money.

[6] **Captives** are the Private equity firms that obtain their funds mainly from their parent organization.
[7] **Semi-captives** are those in which former captives raise funds from external sources as well.

Appendix 2

Entrepreneurial Framework Index

Entrepreneurial Framework Index (rankings out of 60 countries)

	2002-06 rank	2002-06 score	1997-2001 rank	1997-2001 score
Netherlands	1	8.44	4	8.32
Denmark	2	8.39	5	8.04
UK	3	8.39	1	8.34
US	4	8.34	3	8.32
Switzerland	5	8.34	2	8.34
Finland	6	8.21	7	7.89
Canada	7	8.01	6	7.96
Sweden	8	7.98	8	7.76
Israel	9	7.92	19	7.06
Germany	10	7.92	12	7.52
France	11	7.87	16	7.32
Singapore	12	7.76	14	7.41
New Zealand	13	7.75	9	7.73
Belgium	14	7.75	13	7.45
Ireland	15	7.74	18	7.28
Norway	16	7.73	11	7.52
Taiwan	17	7.56	20	6.96
Australia	18	7.54	15	7.38
Austria	19	7.54	17	7.31
Hong Kong	20	7.26	10	7.59
Japan	21	7.04	21	6.91
Chile	22	7.02	22	6.53
Spain	23	7.00	25	6.28
Italy	24	6.99	24	6.36
Portugal	25	6.89	27	5.96
South Korea	26	6.82	23	6.38
Hungary	27	6.40	26	6.03
Czech Republic	28	6.33	29	5.68
Poland	29	6.31	30	5.65
Greece	30	6.01	33	5.18
Slovakia	31	6.00	32	5.41
Malaysia	32	5.68	31	5.46
Mexico	33	5.39	40	4.64
Bulgaria	34	5.39	37	4.79
Saudi Arabia	35	5.38	42	4.57
Peru	36	5.37	38	4.79
Philippines	37	5.36	36	4.92
Argentina	38	5.31	28	5.74
Colombia	39	5.28	34	5.10
Sri Lanka	40	5.27	39	4.70
South Africa	41	5.10	46	4.38
Turkey	42	5.10	48	4.28
Thailand	43	5.09	35	5.01
Egypt	44	5.07	45	4.43
Brazil	45	5.06	41	4.62
India	46	5.05	49	4.27
Russia	47	5.04	50	4.17
Romania	48	4.84	43	4.46
Venezuela	49	4.62	44	4.44
China	50	4.41	54	3.64
Ecuador	51	4.40	51	4.12
Pakistan	52	4.38	53	3.64
Vietnam	53	4.36	52	3.79
Indonesia	54	4.35	47	4.31
Azerbaijan	55	4.35	58	3.23
Iran	56	4.28	60	2.81
Kazakhstan	57	4.28	56	3.40
Ukraine	58	4.15	57	3.33
Algeria	59	4.05	55	3.61
Nigeria	60	3.57	59	3.09

Source: Economist Intelligence Unit

Source: Economist Intelligence Unit

Appendix 3

Essential Data on Asia

- In 2005, over $17.6 billion of fresh capital came into the market, compared to $5.6 billion in 2004
- India led all other markets in attracting over $2.3 billion of fresh capital
- $15.2 billion of capital was deployed, a 29% increase over 2004
- Although there was no increase in the number of deals (271) the average deal size increased by over 30%, to $63 million
- Buy-out situations accounted for less than 50% of transactions, with growth/expansion forming the majority, indicating the return of growth capital investment in Asia
- Services companies were the most-favored sector, raising $5.3 billion
- 188 exits were recorded, a rise of 25% from 2004
- $20 billion has been returned to investors, from an invested capital of $6 billion
- Japan accounted for 46% of that total, followed by China and India
- IPOs were the most preferred exit route, taking up 50% of the divestment route
- Trade sale remains the dominant exit route in Japan, where it accounted for 85% of divestments.

Source: The Centre for Asian Private Equity Research

Appendix 4

Comparative Data – China, India, Pakistan

	China	India	Pakistan
GNP	8.5 percent	6.5 percent	5.2 percent
Reserves	$450 billion	$110 billion	$12.56 billion
Population	1.34 billion	1.05 billion	156 million
Per Capita Income	$1,300	$600	$500
Skilled Labor	200 million	400 million	50 million
Cost per Labor	$1.2	$0.90	$1.17
Poverty Level	57 percent	40 percent	38 percent
Foreign Investment	$3.00 billion	$1.64 billion	$850 million
Economic Level	Fast	Fast	Medium
Country Rating	A+	B+	B-
Political Level	Stable	Stable	Mixed
Country Risk	Low	Low	Medium
Country's Perception	Moderate/Open	Open	Moderate

Sources: (i) World Bank, (ii) Asian Development Bank-Country Report, (iii) IMF-Annual Report, (iv) State Bank of Pakistan, (v) IBA-Karachi Library, (vi) Fortune Magazine, (vii) Brooking Institute, (viii) Economic Intelligence Unit

Appendix 5

South Asian GDP Per Capita Growth Rates

Growth Rate of GDP per capita				
Country Name	**60's**	**70's**	**80's**	**90's**
Pakistan	4.29	2.11	3.82	1.47
India	1.52	0.75	3.70	3.73
Bangladesh	1.40	-0.52	1.98	3.15
Nepal	0.48	-0.32	1.49	2.25
Sri Lanka	2.15	2.63	2.84	3.98

Source: World Development Indicators

Foreign Direct Investment Inflows

	1980-85	**1990**	**1995**	**1998**
World	49813	203341	331189	643879
Developing Countries	12634	31345	105511	165936
Asia	5043	18948	67386	84880
SAARC	178.8 (3.5%)	458 (2.4%)	2753 (4.08%)	3433 (4.04%)
Bangladesh	-0.1 (0%)	3 (0.01%)	2 (0.002%)	317 (0.37%)
India	62 (1.2%)	162 (0.85%)	1964 (2.9%)	2258 (2.7%)
Pakistan	75 (1.5%)	244 (1.3%)	719 (1.07%)	497 (0.6%)
Sri Lanka	42 (0.8%)	43 (0.2%)	53 (0.7%)	345 (0.4%)

Source: UNCTAD, World Investment Report, various years, taken from Institute of Policy Studies
Note: Parenthesis gives country FDI as a percentage of Asian FDI.

Appendix 6

Net Inflow of Forign Private Investments

A. Foreign Investment

Million US $

Country / economy	2001-02	2002-03	2003-04	2004-05	2005-06	July-January 2005-06	July-January 2006-07
Total world	**- 10.0**	**18.2**	**- 27.7**	**152.6**	**351.5**	**400.5**	**697.4**
Developed countries	**- 13.6**	**- 26.3**	**- 5.8**	**77.2**	**282.6**	**305.2**	**613.0**
Western Europe	**- 15.0**	**- 40.9**	**- 21.9**	**33.4**	**- 12.7**	**12.3**	**207.9**
European Union	**- 38.1**	**- 43.4**	**- 27.9**	**43.5**	**- 24.3**	**2.8**	**245.3**
Luxembourg	- 5.2	0.2	0.1	0.7	- 1.0	- 1.0	- 0.2
Denmark	- 0.1	- 9.1	-	0.1	0.5	0.5	0.1
France	0.3	0.0	-	0.1	-	-	0.0
Germany	0.0	0.1	- 3.0	2.1	- 3.5	- 3.3	0.4
Netherlands	- 0.8	0.0	- 2.0	23.2	- 0.7	7.0	- 2.1
Sweden	-	0.0	-	- 0.3	-	-	1.1
U.K	- 32.4	- 34.6	- 23.0	17.6	- 19.5	- 0.3	246.0
Other Western Europe	**23.1**	**2.5**	**6.0**	**- 10.0**	**11.6**	**9.4**	**- 37.4**
Norway	- 0.0	0.0	-	-	-	-	-
Switzerland	23.2	2.5	6.0	- 10.0	11.6	9.4	- 37.4
North America	**1.1**	**15.1**	**21.4**	**47.1**	**304.0**	**298.3**	**404.9**
Canada	2.7	0.0	0.0	0.1	0.2	0.2	0.2
U.S.A	- 1.7	15.1	21.4	47.1	303.8	298.2	404.7
Other developed countries	**0.3**	**- 0.3**	**- 3.5**	**- 3.4**	**- 8.7**	**- 5.4**	**0.2**
Australia	0.1	0.0	0.0	- 0.0	-	-	0.0
Japan	0.2	- 0.3	- 3.5	- 3.4	- 8.7	- 5.4	0.2
Unspecified Developed Countries	0.1	- 0.3	- 1.9	0.0	0.0	0.0	0.0
Developing economies	**0.4**	**51.0**	**- 5.9**	**91.7**	**72.6**	**98.3**	**83.5**
Caribbean Islands	**0.9**	-	**3.8**	**4.3**	**- 9.3**	**8.3**	**1.2**
Cayman Island	-	-	-	- 0.1	-	-	-
Bahamas	-	-	-	-	0.1	0.1	-
Other carbbean Countries	0.9	-	3.8	4.5	- 9.4	8.2	1.2
Africa	**0.6**	**0.1**	**8.2**	**0.2**	**- 5.0**	**- 3.0**	**9.5**
Libya	-	-	-	-	-	-	-
Egypt	0.0	-	0.0	-	- 1.3	-	-
Mauritius	-	-	7.0	0.2	- 4.1	- 3.2	9.7
South Africa	-	-	-	-	-	-	-
Other African Countries	0.6	0.1	1.2	0.1	0.4	0.3	- 0.1
Asia	**- 1.1**	**50.8**	**- 18.6**	**82.1**	**85.7**	**92.7**	**72.3**
West Asia	**- 3.0**	**66.9**	**- 1.4**	**52.7**	**48.4**	**36.1**	**38.1**
Oman	0.4	- 0.0	- 0.6	0.7	0.2	0.1	-
Iran	-	-	-	-	-	-	-
Kuwait	0.2	0.1	0.0	0.0	2.9	3.1	18.2
Bahrain	-	9.4	- 5.1	2.0	- 19.4	- 19.3	5.0
Qatar	0.1	57.0	0.2	0.4	0.1	0.1	-
Saudi Arabia	0.1	0.1	- 1.9	- 0.2	0.8	1.0	- 0.0
Turkey	-	-	-	-	1.0	1.0	-
U.A.E	- 4.2	0.4	11.9	49.8	63.3	50.7	14.9
Unspecified West Asia	0.4	-	- 6.0	-	- 0.5	- 0.5	0.0
South, East and South-East Asia	**1.8**	**- 16.2**	**- 17.1**	**29.4**	**37.4**	**56.7**	**34.2**
Bangladesh	-	-	-	0.0	-	-	-
China	0.0	- 0.2	-	0.0	-	-	-
Hongkong	20.6	- 0.5	- 1.3	28.9	31.2	46.2	- 78.9
Malaysia	- 0.0	0.2	0.0	-	0.7	0.7	2.2
Singapore	- 17.2	- 8.8	- 5.6	2.7	5.6	9.9	113.4
India	-	-	-	-	-	-	-
Korea (South)	-	- 6.9	- 9.4	0.0	-	-	-
Unspecified South, East and South-East Asia	- 1.5	- 0.0	- 0.8	- 2.2	- 0.1	- 0.1	- 2.5
Unspecified developing countries	0.0	0.2	0.6	5.0	1.2	0.3	0.4
Unspecified	**3.1**	**- 6.4**	**- 16.0**	**- 16.3**	**- 3.8**	**- 3.1**	**0.9**

Source: State bank of Pakistan

B. Direct Investment (Million US $)

Country / economy	2001-02	2002-03	2003-04	2004-05	2005-06	July-January 2005-06	July-January 2006-07
Total world *with Privatisation*	**484.8**	**798.0**	**949.4**	**1 524.0**	**3 521.0**	**1 244.7**	**2 096.0**
Total world *without Privatisation*	**367.8**	**610.0**	**750.4**	**1 161.0**	**1 980.7**	**989.7**	**1 962.8**
Developed countries	**377.2**	**463.6**	**693.7**	**798.0**	**1 455.2**	**742.8**	**1 332.1**
Western Europe	**38.5**	**231.8**	**434.1**	**419.5**	**844.0**	**403.0**	**738.2**
European Union	**31.0**	**228.5**	**82.3**	**250.5**	**420.8**	**212.3**	**584.2**
Luxembourg	0.0	- 0.9	1.3	18.7	23.5	5.8	13.2
Denmark	0.8	0.4	0.5	1.1	- 5.7	0.5	0.2
France	- 6.9	2.6	- 5.6	- 3.6	3.2	1.9	- 1.5
Germany	11.2	3.7	7.0	13.1	28.6	25.1	21.6
Netherlands	- 5.1	3.0	14.0	36.7	121.1	72.6	62.5
Sweden	0.8	0.2	0.1	3.1	6.1	6.1	0.1
U.K	30.3	219.4	64.9	181.5	244.0	100.3	488.2
Out of Which Privatisation proceeds		*74.0*		-	-		
Other Western Europe	**7.5**	**3.4**	**351.8**	**168.9**	**423.1**	**190.6**	**154.0**
Norway	0.1	0.3	146.6	31.4	252.6	139.7	24.9
Switzerland	7.4	3.1	205.3	137.5	170.6	50.9	129.1
Out of Which Privatisation proceeds			*199.0*	*103.0*	*99.3*	-	-
North America	**329.8**	**212.0**	**238.8**	**327.8**	**521.5**	**293.9**	**514.4**
Canada	3.5	0.5	0.5	1.9	4.8	2.9	1.6
U.S.A	326.4	211.5	238.4	326.0	516.7	291.0	512.9
Out of Which Privatisation proceeds	*117.0*	*10.0*		-	-		
Other developed countries	**6.9**	**16.3**	**16.7**	**50.7**	**89.7**	**44.9**	**77.7**
Australia	0.4	2.2	1.5	1.6	31.3	18.4	43.4
Japan	6.5	14.1	15.1	45.2	57.0	26.6	34.3
Unspecified Developed Countries	2.0	3.4	4.0	3.9	1.5	1.0	1.8
Developing economies	**72.3**	**229.4**	**165.5**	**624.9**	**1 924.0**	**419.4**	**515.9**
Caribbean Islands	**2.6**	**2.7**	**1.2**	**36.7**	**11.3**	**2.3**	**13.8**
Cayman Island	0.6	0.5	1.2	34.8	8.1	0.4	7.7
Bahamas	-	-	-	0.5	3.0	1.8	1.1
Other carbbean Countries	2.0	2.2	-	1.4	0.2	0.1	5.0
Africa	**0.5**	**0.6**	**1.4**	**67.9**	**93.2**	**49.3**	**50.6**
Libya	-	-	-	1.4	2.4	1.4	8.6
Egypt	0.3	0.1	0.1	0.4	3.0	1.6	0.0
Mauritius	0.0	0.1	0.2	65.1	87.0	46.0	44.7
South Africa	0.0	0.1	0.3	0.7	0.4	0.3	0.1
Other African Countries	0.1	0.3	0.7	0.3	0.3	0.1	- 2.9
Asia	**69.1**	**226.0**	**161.8**	**521.0**	**1 814.8**	**365.9**	**448.9**
West Asia	**59.0**	**209.3**	**140.5**	**456.4**	**1 755.0**	**345.8**	**388.5**
Oman	3.2	9.8	1.9	2.6	3.6	2.5	17.8
Iran	0.0	0.0	0.0	0.5	0.5	0.3	0.3
Kuwait	2.2	1.5	4.5	38.5	18.1	8.7	36.9
Bahrain	21.9	34.1	1.1	27.4	21.0	13.0	28.2
Qatar	1.0	0.2	- 8.9	- 5.2	8.7	8.5	- 0.1
Saudi Arabia	1.3	43.5	7.2	18.4	277.8	268.8	9.5
Out of Which Privatisation proceeds				-	*255.0*	*255.0*	-
Turkey	0.0	0.3	0.1	3.3	0.8	0.6	0.0
U.A.E	21.5	119.6	134.6	367.5	1 424.5	43.2	295.9
Out of Which Privatisation proceeds		*104.0*		*260.0*	*1 186.0*		*133.2*
Unspecified West Asia	7.8	0.0	0.0	3.4	0.2	0.1	- 0.1
South, East and South-East Asia	**10.1**	**16.7**	**21.3**	**64.6**	**59.8**	**20.2**	**60.5**
Bangladesh	1.7	0.4	- 1.5	- 0.3	3.4	0.3	5.5
China	0.3	3.0	14.3	0.4	1.7	1.5	3.0
Hongkong	2.8	5.6	6.3	32.4	24.0	14.8	26.2
Malaysia	0.9	2.3	1.2	22.1	2.9	- 2.5	- 2.8
Singapore	3.9	3.7	5.1	8.0	9.9	4.6	13.1
India	0.0	0.0	0.1	0.1	0.5	0.3	0.1
Korea (South)	0.5	0.2	1.0	1.4	1.6	0.9	1.0
Unspecified South, East and South-East Asia	0.1	1.5	- 5.2	0.6	15.8	0.3	14.5
Unspecified developing countries	0.1	0.1	1.2	- 0.7	4.7	1.9	2.6
Unspecified	**35.3**	**105.0**	**90.2**	**101.1**	**141.8**	**82.5**	**248.0**

Source: State bank of Pakistan

C. Total Investment (A + B) (Million US$)

Country / economy	2001-02	2002-03	2003-04	2004-05	2005-06	July-January 2005-06	July-January 2006-07
Total world *with Privatisation*	**474.7**	**816.3**	**921.7**	**1 676.6**	**3 872.5**	**1 645.2**	**2 793.4**
Total world *without Privatisation*	**357.7**	**628.3**	**722.7**	**1 313.6**	**2 332.2**	**1 390.2**	**2 660.2**
Developed countries	**363.6**	**437.2**	**687.9**	**875.1**	**1 737.9**	**1 048.1**	**1 945.1**
Western Europe	**23.5**	**191.0**	**412.3**	**452.9**	**831.3**	**415.2**	**946.1**
European Union	**- 7.1**	**185.1**	**54.4**	**294.0**	**396.5**	**215.1**	**829.5**
Luxembourg	- 5.2	- 0.7	1.4	19.4	22.5	4.7	13.0
Denmark	0.7	- 8.7	0.5	1.2	- 5.2	1.0	0.3
France	- 6.5	2.6	- 5.6	- 3.5	3.2	1.9	- 1.5
Germany	11.2	3.8	4.0	15.2	25.1	21.8	22.1
Netherlands	- 5.9	3.1	12.0	59.8	120.4	79.6	60.5
Sweden	0.8	0.2	0.1	2.8	6.1	6.1	1.1
U.K	- 2.1	184.8	41.9	199.1	224.5	100.0	734.1
Out of Which Privatisation proceeds	-	*74.0*	-	-	-	-	-
Other Western Europe	**30.6**	**5.9**	**357.9**	**158.9**	**434.8**	**200.1**	**116.6**
Norway	0.1	0.3	146.6	31.4	252.6	139.7	24.9
Switzerland	30.5	5.6	211.3	127.5	182.2	60.3	91.7
Out of Which Privatisation proceeds	-	-	*199.0*	*103.0*	*99.3*		
North America	**330.9**	**227.1**	**260.3**	**375.0**	**825.5**	**592.3**	**919.3**
Canada	6.2	0.5	0.5	2.0	5.0	3.1	1.7
U.S.A	324.7	226.6	259.8	373.0	820.5	589.1	917.6
Out of Which Privatisation proceeds	*117.0*	*10.0*	-	-	-	*0.0*	*0.0*
Other developed countries	**7.2**	**16.0**	**13.2**	**47.2**	**81.1**	**40.6**	**79.7**
Australia	0.5	2.2	1.5	1.6	31.3	18.4	43.4
Japan	6.7	13.8	11.7	41.8	48.2	21.2	34.5
Unspecified Developed Countries	2.0	3.1	2.2	3.9	1.5	1.0	1.8
Developing economies	**72.7**	**280.4**	**159.6**	**716.7**	**1 996.6**	**517.8**	**599.4**
Caribbean Islands	**3.5**	**2.7**	**5.0**	**41.1**	**2.0**	**10.6**	**15.1**
Cayman Island	0.6	0.5	1.2	34.7	8.1	0.4	7.7
Bahamas	-	-	-	0.5	3.1	1.9	1.1
Other carbbean Countries	2.9	2.2	3.8	5.9	- 9.3	8.3	6.3
Africa	**1.1**	**0.7**	**9.6**	**68.1**	**88.2**	**46.3**	**60.1**
Libya	-	-	-	1.4	2.4	1.4	8.6
Egypt	0.3	0.1	0.1	0.4	1.7	1.6	0.0
Mauritius	0.0	0.1	7.2	65.3	83.0	42.8	54.4
South Africa	0.0	0.1	0.3	0.7	0.4	0.3	0.1
Other African Countries	0.7	0.4	1.9	0.4	0.7	0.3	- 3.0
Asia	**68.0**	**276.8**	**143.3**	**603.1**	**1 900.6**	**458.7**	**521.2**
West Asia	**56.1**	**276.3**	**139.1**	**509.1**	**1 803.4**	**381.8**	**426.6**
Oman	3.7	9.8	1.3	3.3	3.7	2.6	17.8
Iran	0.0	0.0	0.0	0.5	0.5	0.3	0.3
Kuwait	2.4	1.7	4.5	38.5	21.0	11.8	55.1
Bahrain	21.9	43.5	- 3.9	29.4	1.7	- 6.3	33.3
Qatar	1.1	57.2	- 8.7	- 4.8	8.8	8.6	- 0.1
Saudi Arabia	1.4	43.6	5.3	18.2	278.5	269.7	9.5
Out of Which Privatisation proceeds	-	-	-	-	*255.0*	*255.0*	-
Turkey	0.0	0.3	0.1	3.3	1.8	1.6	0.0
U.A.E	17.3	120.0	146.5	417.3	1 487.8	93.8	310.8
Out of Which Privatisation proceeds	-	*104.0*	-	*260.0*	*1 186.0*	-	*133.2*
Unspecified West Asia	8.2	0.0	- 6.0	3.4	- 0.3	- 0.3	- 0.1
South, East and South-East Asia	**11.9**	**0.5**	**4.2**	**94.0**	**97.2**	**76.8**	**94.6**
Bangladesh	1.7	0.4	- 1.5	- 0.3	3.4	0.3	5.5
China	0.3	2.7	14.3	0.5	1.7	1.5	3.0
Hongkong	23.4	5.2	4.9	61.2	55.2	61.0	- 52.7
Malaysia	0.9	2.5	1.2	22.1	3.6	- 1.8	- 0.6
Singapore	- 13.3	- 5.0	- 0.4	10.6	15.5	14.5	126.5
India	0.0	0.0	0.1	0.1	0.5	0.3	0.1
Korea (South)	0.5	- 6.7	- 8.4	1.4	1.6	0.9	1.0
Unspecified South, East and South-East Asia	- 1.4	1.5	- 6.0	- 1.6	15.7	0.2	12.0
Unspecified developing countries	0.1	0.3	1.8	4.4	5.9	2.2	3.0
Unspecified	**38.4**	**98.6**	**74.1**	**84.8**	**138.0**	**79.4**	**248.9**

Source: State bank of Pakistan

Appendix 7

Net Inflow of Foreign Private Investment - Sector-wise

Million US$

S.N	ECONOMIC GROUP	2001-02	2002-03	2003-04	2004-05	2005-06	July-January 2006-07	July-January 2005-06
1	Food	7.6	6.0	3.3	10.0	51.3	8.4	37.2
2	Food Packaging	0.0	-	-	-	2.0	0.3	2.0
3	Beverages	-13.6	1.0	0.7	6.2	6.2	8.1	4.3
4	Tobacco & Cigarettes	0.9	0.0	0.5	6.7	2.5	4.0	1.4
5	Sugar	0.1	0.9	0.4	4.2	5.1	13.2	3.8
6	Textiles	18.4	26.1	35.5	39.3	47.0	38.0	24.6
7	Paper & Pulp	0.7	1.4	1.7	0.0	0.1	0.5	0.1
8	Leather & Leather Products	0.5	1.2	3.5	6.5	3.5	2.0	2.8
9	Rubber & Rubber Products	0.3	0.0	0.0	0.0	4.7	3.1	2.2
10	Chemicals	10.6	86.2	15.3	51.0	62.9	18.6	34.6
11	Petro Chemicals	2.2	0.8	1.5	1.1	9.5	3.3	0.2
12	Petroleum Refining	2.8	2.2	70.9	23.7	31.2	66.6	18.6
13	Minning & Quarrying	6.6	1.4	1.1	0.5	7.1	16.3	3.6
14	Oil & Gas Explorations	268.2	186.8	202.4	193.8	312.7	328.5	174.3
	Of which Privatisation proceeds	*117.0*	*10.0*	-	-	-		
15	Pharmaceuticals & OTC Products	7.2	6.2	13.2	38.0	34.5	17.2	19.1
16	Cosmetics	0.0	0.0		1.1	0.8	0.0	0.8
17	Fertilizers	0.0	0.0	0.0	3.5	- 107.6	2.3	- 109.2
18	Cement	0.4	-0.4	1.9	13.1	39.0	13.7	28.2
19	Ceramics	0.0	0.0	0.1	0.4	0.4	0.2	0.2
20	Basic Metals	0.0	0.1	0.1	0.4	3.1	2.9	1.7
21	Metal Products	0.3	0.1	1.3	2.1	4.0	3.6	1.7
22	Machinery other than Electrical	0.1	0.4	0.7	2.8	1.2	2.4	0.8
23	Electrical Machinery	10.5	10.5	8.7	3.4	1.7	-1.4	1.0
24	Electronics	15.9	6.7	7.5	10.3	18.1	10.3	12.9
	I) Consumer/Household	12.6	4.2	6.0	7.9	7.8	6.8	5.6
	II) Indutrial	3.3	2.5	1.6	2.4	10.3	3.6	7.3
25	Transport Equipment(Automobiles)	1.1	0.6	3.3	33.1	33.1	28.2	19.2
	I) Motorcycles	0.8	0.0	0.0	0.9	3.3	0.7	1.2
	II) Cars	0.0	0.5	2.4	27.2	26.7	23.1	16.1
	III) Buses,Trucks,Vans & Trail	0.3	0.2	0.9	5.1	3.2	4.3	1.9
26	Power	36.4	32.8	-14.2	73.3	320.6	102.4	291.9
	I) Thermal	29.8	12.1	-21.4	69.3	319.7	101.6	291.8
	Of which Privatisation proceeds	-	-	-	-	*255.0*		*255.0*
	II) Hydel	6.5	20.6	7.1	4.1	0.9	0.8	0.1
27	Construction	12.8	17.6	32.0	42.7	89.5	86.2	44.5
28	Trade	34.2	39.1	35.6	52.1	118.0	104.6	71.9
29	Tourism	0.1	0.1	0.0	0.0	3.4	1.8	2.0
30	Transport	21.4	87.4	8.8	10.6	18.4	9.9	4.3
31	Storage Facilities	0.0	2.4	0.0	3.7	0.2	0.2	0.1
32	Communications	12.7	24.3	221.9	517.6	1,937.7	546.4	346.5
	1) Telecommunications	6.0	13.5	207.1	494.4	1,905.1	512.3	333.1
	Of which Privatisation proceeds				*260.0*	*1,186.0*	*133.2*	
	2) Information Technology	6.3	9.9	13.7	22.2	30.2	32.6	11.9
	I) Software Development	3.5	4.4	6.3	8.8	5.0	2.9	3.4
	II) Hardware Development	0.4	1.2	1.3	3.9	1.1	1.8	0.7
	III) I.T.Service	2.4	4.2	6.2	9.6	24.2	27.9	7.9
	3) Postal and Courier Services	0.3	0.9	1.1	1.0	2.4	1.5	1.5
33	Financial Business	3.5	207.6	242.1	269.4	329.2	553.6	127.8
	Of which Privatisation proceeds		*178.0*	*199.0*	*103.0*	*99.3*		
34	Social Services	2.0	0.3	0.9	1.2	3.1	2.8	0.8
35	Personal Services	8.3	19.4	15.5	23.5	61.6	52.5	35.8
36	Others	12.7	28.8	33.1	78.9	65.5	45.4	32.9
	TOTAL	**484.7**	**798.0**	**949.4**	**1,524.0**	**3,521.0**	**2,096.0**	**1,244.7**
	Total Without Privatisation	***367.7***	***610.0***	***750.4***	***1,161.0***	***1,980.7***	***1,962.8***	***989.7***

Source: State bank of Pakistan

Appendix 8

Summary of Regulation for Venture Capital Investments Section 25-32 of NBFC Rules 2003

25. Eligibility conditions of a venture capital fund. (1) A venture capital fund shall not be granted licence by the Commission unless it fulfills the following conditions, namely:-

(a) it is incorporated as a company under the Ordinance;

(b) it is not engaged in any business other than that of investment in venture projects;

(c) it has a minimum equity of fifty million rupees raised through private placement; and

(d) for the purpose of managing its entire business, it has entered into a contract, in writing, with a NBFC duly licensed by the Commission to operate as a venture capital company and a copy of which has been filed with the Commission.

(2) The board of venture capital fund shall not have a director, who is on the board of any venture project being financed by the fund.

26. Condition for grant of licence.

(1) No venture capital fund shall commence business unless a licence is granted by the Commission under these rules.

(2) For obtaining a licence a venture capital fund shall,¾

(a) make an application, as set out in Form VI, to the Commission providing information as sought in Annex thereto, along with all the relevant documents;

(b) submit a bank draft payable to the Commission evidencing the payment of non-refundable application processing fee amounting to fifty thousand rupees; and

(c) submit an undertaking that no change in the memorandum and articles of association and in the directors shall be made without prior written authorization of the Commission and that all conditions for grant of licence shall be complied with.

(3) On being satisfied that a venture capital fund is eligible for the grant of a licence and that it would be in the public interest so to do, the Commission may grant a licence as set out in Form VII.

(4) Without prejudice to any other conditions under these rules, the Commission may while granting licence imposes any conditions, as it may deem necessary.

27. Terms and conditions of operation. Unless granted a general or specific waiver by the Commission, a venture capital fund shall,

(a) not expose more than forty per cent of its equity to any single person or group of companies:

Explanation: For the purposes of this rule group of companies shall mean companies managed by the members of one family including spouse, lineal ascendants and descendants and brothers and sisters;

(b) disclose in its accounts all investments in companies and group of companies exceeding ten per cent of paid-up capital of venture capital fund;

(c) ensure that the maximum exposure of the venture capital fund to its directors, affiliated companies and companies in which any of the directors and their family members including spouse, lineal ascendants and descendants and brothers and sisters hold controlling interest, shall not exceed ten per cent of the overall portfolio of venture capital; and

(d) not accept any investment from any investor, which is less than one million rupees.

28. Renewal of licence. (1) The licence granted to the fund under rule 26 shall be valid for one year and shall be renewable annually on payment of a fee of twenty five thousand rupees on an application as set out in Form VIII.

(2) The Commission may, after making such inquiry and after obtaining such further information as it may consider necessary, renew the licence of such fund for one year on Form IX on such conditions as it may deem necessary.

29. Private placement. A venture capital fund shall raise and receive funds for investment in venture projects through private placement of such securities as may be notified by the Commission, from time to time.

30. Placement memorandum. A venture capital fund shall, before soliciting placement of its securities, file with the Commission a placement memorandum, which shall inter alia give details of the terms subject to which funds are proposed to be raised from such placements.

31. Enquiry. The Commission may cause an enquiry to be made, by any person appointed in this behalf, into the affairs of any venture capital fund.

32. Cancellation of licence. (1) Where the Commission is of the opinion that a venture capital fund has contravened any provision, or has failed to comply with any requirement of any rule or any provision of applicable laws or conditions imposed by the Commission or order passed by the Commission or direction made or given hereunder, the Commission may, if it considers necessary in the public interest so to do, by order in writing, cancel the licence of the venture capital fund:

Provided that no such order shall be made except after giving the venture capital fund an opportunity of being heard.

(1) Upon cancellation of licence, the functions and carrying on the business of the venture capital fund shall cease and the Commission may apply to move the Court for a winding up order in respect of the venture capital fund or take such other action against the venture capital fund, as the Commission may deem fit.

(2) Notwithstanding cancellation of licence under sub-rule (1), the directors, chief executive, chairman and other officer of the venture capital fund shall not be absolved of any civil and criminal liability under these rules, the Securities and Exchange Ordinance, 1969 (XVII of 1969), or any other law for the time being in force.

(3) Where the licence of the venture capital fund has been cancelled under sub-rule (1), the Commission may, by an order in writing, appoint a person as Administrator to manage the affairs of the fund subject to such terms and conditions as may be specified in the order.

(4) The management of the affairs of the venture capital fund, shall vest in the Administrator on and from the date of the Administrator's appointment until a liquidator is appointed by the Court.