

# Investing in tomorrow's markets

Rapid growth and serious social and environmental challenges are generating exciting opportunities for entrepreneurs in developing economies – if they can attract finance. **Sara Standish** considers how to accelerate the transfer of capital to companies in emerging markets

**W**ith private capital flows to emerging economies reaching an all-time high of \$358 million last year, it is clear that investors are taking new opportunities in developing countries seriously. This trend is set to continue as projected growth rates are nearly double those in developed countries. But, while more investors are entering these markets, overall capital transfer remains low. And, as large-scale infrastructure projects garner the majority of financing, the lack of investments in small and medium-sized enterprises (SMEs), which provide more than 80% of employment in these countries, is stifling growth potential.

At the same time, global environmental and social trends reveal deep, complex challenges that require the mobilisation of new business models and strategies. In the past 20 years, world energy production rose 42%; in the next 50, it is set to rise by 150–230%. Two out of five people in the world live in India or China and more than 80% of the world's population lives in a developing country. More than 1 billion people lack access to clean water and 2.5 billion lack access to adequate sanitation.

While these facts are startling, they present a clear demand for sustainable solutions in emerging economies where rapid industrialisation is exacerbating the depletion of already strained resources. As these countries continue their current growth trajectory, providing innovative solutions to problems such as air pollution, energy consumption, urban transport and inadequate water and sanitation is not only necessary, but will also define tomorrow's markets.

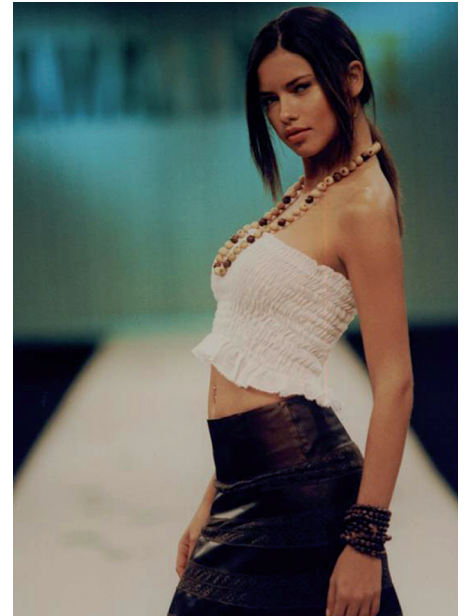
But investments are being made at the venture level in small businesses in emerging

economies, providing new solutions to global challenges and opportunities for investors to benefit from participation in cutting edge markets. Business can profit from solving the toughest global issues by incorporating the world's poor into international markets – but additional support is needed to scale the impact of these investments.

Studies estimate the annual global market for environmental goods and services – including the clean technology, organic foods, and sustainable forestry sectors – to be more than \$600 billion, with projections reaching \$800 billion in the next 10 years. These industries have seen strong growth both in developed and emerging economies. An estimated \$180 million was invested in the US clean technology market in 2005 – nearly double the amount of the previous year.<sup>1</sup> While much of the investment is still directed to developed countries, the need for environmentally friendly products and services is high in emerging economies, making them promising sources of profits and innovation.

One company meeting this demand is Vehizero, a manufacturer of an electric-hybrid urban delivery vehicle. Using an internal combustion engine and regenerative braking technology, the compact truck recycles more than 60% of its energy, compared to less than 10% in vehicles currently offered. This results in an estimated 60% reduction in fuel costs and reduced emissions. Based in Mexico City – a metropolitan area that is rated as one of the five worst in the world for air pollution, with 84% resulting from vehicle emissions – the company is focusing on strongly growing regional markets. Investments from E+Co, a US-based investment firm specialising in energy, and others have financed initial operations and now revenues are projected to grow by a factor of eight in the next four years.

A recent study of US venture capitalists



AmazonLife – putting biodiversity on the catwalk

reveals that more than 20% of investors are looking to enter global markets. Not surprisingly, with their rapid growth rates, China and India top the list. Catherine Cao, executive director of Tsinghua Venture Capital, a Chinese investment firm specialising in sustainability, understands the potential. She identifies products and services that provide solutions to growing problems such as rural energy needs and waste management as good investments for the future.

“Chinese entrepreneurs are a source of innovation. By creating high-quality, low-cost environmental products they will meet current and future needs at home – and expand the country's ability to export local solutions to world markets that face similar challenges,” she notes. Only 69.5% of people in Asia have access to electricity. This represents a market of over 1.1 billion people who need basic energy services in the region.

In addition, recently adopted international climate policies are driving strong growth in clean energy solutions. Business leaders such as General Electric, which has committed \$1.5 billion a year to developing new clean technologies, view this sector as a major growth opportunity. SMEs are capitalising on this market trend. Clean technology leaders, such as Yunnan Zhenghong Environmental Protection Energy Conservation, which manufactures energy-saving ovens that increase fuel efficiency by up to 40%, and Nanning Growing Power Tech, which manufactures energy-efficient small-scale boilers, are profitable options for investors in China. Understanding regional and global trends and using a “problem-solving approach,” allows investors to select companies that meet social and environmental needs and provides them with capital to scale and capture market value as early movers.

One company, Xinjiang SunOasis, illus-

<sup>1</sup> Pricewaterhouse Coopers, Thomson Venture Economics, National Venture Capital Association, 2005, *MoneyTree Survey*. Available at: [www.pwcmoneytree.com/moneytree/index.jsp](http://www.pwcmoneytree.com/moneytree/index.jsp)

trates the value of this investment approach and has posted ten-fold growth over four years. The company produces small- to medium-scale solar photovoltaic and thermal installations for commercial and private use, with some of its products incorporated into buildings designed for the 2008 Beijing Olympics.

Beyond the booming construction sector, SunOasis is meeting the unmet needs of low-income users. In 2001, the company initiated a rural electrification project with Shell Solar – financially leveraged by the Chinese and Dutch governments – to bring energy services to more than 78,000 households. This success, and the company's ability to integrate socially and environmentally friendly services into its core business strategy, illustrates the potential of profitably aligning business and development goals. Early financial support provided returns for the investor, the entrepreneur and the community.

**B**iodiversity also offers an attractive potential market, with the value of biodiversity-derived products estimated to be upward of \$500 billion a year<sup>2</sup>. This includes products related to agricultural, health and other biotechnology sectors that utilise genetic materials. In the pharmaceutical business alone, half of the top 10 prescription drugs are based on natural plant products. And, while 35,000 plants are estimated to be of medicinal value, only 5,000 have been studied – indicating the immense potential of biological resources and the economic importance of conservation.

Additionally, services dependent on biodiversity and natural resource management, such as ecotourism, are important sources of income in many developing countries. Their success translates into attractive returns for investors; for example, ecotourism-related companies can provide rates of return of between 20 and 40%.<sup>3</sup>

New Ventures, a programme of the World Resources Institute, a Washington, DC-based environmental think-tank, seeks to accelerate the growth of these markets by paying special attention to SMEs. With local partners in Brazil, China, India, Indonesia and Mexico, the programme identifies, selects and mentors outstanding environmental entrepreneurs who then present their companies to a suite of global investors. Since 1999, New Ventures has provided nearly 1,000 enterprises in developing countries with business development services, leveraging \$12 million in total financing.

Through prior work, New Ventures observed that biodiversity-related companies represented a potentially successful but under-developed market segment. "The biodiversity sector is poised for a breakthrough in scale. Yet many promising companies lack access to business development services that will help them attract capital and grow their operations," comments Virginia Barreiro, director of global operations for New Ventures.

### Other investment opportunities in emerging economies

- **BioCentinela** has produced and commercialised high-quality white shrimp for more than 15 years in Ecuador. In 2002 it was officially certified as organic by the Naturland Association for Organic Agriculture [www.biocentinela.com](http://www.biocentinela.com)
- Brazil-based **Eletra** has created a patented system of hybrid electric traction for urban mass transit buses and trucks. Its buses are found in Brazil and Chile, with plans to expand to other cities in Latin and North America, and Asia [www.eletrabus.com](http://www.eletrabus.com)
- **Green Circle Company**, based in China, provides high-quality biodegradable tableware and packaging for food products in China, Japan and South Korea
- **Rio y Montana** offers innovative expeditions and ecotourism trips in Mexico. The company has developed products that include adventure villages, boutique hotels, entrepreneurship programmes, and expeditions [www.rioymontana.com](http://www.rioymontana.com)

To address this gap, New Ventures, together with two economic development organisations – the United Nations Conference on Trade and Development (UNCTAD) and the Andean Development Corporation (CAF) – embarked on an initiative to support companies whose business promotes biodiversity conservation. Through the joint project, New Ventures, UNCTAD and CAF engaged companies that incorporate social and environmental benefits in the biodiversity sector.

These include companies such as AmazonLife, a Brazilian pioneer in the manufacturing and commercialisation of leather-like rubberised fabric for the fashion industry, whose clients have included Hermes and Giant Bicycles. Its business illustrates the global reach that the biodiversity sector can have. The company uses a unique raw material extracted from the Amazon and works with local indigenous and rubber-tapper families to support conservation and community livelihoods.

The result of these efforts was the transfer of more than \$6.5 million in financing to a portfolio of New Ventures' companies that protect the environment through economic growth in the biodiversity sector. Beyond the success of the individual companies, the New Ventures initiative represents strategic, industry-focused development – one that should be of interest to investors looking to enter these potentially lucrative markets. By building a pipeline of outstanding companies and convening stakeholders that are poised to support them, New Ventures provides well-prepared companies ready for growth and investment.

Despite these trends and opportunities, perceived risks remain high. Inconsistent returns, geopolitical instability, and policy barriers are enough to give many investors pause. However, the strong growth observed in emerging economies and the overwhelming interest among investors to reach energy and environment-related markets underscores the importance of finding ways to reduce these obstacles. Risk abatement strategies and mechanisms such as co-investment, global development bonds, guarantees, bundling and increased business development services should be further tested and refined. New strategies are needed to draw financing from global capital markets to developing countries, with special attention to small and medium-sized enterprises.

**E**xamples from the clean technology, renewable energy, and biodiversity sectors offer insight into the potential size and value of environmental markets. And examining the success of SMEs such as Vehizero, SunOasis and AmazonLife reveals key opportunities and challenges. Among them, new approaches to enterprise identification, strategic business development and financing mechanisms that draw on additional financing from global capital markets are important elements in the acceleration of business opportunities in developing countries. Looking at economic and social trends, it is clear that sustainable enterprises in emerging economies will be an increasing source of profit for investors – and, as they prosper, they will generate a wealth of benefits for people and the environment. ■

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### Additional resources on investing in emerging economies and sustainable enterprises

**Association for Sustainable & Responsible Investment in Asia** [www.asria.org](http://www.asria.org)

**Business in Development Network** [www.bidnetwork.org](http://www.bidnetwork.org)

**China Venture Capital Association** [www.cvca.com.hk](http://www.cvca.com.hk)

**Cleantech Venture Network** [www.cleantech.com](http://www.cleantech.com)

**Emerging Markets Private Equity Association** [www.empea.net](http://www.empea.net)

**Latin American Venture Capital Association** [www.lavca.org](http://www.lavca.org)

**National Venture Capital Association** [www.nvca.org](http://www.nvca.org)

<sup>2</sup> ten Kate, Kerry, Laird, Sarah A, 1999, *The Commercial Use of Biodiversity*. London: Earthscan

<sup>3</sup> United Nations Development Programme, United Nations Environment Programme, International Institute for the Environment and Development, The World Conservation Union (IUCN), World Resources Institute, 2005, *Sustaining the Environment to Fight Poverty and Achieve the MDGs: The Economic Case and Priorities for Action*. New York: Bedwick & Jones Printing