

Memorandum to the HOC committee on the future of the CDC

We hope we may contribute to the review currently underway and believe that the experience we have as the largest sustainable investors in small and medium sized enterprises globally could be of value in your deliberations.

HOC memorandum

1. An executive summary of the main points made in the submission

- History has proved private sector growth is the engine of development. The importance of the contribution of the private sector in tackling poverty has been recently reinforced at the UN MDG summit with DFID being a strong partner in the ratification of this agreement.
- The key value addition of the private sector is in facilitating economic growth at an enterprise level. However, the largest development impact comes from sustainable small and medium businesses which remain in the formal and informal sectors, the largest providers of employment and economic output.
- A catalytic effect can be achieved in addition by scaling up sustainable small and medium businesses, especially those which are engaging in inclusive business practices. These inclusive business practices comprise engaging with lower and middle income individuals as producers, sellers, buyers and employees.
- These small and medium size enterprises however face internal and external challenges when trying to grow including:
 - Lack of patient capital
 - Lack of appropriate professional business knowledge
 - Lack of resource and business knowhow to take advantage of opportunities
 - High cost of doing business
 - Lack of a sufficient pool of quality managers
 - Inability to overcome barriers and to scale-up
- The private equity method is well placed to address these challenges in so far as fund managers apply both a strong process approach to instilling good practices as well as close participation, working closely with the businesses to build their capacity to thrive. This is the value addition afforded by Private Equity which transcends the provision of capital.

2. A brief introduction to the submitter, perhaps explaining their area of expertise

- Sev Vettivetpillai, CEO of Aureos Capital, was a senior Investment Executive in the CDC Funds Group, when the CDC was directly investing in equity and debt in local companies. He served for three years at CDC's fund management company in Sri Lanka where he was originating, evaluating, executing and monitoring private equity deals in small and medium sized businesses. Sev was at the forefront of the development of Sri Lanka's capital markets. This was seen as a prime example of the development path of small frontier markets, indeed setting the paradigm in terms of liberalisation and deregulation.
- Sev then transferred to CDC in London, where he was responsible for evaluating third party fund investments where CDC was just an investor. In addition, he monitored CDC's portfolio of 19 managed funds investing in Small and Medium Sized enterprises in Central America, Africa and Asia.
- In 2001, 139 Small and Medium sized enterprise investments made directly by CDC were spun off into Aureos, a fund management company owned by CDC and Norfund (the Norwegian Development Finance Institution). The mandate given to Aureos was to manage out these investments and to raise new third party capital to further invest in Small and Medium Enterprise funds.
- Aureos continued to manage these investments and has now exited from all but five of them, returning the capital to the shareholders of the funds.
- Aureos went on to raise new capital, primarily from Development Finance Institutions and multilaterals to create 17 funds, to invest sustainably in small and medium sized enterprises in Latin America, Africa and Asia. From 10 offices in 2001, Aureos now has 29 offices globally with 170 employees hailing from over 25 emerging markets. Aureos also went from investing in 16 emerging and frontier markets to 34 today.
- Aureos' latest fund is the Africa Health Fund, the first fund to fully combine development impact and finance targets. The innovative fund is backed by investors including the IFC (the Private Sector arm of the World Bank) and the Bill and Melinda Gates Foundation. The intent of the fund is to invest in small and medium sized companies in the challenged health space in Africa, to increase access, quality and affordability of healthcare to those at the Bottom of the Pyramid.
- Aureos continues to bridge the missing middle in Emerging Markets. We do this through the provision of critically necessary financing, capacity building, business mentorship and sound Environmental, Social and Governance practices. We work in collaboration with entrepreneurs to grow and expand small and medium sized businesses across regional markets. This has resulted in significant South-South trade as well as an increase in the local sourcing of goods and services, demonstrating economic development and vitality which underpin private sector development.
- Over the last two decades, Aureos has invested in over 275 small and medium sized enterprises in some of the most challenging markets Latin America, Africa and Asia- Pacific. Today, Aureos has an active portfolio of more than 120 companies it is working closely with to scale across the regions of the Global South.

3. Any factual information the submitter has to offer from which the committee might be able to draw conclusions, or which could be put to other witnesses for their reactions

Please refer to Appendix 1 for details.

1. The diversified portfolio across 40+ countries by June 2010 provided \$564 million to finance Small and Medium Enterprises in critical sectors vital for growth.
2. In 2009, Aureos portfolio companies employed 48,000 people, spending \$5.6 million on capacity building in skills.

3. The companies paid local taxes of \$121 million in 2009. Portfolio companies paid in excess of \$241 million cumulatively in taxes between 2005 and 2009.
4. The viability of the regional trade by these companies is demonstrated by the increase in total exports of \$304 million experienced by the companies in 2009.
5. Aureos utilises the power of technology to empower businesses to grow, increase productivity, increase accountability through enhanced governance and to scale up in a sustainable manner. In 2009, portfolio companies spent \$54.6 million in new technology.
6. The companies source local services and utilities, spending \$152 million in 2009.

4. Any **recommendations for action** by the Government or others which the submitter would like the committee to consider for inclusion in its report to the House.

- The PE model is essentially ideal for the deployment of capital through qualified intermediaries to make the capital efficient and effective in achieving development goals.
- The provision of appropriate capital spurs to create economic activities, using different instruments, at different times in the development cycles of companies is vital and is what the CDC should continue to support. CDC has built a strong competency as a Fund of Funds. This should not be neglected. Instead, CDC should look to share its learning with Local Pension funds to mobilise more capital.
- Additional capital should be brought to bear in the Emerging Markets, through direct and indirect means without geographical or sectoral limitations. By applying a balanced approach to multiple emerging markets, it is possible to leverage the strengthening trends of South-South trade to use MICs to further develop lower income countries.

SMEs remain a vital sector that need to be funded and the demand is further increasing with the growth of the emerging markets.

Appendix 1

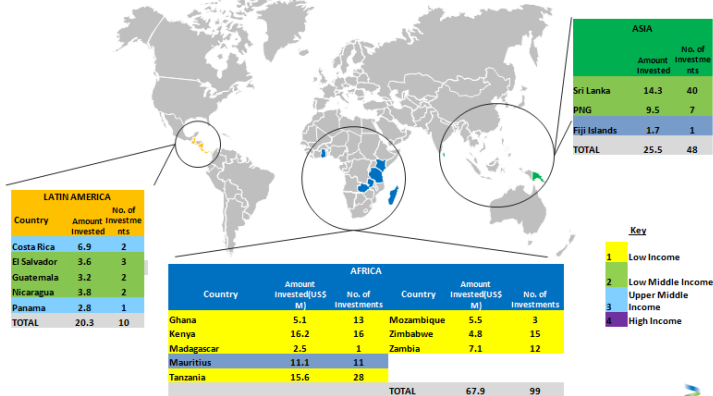
Aureos is a local expert with global reach and aims to generate superior returns through sustainable Small to Medium business investments in the Emerging Markets

AN EVOLVING HISTORY FROM A STRONG HERITAGE IN DEVELOPMENT

- Aureos has in 10 years, increased the capital invested, increased its **geographical diversification** while still investing primarily in low and low-middle income countries. Aureos developed a platform approach, investing in low middle-income countries, utilizing the more developed human and capital infrastructure of these countries to expand businesses into low-income countries.

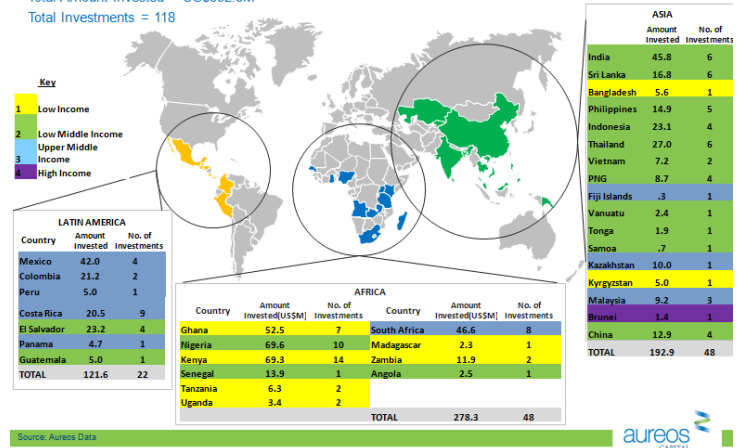
Aureos Legacy Funds in Emerging Markets

Total Amount Invested = US\$113.7M
Total Investments = 157



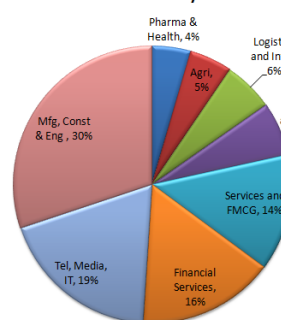
Aureos New Funds Continuing Growth in Emerging Markets

Total Amount Invested = US\$592.8M
Total Investments = 118



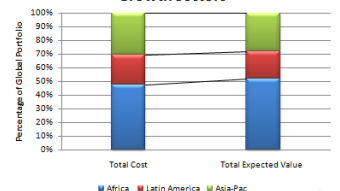
- Aureos' investments in small and medium sized enterprises span multiple crucial sectors. This **sector diversification** has compounded the development of the SME sector which represents an overwhelming proportion of enterprises in Emerging Economies, often providing the highest employment rates and significantly contributing to GDP output. By investing in these businesses, Aureos is working to fill the **“Missing Middle” in the Emerging Markets**.

Aureos Portfolio by Sector



A diversified portfolio across 29 countries, providing by June 2010 \$564 million to finance Small and Medium Enterprises in critical sectors vital for growth.

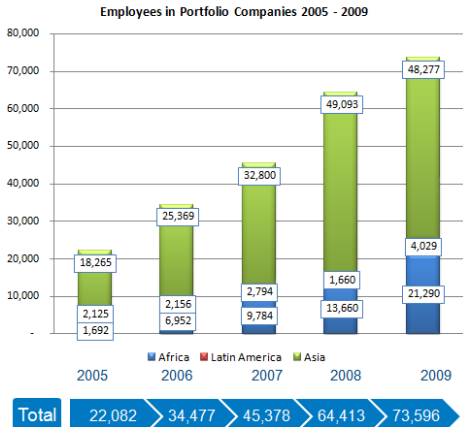
A Diversified Portfolio Invested in Growth Sectors



- The Aureos investment team is **highly experienced in developed markets and emerging markets**, possessing a diverse range of skills, backgrounds and nationalities. The team is based in 29 offices globally. Experience has shown that investee companies are attracted to Aureos' hands-on support, value addition and access to its global network of sector specialists, investment/operating partners, and commercial relationships.
- Signatory to the UN PRI, embedding **strong Environmental, Social and Governance standards**.
- Aureos has developed the bespoke Aureos Sustainability Index (ASI), a proprietary interactive tool to report development impact over the lifetime of our investments. It collates information on 70 quantitative and qualitative indicators to yield insight into the relationship between financial performance and 'intangibles'. The six aspects of sustainability tracked by the ASI are Financial Performance, Economic Linkages, Socio-economic Impact, Private Sector Development, Management & Governance, Health, Safety, Environmental & Social.

2009 ASI GLOBAL DATA

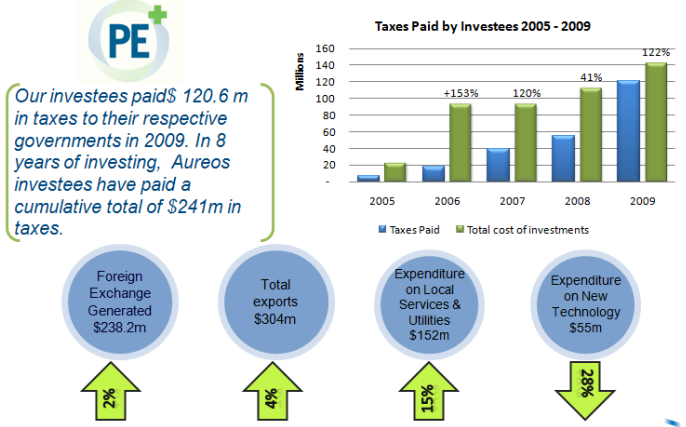
Putting Capital to Work: Increasing Employment, Skills and Building Scale



With the critical capital and expertise provided by Aureos, in 2009, \$5.6m was spent on training, a 3.2x increase per employee versus 2008

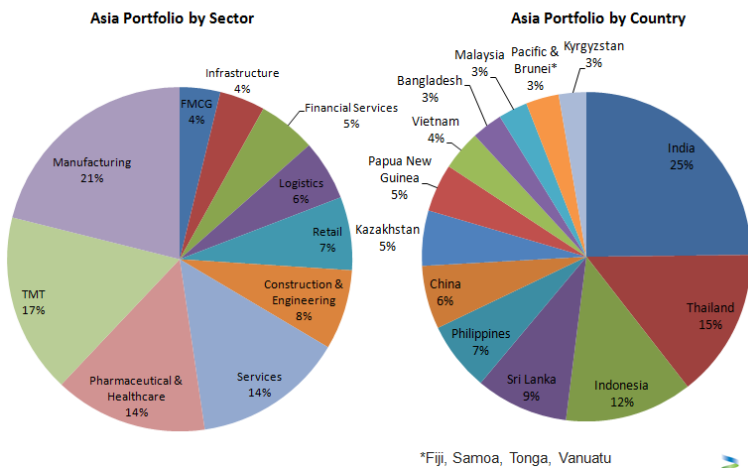
In 2009, Aureos made investments of \$142m in companies that employed 16,000 people

2009 - The Contribution of Our Investees During a Difficult Year

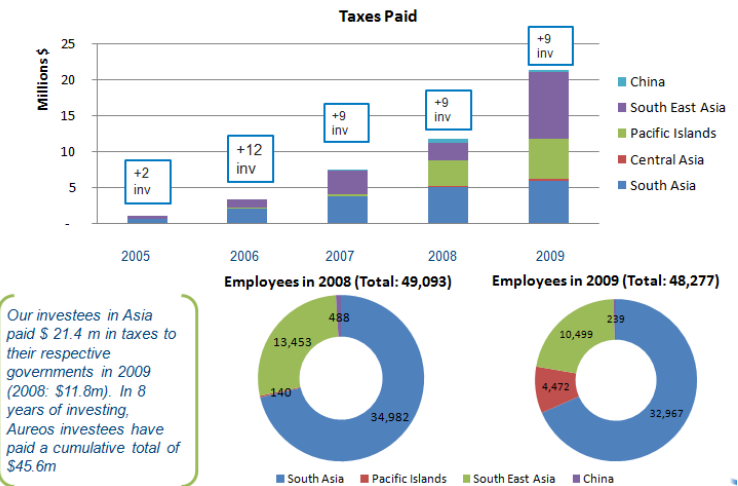


2009 ASI ASIA DATA

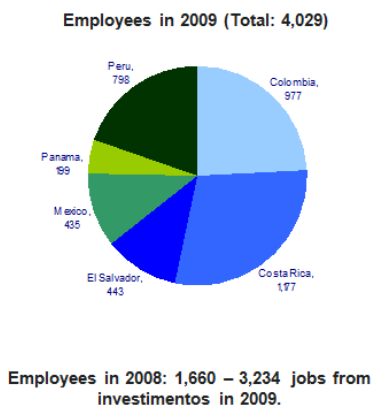
Aureos in Asia – Diversification by Sector and Country



2009 – Snapshot of Asia



2009 ASI LATIN AMERICA DATA



- RedIT (18 – Mexico) and ITS (65 – Costa Rica) ranked as "Great Places to Work"
- Major investment in training in technology based companies – ITS and RedIT – up to US\$250k spent in 2009
- US\$16.1m paid in taxes in 2009
- Irradius – an investment made in June 2010 – is targeting to provide housing solutions to an underserved market with low acquisition power – Rent to own program, average home prices US\$20k to US\$35k
- Corporate governance enhancement

2009 ASI AFRICA AMERICA DATA

