SigmaBleyzer

*Where Opportunities Emerge.*

THE BLEYZER FOUNDATION

**Turning Transitions into Prosperity**

# Investing in Transition Economies

## *A Revised Approach*

**February, 2003**

# The New Approach (USG)

- Improved Global Security through Economic Development leveraged by private capital
- Accelerated development and market economy expansion lead to greater stability
- Private capital could be one of the main beneficiaries of more predictable and transparent environment

# The New Approach (Global Corp.)

- Improved Risk / Reward ratios for Global investments through stability, predictability and transparency
- Accelerated development and market economy expansion lead to greater stability
- Private capital could be one of the main beneficiaries of more predictable and transparent environment

# The New Approach (Foundations)

- Improved Global security through wealth creation by expanding market economy
- Accelerated development and market economy expansion lead to greater stability
- Private capital could be one of the main beneficiaries of more predictable and transparent environment

# The New Approach (High Net Worth)

- Improved Risk / Reward ratios and Global Security through wealth creation by expanding market economy
- Accelerated development and market economy expansion lead to greater stability
- Private capital could be one of the main beneficiaries of more predictable and transparent environment

# SigmaBleyzer

- US company managing a premier Ukrainian Investment Banking group
- Three Private Equity Funds in FSU, with focus on Ukraine
- Ten years experience in Ukraine
- Investors include: global financial institutions and high net worth individuals / families
- Ukrainian Growth Funds (UGF) – over $100 million under management
- Investments in over 100 Ukrainian companies
- Substantial experience in business development, managing and restructuring companies, country economic development
- Significant number of successful exits ($50M)
- Leadership in International Private Capital Task Force (IPCTF)
- Significant experience in benchmarking economic policies

# Major challenge of the 21st Century: Developed and Developing Nations - Assured Interdependence

- The polarization in the world is growing leading to envy and instability
- Wealth redistribution idea is flawed and outdated
- Instead replication of wealth creation capacity is needed
- This can only be accomplished through a combination of precisely targeted assistance and active engagement – tight linkage between macro level economic development and micro level business development
- Methodology and tools are necessary to develop implementation plans and measure progress
- Private Capital must lead new nations to market economy

# Problems in Transition Economies

- Lack of transparency
- Illiquid markets
- Unpredictable regulatory environment
- Excessive taxation and licensing requirements
- Corruption
- Piracy
- Lack of sufficient corporate governance
- Political risk
- Undeveloped financial sector

# Implications for International Investors

- High-risk investments
- Limited opportunities
- Lack of liquidity
- Higher costs
- Loss of revenue from piracy
- Diminished returns

# Private Equity (FDI) - the Most Stable Source of International Financing

## Net Capital Flows to Emerging Markets[1] (in US Dollars billions)

| | 1984-89 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 e | 2003 e |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Net Private Capital | 12 | 152 | 212 | 229 | 102 | 62 | 85 | 29 | 25 | 62 | 65 |
| Foreign Direct Investment | 13 | 81 | 98 | 114 | 142 | 154 | 164 | 158 | 172 | 151 | 161 |
| Portfolio Investment | 6 | 113 | 43 | 90 | 47 | 0 | 34 | -4 | -43 | -3 | -4 |
| Commercial Bank Loans | -5 | -42 | 71 | 24 | -86 | -92 | -113 | -124 | -105 | -86 | -92 |
| | | | | | | | | | | | |
| Official Assistance | 24 | 4 | 27 | -2 | 68 | 70 | 12 | 0 | 15 | 21 | 18 |
| | | | | | | | | | | | |
| International Reserves[2] | -8 | -69 | -118 | -108 | -69 | -48 | -88 | -113 | -120 | -147 | -130 |

[1] Emerging Markets includes developing countries, countries in transition, Korea, Singapore, Taiwan Province of China, and Israel.

[2] A minus sign indicates an increase in international reserves

Source: World Economic Outlook (WEO) database, IMF, September 2002

# Magic Formula:
# Economic Development Framework

- Macroeconomic Stabilization
  - Fiscal policies
  - Monetary policies
- Investment Drivers (Initially 70 investment drivers were identified through benchmarking and statistical analysis of 110 countries, analyzed and grouped into the following key government policy action groups, which stimulated foreign direct investments in successful transition economies)

1. Liberalization and deregulation of business activities
2. Stability and predictability of legal environment
3. Corporate and Public Governance
4. Liberalization of Foreign Trade and International Capital movements
5. Financial Sector Development
6. Corruption Level
7. Political Risk
8. Country Promotion and Image
9. Targeted Investment Incentives

# Main Role of the IFIs

- Help reduce poverty by making loans that support development projects to governments (World Bank)
- Provide loans to countries experiencing balance-of-payments problems so that they can restore conditions for sustainable economic growth (IMF)
- Provide project financing for banks, industries and businesses, both new ventures and investments in existing companies to help build market economy (EBRD)
- Provide technical assistance
- Conduct extensive research on development topics

# IFIs Shortcomings

- Too much focus on debt capital – loans that often cannot be repaid
- Too much focus on programs that do not generate their own self-financing, such as government budget deficit financing, poverty alleviation, environmental programs, infrastructure building.
- Not enough focus on wealth creation through private business development, capital-friendly environment creation, private equity investments, economic and business development
- Significant vested interest groups on both sides of the divide coupled with complicated government bureaucracies make changes very difficult and slow

# Aid Can Actually Be Counterproductive

- Many of the old models of economic development assistance are outdated. Money that is not accompanied by legal and economic reform are often wasted. In many poor nations, corruption runs deep. Private property is unprotected. Markets are closed. Monetary and fiscal policies are unsustainable. Private contracts are unenforceable
- When nations refuse to enact sound policies, progress against poverty is nearly impossible. In these situations, more aid money can actually be counterproductive, because it subsidizes bad policies, delays reform, and crowds out private investment
- In sound policy environments, aid attracts private investment by two to one

President Bush, March 14, 2002

# Solution – Privatized Financial Aid

- Hybrid investment style – combined economic development, business development and private equity investments to accelerate the transition to market economy and achieve superior returns
- Combine traditional NGO, non-profit activities with for-profit investment in the same vehicle
- Use private capital to improve the investment environment at the macro level to achieve superior returns at the micro level
- Create private capital funded financial aid program

# Benchmarking Economic Policies

- This approach is based on historical results in a large sample of countries
- Benchmarking and statistical analysis of 110 countries indicate strong correlation between flows of FDI and investment environment
- Increased flows of FDI is normally correlated with incremental economic growth, improved investment returns, higher risk / reward ratios

# Action Plan

- Conduct a pilot to prove the concept of a "Private World Bank"
- Raise $100 – 500M initial fund to act as the first hybrid investment vehicle
- Identify 10-20 multinational corporations, high net worth individuals or families, major foundation to participate in the pilot
- Investors in the fund also act as members of the advisory board
- Jointly with the advisory board select a country or a group of countries for the pilot (initial list will be proposed)
- Negotiate an arrangement with the recipient country government to provide macro level economic development plan creation and implementation support and micro level private equity investments in the country in exchange for government's commitment to implement jointly developed action plan

# What can you do?

- Provide feedback, critique, comments, suggestions for changes
- Laugh
- Throw us out and lock the door
- Join the action group, which is developing the conceptual framework for the Private World Bank
- Participate in the first fund
- All of the above

# BLEYZER INITIATIVE

- Replicate the Developed countries Wealth Creation Capacity in Developing Countries, beginning with FSU countries
- Refocus multilateral and bilateral assistance to FSU countries on the creation of market economies and stronger private sector
- Use IPCTF framework to create capital-friendly environment in the FSU countries and attract private equity capital
- Focus most financial assistance on creating private businesses – SMEs and conditions for large multinationals operations in the FSU countries
- Leverage private capital with donor's money
- Implement comprehensive coordinated assistance program to the FSU countries: **use donor capital to create the environment, which attracts private capital**
- **Consider privatizing foreign assistance programs beginning with private capital funded pilot offering a hybrid investment approach to countries in transition**