

Designing Government Incentives for Investing into Inclusive Businesses

Chris Tozer

United Nations Development Programme

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Contents

1. Why should Government Incentivize investment Programs?
 - Reasons for support and examples of other government programs
2. What do Government Incentive programs look like?
 - Features of successful programs, case studies and best practices
3. The Turkish Context
4. Background of UNDP Research
 - Definitions, Introduction, Goals and Methodology
5. What do Impact Investors Advise?
 - Design features of government incentive programs and other recommendations
6. Conclusion



WHY SHOULD GOVERNMENT
INCENTIVIZE INVESTING PROGRAMS?

Why should Government incentivize 'impact' investing?

Mitigate Market Failure

Raise awareness about overlooked sectors

Improve risk/return profile for investors

Enhance credibility/provide comfort

Leverage investment into poverty-reducing sectors

Lack of Intermediaries

Other government examples

Direct refinancing of VC

- Low interest loans (KfW Germany)

R & D Financing

- SBIR (USA)
- VINNOVA (Sweden)

Incubators and Tech Transfer

- IRAP (Canada)
- OSEO (France)

Bonds

- Surety Bonds (USA)
- Tax-Exempt Bonds (US)

Grants/Subsidies

- SBA (USA)
- OCS (Israel)

Direct Investment

- Industrifonden (Sweden)
- BDC (Canada)

Fund of Funds

- Yozma (Israel)
- IIFP & Pre Seed Fund (Australia)
- Vækstfonden (Denmark)
- BDC (Canada)
- NZVIF (NZ)

Direct Co-Investment

- TGB (Germany)
- Scottish Co-Investment Fund (UK)

WHAT DO GOVERNMENT INCENTIVE
PROGRAMS LOOK LIKE?

Features of Government Incentivized Investment Programs

Funding/ Returns	Ratios differ (matching, 2:1, 3:1, 4:1 common)
	Govt subordinated to XX% preferred return
Returns	Downsize protection (Govt to underwrite loss)
	Govt funding in first & last out
Govt. Objective	Tax breaks on returns for set period
	Profit/Break Even
Govt. Objective	Typically aligned to key economic development policy
	Catalyst (Rapid Exit Available)
Foreign Partners	Loss position/grant/subsidy
	Mandated or Desirable
Foreign Partners	Not encouraged or Actively Prevented
	Often seen to be able to provide: a) access to additional second round funding, b) access to new markets and c) additional managerial/strategy guidance
Govt. Reinvestment	Committed/legislatively mandated
	Case by case
Fund Management	Co-managed (Govt/Private)
	Direct Govt investment or Govt gives subsidy for fund management costs
Fund Management	“Arms length” (Fund of funds)
	Blend of both private and public experience often considered useful



Case Study: YOZMA, Israel



- US\$100m fund of funds program started by the Israeli Government in 1992 designed to assist high growth businesses and kick start the Israeli venture capital industry.
- The initial program set up 10 venture capital funds of around US\$20m in size to invest in Israeli tech companies. Private investors were matched US\$1 govt for every US\$1.50 of private funding.
- Emphasis on foreign investors taking part in the initial funds.
- Option for private investors to buy out govt share after 5 years.
- Considered by many to “have delivered beyond the wildest dreams of the founders”. After a decade the Yozma groups, who bought out the govt, were managing US\$2.9b of funds with many Israeli companies listing on stock exchanges and the VCs earned “spectacular returns” (Source: Lerner, J, (2010), Boulevard of Broken Dreams, p.157)



Case Study: The Finnish Industry Investment Ltd. (FII), Finland



- Started in 1995 and a government owned investment company.
- Goals is to “is to promote Finnish business, employment and economic growth through venture capital and private equity investments”.
- Finnish Industry Investment invests in funds and directly in growth companies in all sectors.
- FII co-invest with private investors, limiting the investment to at most half the capital invested and ownership.
- FII has invested in approx. 66 companies directly and more than 40 funds.
- The investments of Finnish Industry Investment amount to €660m.
(Source: <http://www.teollisuussijoitus.fi>)



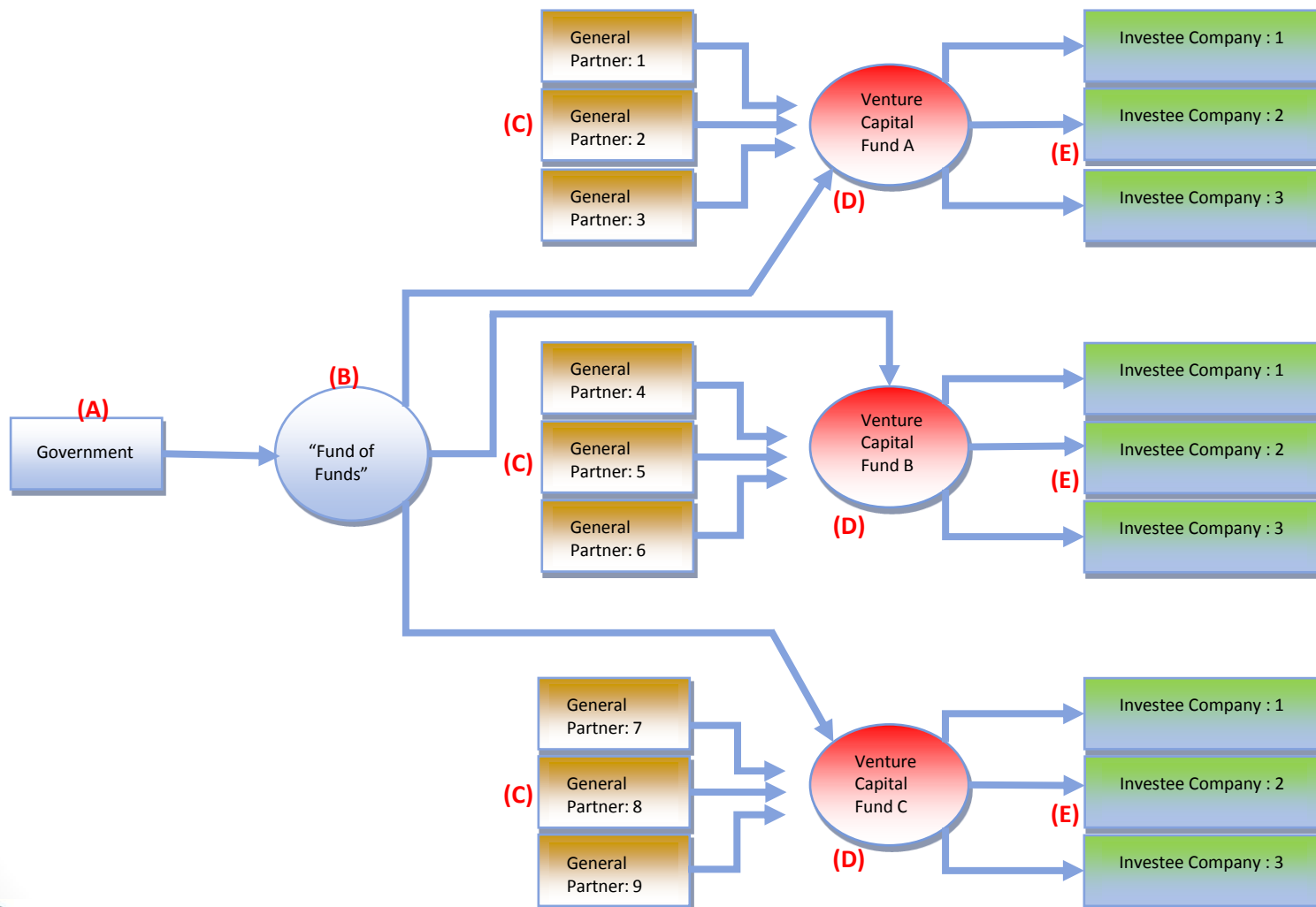
Case Study: New Zealand Venture Investment Fund (NZVIF), New Zealand



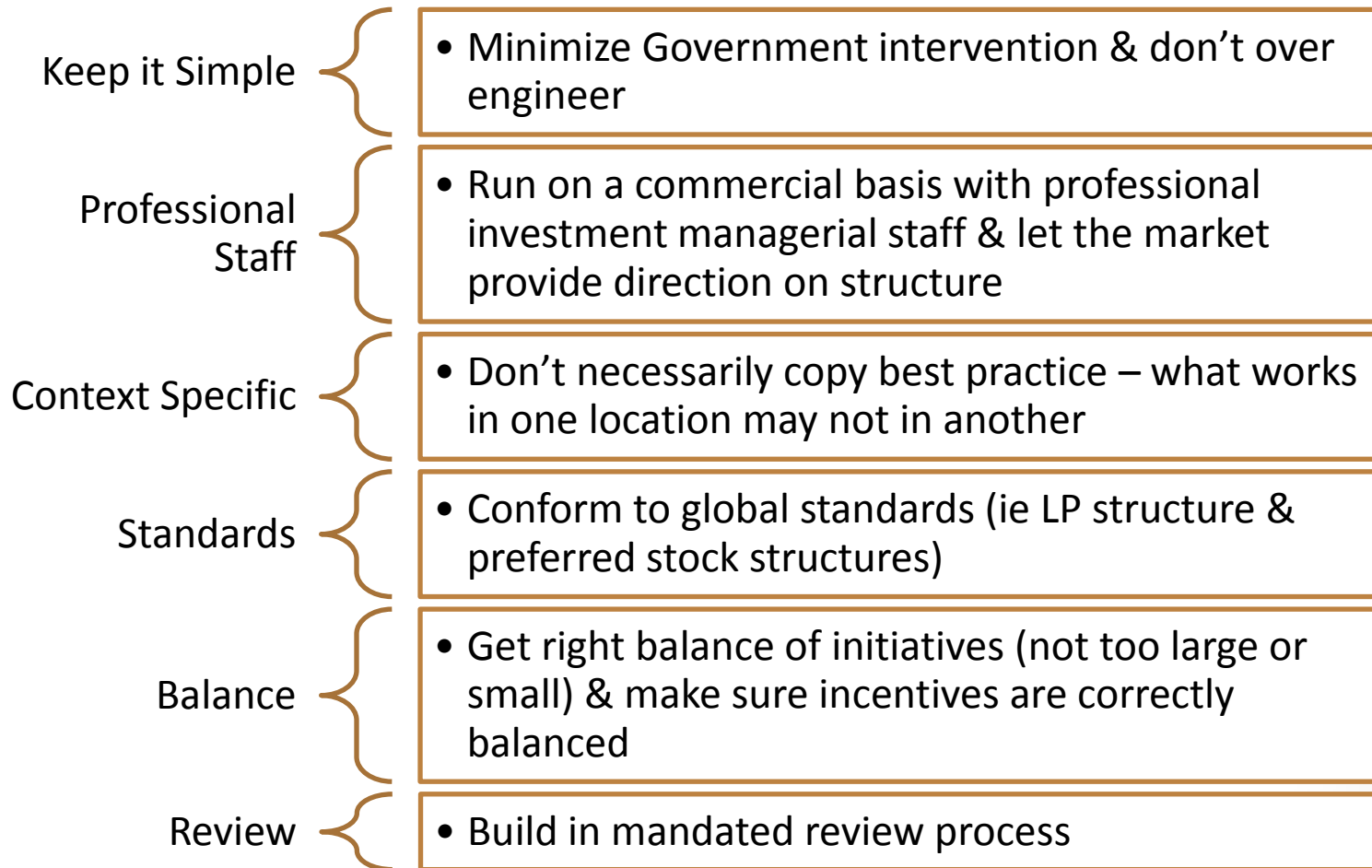
- Initial NZ\$100m(US\$73m) fund of fund program started in in 2002 designed to originally assist seed investments (later broadened to expansion stage) tech companies and develop of the NZ VC industry.
- Modeled very closely on Yozma
- Matching funds were on a \$1 (govt) for every \$2 of private funds. A buy out option was also included.
- Less emphasis on foreign investors involvement (desired but not compulsory)
- NZVIF has invested in 7 VC partner funds, who in turn have invested in 51 NZ companies.
- As yet no private investors have bought out the govt share. NZVIF considered to have had “initial success” but still a work in process. ”
(Source: Lerner, J, (2010), Boulevard of Broken Dreams, p.105)



Case Study: NZVIF, New Zealand - Continued



Best Practices from Established Government Incentive Programs



THE TURKISH CONTEXT

UNDP understanding of VC/PE Industry in Turkey



The UNDP understands the following organizations/entities are involved in the entrepreneurial/venture capital sector in Turkey:

- **Capital Market Boards (CMB)** of Turkey (equivalent of SEC).
 - Regulates and administers capital markets activities, including both equity and debt securities, public offerings and other regulatory matters
 - Determines establishment & operation principles of the venture capital mutual funds, and venture capital investment companies.
- Six **Venture Capital Investment Trust (VCIT)** companies in Turkey.
 - ANADOLU Venture Capital Investment Trust Inc.
 - Egeli-Co Venture Capital Investment Trust
 - Gözde Venture Capital Investment Trust Inc.
 - İş Venture Capital Investment Trust Inc.
 - Kobi Venture Capital Investment Trust Inc.
 - Rhea Venture Capital Investment Trust Inc.



UNDP understanding of VC/PE Industry in Turkey - Continued



- Technology Development Foundation of Turkey (**TTGV**)
 - PPP for technology development.
 - TTGV has shares in several public and several venture capital companies (İş, Türkven, Teknoloji Yatırım).
 - TTGV is also one of the investors of the Istanbul Venture Capital Initiative (iVCi).
- The PE and VC companies has recently established a sector assembly under the Union of Chambers and Commodity Exchange of Turkey (**TOBB**).
- **TEPAV**, think tank of TOBB ETU is an advocate of the venture capital sector



UNDP understanding of VC/PE Industry in Turkey - Continued



- Istanbul Venture Capital Initiative (**iVCi**): Turkey's first ever dedicated fund of funds and co-investment programme
- **KOSGEB** is the public agency tasked with supporting the development of Turkish SMEs through various programmes and services
- **G43 Anatolian Venture Capital Fund Project** : aiming at supporting SMEs in the least developed areas of Turkey.
 - Involves:
 - European Union,
 - The Ministry of Science, Industry and Technology,
 - KOSGEB
 - EIF
 - Istanbul Venture Capital Initiative (iVCi)



BACKGROUND OF UNDP RESEARCH

Definition: Investing in Inclusive Businesses

What is Inclusive Business?

Inclusive business models include the poor on the demand side as clients and customers and on the supply side as employees, producers and business owners at various points in the value chain.



Who Invests in Inclusive Business?

Impact investments are investments intended to create positive impact beyond financial return. They require the management of social/environmental performance in addition to financial risk and return.



How are investment results measured?

Financial Returns (usually at 'market-rate')

Social and Environmental Indicators (e.g. job creation, income generation etc.)

The impact investing sector

- According to J.P. Morgan, the size of the impact investing market is substantial and growing, with profits estimated to be between US\$183b – US\$667b across the five main subsectors over the next ten years. Other estimates
- These subsectors include affordable urban housing, water, health, microfinance and education.
- The affordable housing sector makes up the majority of this profit, comprising US\$177-\$648bn, notably a rather wide range. The next most promising sector, education, indicates a profit potential of US\$2.6-\$11bn—tiny when compared to housing. Clean water delivery is on par with education, with a potential profit range of US\$2.7-\$7bn. Health comes in at US\$.1bn-\$1bn.

Source: Impact Investments: An emerging asset class, JP Morgan, 2010, p.11)



Focus of UNDP research

Goal of UNDP Research

- To identify the demand from 'impact investors' for government incentives
- To identify 'preferred' structures and design of government incentives/support
- To provide preliminary recommendations for governments, donors and others on how to support such public private partnerships

Methodology

- Developed eight overarching questions for impact investors and government programs around the world
- Identified and Interviewed 30 Impact investors/organizations from 7 countries
- Completed literature survey on impact investing and earlier predecessors



List of Interviewees

Eco Enterprise Fund	Hon. Pete Hodgson, Former NZ Government Cabinet Minister	Bill & Melinda Gates Foundation	Charity Bank
Gatsby Charitable Foundation	Global Impact Investing Network	Grass Roots Capital	Equilibrium Capital Group
Big Society Capital	New Zealand Venture Capital Association	Rockefeller Foundation	Root Capital
The Robertson Foundation	TIAACREF	University of Exeter Business School	W.K. Kellogg Foundation
Capital for Enterprise	New Zealand Venture Investment Fund	H2O Venture Partners	New Zealand Ministry of Economic Development
Adobe Capital	Devenco	Monitor Institute	Voxtra
Fondo Inversor	Deutsche Bank	cKinetics	Sarona Asset Management
Blended Value Group	Equity for Africa	Vox Capital	Aquifer
Non Profit Finance Fund	Cambridge Associates		

WHAT DO IMPACT INVESTORS ADVISE?

What kind of support should government offer?

- Co-investment ONLY up to a point (govt. should never be the majority) – de-risk; only up to a point
- First loss also of interest
- Support should be aligned to Govt. policy
- Legal/Business environment reform (long run) as well as capacity building for entrepreneurs
- R&D – the Govt.'s responsibility?

“... the private sector should not get a hand out but what it does need is certainty.”

(US Impact investor)

Government should also be mindful not to “squeeze out private enterprise through an overly generous program as well as be prepared to operate at the pace that the private sector operates at”.

(UK Impact Investor)

What are challenges for investors when working with government?

- Govt. works on election cycles-politically challenging as well as other cultural alignment issues
- Fear of corruption, nationalization, leakage
- Investors work on long term cycles/ govt. works on short term cycles; these are mismatched
- Exchange rate risks
- Measurement is critical

... their company “would have had to have employed another whole staff member just to keep up with the red tape and excel spreadsheets the government expected us to fill out”.

(US Boutique investment fund)

“.....had the requirement to measure how many jobs it created , resulting in strange and unfortunate distortions of how the fund managers managed that program Almost like a butcher being told to make bread.”

(UK Organization)



What could legislation/vehicle structures look like?

- Fund of Funds and/or co-inv vehicles/
- 1st loss (short term)
- Seed programs (medium term)
- Tax incentives (medium term)
- Loan pools/equity pools alongside government
- General principles:
Transparency/clarity/accountability
- Govt: Must set and stick to policy

“to keep government as far away as possible in terms of making direct decisions. Hence a fund of funds or an enhanced fund of funds might be the way to go ...

(US Impact investor)

“...a real risk exists that too much government assistance and the investment environment becomes “retarded”.”

(US Impact investor)

Who are necessary partners?

- Development Finance Institutions
- Technical assistance (TA) providers (Capacity building vital; often funds have high proportion just for TA; up to 30%)
- Providers: NGOs, local or international firms
- Educational institutions
- Local investors and local businesses/business groups
- Banks
- Other impact investors



Conclusion: Roles for Stakeholders

Role of donors and aid agencies

- Possible advocates and champions
- Potential providers of technical assistance
- Promote the market & provide valid, unbiased data

Role of investors

- Agree to uniform metrics of measurement of success
- Align to government policy
- Agree to long term commitment
- Shouldn't be driven by "super profits" (ie must have genuine impact)

Role of governments

- Suggest a pilot approach, simple, time bound and well thought out
- Build confidence through time and experience of a partnership; rather than overly-designed and complicated investment structures in emerging asset classes
- Must be part of a growing ecosystem; govt. should not crowd out other investors
- Staffed on the government side with the right people
- Recognize limited but pivotal/catalytic role that government can play in encouraging capital investments



THANK YOU AND QUESTIONS?