

Social Risk Mitigation in Africa through Deployment of Risk Capital

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BUILDING ON STABILITY: 2007 U.S.-Africa Infrastructure Conference

**Applying Private Sector
Approaches Embodied in the
Enterprise Fund Model to
Promote Stability in Africa**

Challenges in Building Stability in Africa – 2007

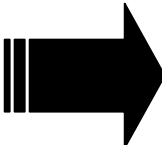
- Rampant poverty and resentment from gap between rich and poor -- How to provide opportunities for mass of population, build diversified economies and avoid reliance on dominant industries, like oil, mining, etc.
- SME private sector businesses are “engine of growth,” but lack financing and technical support -- How to deploy capital quickly and efficiently to make it broadly available to local entrepreneurs
- Absence of institutional infrastructure and Rule of Law
- Giving people hope in future and stake in stability



Providing Economic Opportunity Is Key Element in Building Stability

Policy-Makers and Investors Faced “Daunting” Challenges in 1989 CEE

- Unprecedented Transformation from Command to Free Market Economies
 - No “roadmaps” and Unknown Risks
 - Vast social dislocation underway and getting worse
- Weak Ecosystem/Institutions
 - Political system and commercial laws being established
 - Vested interests, and few people with experience
- **Systemic Change Takes Time** – Open Question Was: Will Public Lose Hope and Turn Back?



Capital, Professionally Employed, was needed to – Fuel business growth; Give broader public a “stake” in society; and Demonstrate prospects for future

USG's SEED Act Response -- Enterprise Funds

\$240 million for Poland, and

\$60 million for Hungary to promote:

(1) development of the Polish and Hungarian private sectors, including small businesses, the agricultural sector, and joint ventures ..., and

(2) policies and practices conducive to private sector development in Poland and Hungary, through loans, grants, equity investments, feasibility studies, technical assistance, training, insurance, guarantees, and other measures.

Basic Elements of EF Model

- Private sector vehicle capitalized with public funding to execute developmental mission – and to demonstrate investment opportunities attracting private capital
- **Focus is on business-to-business**, providing financing on commercial terms and supporting private business growth
- Capital entrusted to independent Board, from private sector
 - defines strategy
 - given flexibility to set direction and take action to achieve objectives without USG approval/interference
 - hires professional management to execute
- Capital not dissipated in “expenditures,” but is “invested” in private enterprises, and remains an ASSET
- **Realities of investing ultimately drive policy/legal reform** – no wait for implementation of theory to drive business activity; but a “bottom-up” building of institutions to support commerce

Polish-American Mortgage Bank

- 1990 – “Poland needs 2 million new homes”
- 1991 – PAEF invests in construction companies
- 1992 – PAEF establishes Polish-American Mortgage Bank
- To be viable, PAMBank required changes in foreclosure Regs – achieved through PAEF and by USAID technical assistance programs educating officials
- By 1998 sale of PAMBank to GE Capital Corp, **4,500 new homes were built with \$45M** in mortgage financing
- In 2004, GE’s bank extended **over \$400M loans**

Enterprise Fund Results – Poland

- In PAEF's 10 years of operations with \$240 million base,
 - it invested \$200M in 50 Polish companies
 - participated in 9 IPOs on WSE
 - provided \$300M in loans to 10,000 SMEs
 - extended \$180M in loans to over 30,000 "microenterprises"
- By 2001, PAEF had completed its mission and returned \$120M to the USG and capitalized a "legacy" foundation PAFF with an initial \$120M – by 2006, increased to over \$250M
- First time a US foreign assistance program returned its funding since Finnish Gov't repaid Marshall Plan loans 50 years before
- By 2006, PAEF's "privatized" management team had raised ~\$1.6 billion in private institutional capital for investment in Poland and region – and attracted multiple competitors

Fundamentals Behind Enterprise Fund Concept

- People who own their businesses have “equity” stake in society and become middle class contributing to stability
- Private Sector approaches produce better, quicker and more sustainable results
- Providing direct opportunity for mass of “little people” has bigger impact than building grandiose institutions
- Addressing micro-economic factors defines workable policy/legal framework from the “bottom-up”
- Taking action and adjusting is more effective than trying to create “perfect” system – Can institutional infrastructure be created in the abstract?

E.G., West Africa Enterprise Fund – with Liberia as its Initial Focus

- ~\$250 million over 4-5 years for Enterprise Fund focused on industries and institutions critical to private sector development, businesses with regional potential and the financing of local SMEs
- Start in Liberia as pilot -- de-mobilization of insurgents and post-conflict reconstruction is underway, high need to provide broad economic opportunity quickly in country with history of basic traditions of democracy and market economy
- With initial \$50-100 million pool of public-sourced capital, organize WEAFF, modeled on Polish-American Enterprise Fund
 - target for investment industries critical to Liberian private sector
 - create/expand disciplined profit-oriented commercial banks, specialized financial institutions and SME/microenterprise loan programs
 - begin to expand workable approaches into Sierra Leone & Cote d'Ivoire
- Supplement investment capital with technical assistance pool (\$5-10 million) for EF to deploy quickly to achieve mission objectives

Private Sector Investment Contributes to Building Stability

- By identifying necessary commercial “building blocks” in this locale/society/economy
- By moving quickly in demonstrating opportunities – and that help is on its way
- By providing foundation for satisfying basic human needs – creating economic opportunity at grassroots
- With small start, can bring broad impact across society, sustained by profit-driven principles
- By mobilizing others in the private sector – both local and foreign investors



Take Risks Instilling Hope in the Future

Enterprise Fund's Risk Mitigation Lessons for Strategic Investors

- Investment not purely a commercial play in transitional economies – socio-economic developmental activities often crucial to viability
- Addressing from inception the potential social risks over life of an investment is integral in structuring deal
- CSR/community development approaches linked directly to supporting core business “bottom-line,” have bigger impact and are more easily sustained
- Private investors can tap multitude of public development initiatives to mitigate risks and leverage commercial potential
- How you define the problem will dictate the solution you seek – in transitional economies, this requires understanding of business drivers AND developmental needs

Every Country in Africa Offers Opportunities and Challenges

Providing Economic Opportunity to meet basic human needs will be key to Building Stability in Africa

- Mitigates risk at grassroots level of society paving way for MNC and local business investment
- Gives vitality to traditional development assistance
 - Policy and legal reform
 - Institution building
 - Physical Infrastructure
 - Education
 - Diverse financing programs
 - Technical assistance to businesses, civic ass'ns
- Private sector decision-making and risk-taking approaches can provide speedy and long-term results
- Enterprise Fund model and experiences are illustrative

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Appendix on Enterprise Fund Concept

The Enterprise Funds: Captured “In a Nutshell”

*“The enterprise funds are a **bold experiment in a new way of delivering economic assistance**. Rather than have the U.S. Government provide a one-time grant to Poland or Hungary, we have developed, instead, the enterprise funds as **a means for tapping into private sector expertise to manage U.S. Government grants**. The President, in consultation with Congress, has asked a group of prominent private citizens from the United States, and from Poland and Hungary for each of the two funds, respectively, to form a corporation to use U.S. Government money to make loans, grants, equity investments and other forms of financial transactions designed to promote private sector development in Poland and Hungary. The hope is that these enterprise funds will be able to **manage the U.S. Government grants in a way that an investment banker might do – unencumbered by the bureaucratic constraints normally associated with government activities** – and that they will be able to **multiply many times over** the financial impact of the initial grant.”*

– Kenneth I. Juster, Esq.
Senior Advisor to the Deputy Secretary
U.S. Department of State
Rand Corporation Conference
September 21, 1990

USG Response SEED Act

“**ENTERPRISE FUNDS,**” capitalized initially with \$240 million for Poland and \$60 million for Hungary, were conceived to promote:

(1) development of the Polish and Hungarian private sectors, including small businesses, the agricultural sector, and joint ventures ..., and

(2) policies and practices conducive to private sector development in Poland and Hungary,

through loans, grants, equity investments, feasibility studies, technical assistance, training, insurance, guarantees, and other measures.

USG SEED Act Response -- Enterprise Funds (*con't*)

- Established as not-for-profit corporations – private, not USG, but subject to oversight
- Board of Directors, appointed by President, are private individuals from US and host country, knowledgeable and committed to democracy and free market
- Grants to Funds through USAID to be used for program and operating expenses
- Funds take into account workers standards, human rights, environment, effect on US and the “commercial viability” of the activity funded
- Authorized to raise and manage private capital to extend reach of public funds and maximize effectiveness

Mandate of the Enterprise Funds

- Dualistic Mission – commercial and developmental
- Focus is at “microeconomic” level with macro impacts
- Act quickly to place capital in hands of local private entrepreneurs “on commercial terms” to
 - grow private businesses
 - demonstrate the benefits of market economy reforms
 - support development of local capital markets and
 - build institutional infrastructure facilitating commercial activity
- Deploy “technical assistance” funding (*e.g.*, additional \$10 million earmarked) to support mission
- Attract private capital to leverage impact of public funds

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Enterprise Fund Achievements in Poland and Hungary

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Enterprise Fund Achievements in Poland and Hungary (*con't*)

HAEF

- HAEF with its **\$62M** capital base had
 - put to work nearly **\$125M** in the Hungarian economy
 - provided direct equity to over 50 companies
 - participated in 8 IPOs on BSE, London's SEAQ and NASDAQ
 - provided SME and micro loans to 200 businesses
 - raised \$40M in private capital
 - privatized its Hungarian investment team
 - trained a generation of Hungarian investment professionals
- By 2004, HAEF had completed its mission, began returning its capital to the USG and established as its "legacy" a Scholarship Fund to bring top Hungarian graduates to USA for internships in American firms

Expanding the EF Initiative and Adapting It to Other Countries

- EFs in Poland and Hungary concentrated on private equity “buy-out” deals, privatizations, small business lending programs, and in Poland particularly, financial institutions
- In ensuing years, EFs created for Czechoslovakia, Bulgaria, Baltics, Romania, Albania under SEED Act, for Russia, Western NIS and Central Asia under Freedom Support Act
- Most have private equity investment programs, have established intermediary financial institutions to make commercial loans, mortgages and the like, and created small/micro business lending facilities to reach smaller entrepreneurs broadly across economy.
- **Strategies of each dictated by local needs and conditions**
- Now, similar funds created for southern Africa, Georgia, North Africa and Middle East and by EBRD and others

The CEE Enterprise Funds: Accomplishments Overall

- Current Asset Base of Funds exceeds the \$1.2 billion in US Gov't grant funding
- Thus, the EFs' capital has been at work in CEE host countries growing private businesses, building capacity, facilitating development of conducive institutional infrastructure for commercial activity and creating a professional cadre; yet, the capital base remains intact

“Enterprise Fund” Achievements in Southern Africa

SAEDF – a modified EF model

- Created to stimulate creation and expansion of disadvantaged SME businesses in post-Apartheid RSA and 11 countries of southern Africa
- Since 1994, SAEDF with its \$108M capital base has
 - put to work more than \$80M to support local business development
 - financed 16 indigenous “start-ups,” and sponsored 11 financial intermediary firms extending the reach of SAEDF’s limited capital
 - attracted additional fresh capital in co-investment from other financial firms
 - developed investment experience in more than 50 staff members creating new generation of indigenous investment professionals