Private equity in emerging markets is a relatively small but vital part of our portfolio. In addition to the arguments for diversification and performance, we believe that experienced fund managers are playing an important role in building local economies—they are generating growth, creating jobs, strengthening corporate governance and raising the overall standards for business across the board.

—Institutional limited partner

A principal theme of this book is that private equity in developing countries bears little resemblance to its counterpart in more advanced countries, where it benefits from a supporting ecosystem, which includes, for example, enabling government policies; confidence-inducing legal frameworks that enforce contracts and protect investors; efficient financial markets that offer firms affordable access to diverse sources of capital; a range of viable exit options; relatively stable macroeconomic and political conditions; business adherence to internationally accepted best practices, such as standards of accounting, financial reporting, and corporate governance; and deep pools of entrepreneurial, managerial, and operational talent. However, it is important to keep in mind that it took more than half a century for this foundation to develop and evolve.
Building a private equity industry in developed countries: over half a century of gradual evolution

Private equity was a relatively obscure slice of the international financial landscape until the late 1980s and early 1990s, when a few mega-buyout funds such as Blackstone, KKR, and The Carlyle Group came to dominate the headlines. But private equity existed long before these firms became household names; its origins trace back to 1946, when the first formal venture capital firm, American Research and Development Corporation (ARDC), was formed by leaders at the Massachusetts Institute of Technology (MIT), Harvard Business School, and the Boston business community. Originally established to channel private investments into businesses run by soldiers returning from the battlefields of World War II, ARDC marked the first legal structure that could raise capital from sources beyond wealthy families, who had previously dominated the private investment landscape.

The gradual transformation of the private equity landscape in developed countries

In its infancy, the term “private equity” was synonymous with venture capital: a type of equity financing aimed at fostering entrepreneurial activity in start-ups or early-stage firms that exhibit the potential for rapid growth. From the beginning, venture capital investing grew at a sluggish pace and was relatively insignificant as a financing vehicle. During the first three decades of its existence, the amount of capital flowing annually into the industry, which was rooted in the United States, never exceeded a miniscule few hundred million dollars.¹ This changed dramatically in the late 1970s, however, following two important regulatory modifications. First, the 1978 Revenue Act decreased the capital gains tax from 49.5 percent to 28 percent, giving individuals greater incentive to invest in venture capital funds. Second, and more importantly, in 1979 the US Department of Labor modified an obscure regulation called the Employee Retirement Income Security Act (ERISA), which governed what was and was not a permissible investment for pension funds. Previously, according to ERISA, pension funds were not considered to be fulfilling their fiduciary responsibility to