Foreign Aid and Private Sector Development
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Private enterprise is the engine that sustains economic growth in today's world. In turn, economic growth is essential for reducing poverty and lessening the tensions that can feed conflict, lead to state collapse, and contribute to the growth of criminal and terrorist networks. Economic growth also promotes the expansion of international markets and commerce, and increased prosperity in both rich and poor countries. The expansion of the middle class that usually accompanies economic growth typically provides a constituency for democracy, free markets, effective governance, and the rule of law. Promoting prosperity abroad, reducing the scope for terrorist and criminal operations, expanding markets for U.S. exports, and promoting democracy are all important goals of U.S. foreign policy, justifying the use of public resources in their support.

Economic growth is driven by private investment, and small and medium-sized enterprises (SMEs) often shape the quality and impact of that investment. SMEs provide goods and services to local markets and frequently produce the inputs used by large firms; in addition, they provide employment and income for the majority of local workers. SMEs help nurture and develop a trained labor force that can, eventually, also become available for large firms or be-

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1 SMEs are typically defined as firms—usually in the formal sector—that have between 10 and 250 employees. These enterprises contrast with micro-entreprises with fewer than ten employees, which are often not in the formal sector, and with large enterprises, like mining or major manufacturing establishments, that have hundreds or thousands of employees. It is important to note that many of the firms served by enterprise funds, equity funds, and technical assistance from NGOs are on the larger side of the SME category or even beyond it. Due to their usually weak capacity, lack of access to capital, small markets, and vulnerability to market changes, aiding smaller SMEs remains a difficult challenge.
come entrepreneurs in their own right. They can strengthen a competitive and innovative economic environment. And they can be a political voice that lobbies for the rule of law and the protection of property.

None of this is news to private investors and entrepreneurs or to scholars and practitioners of development. Mainstream development theory and practice has long included efforts to promote private investment within poor countries by creating the necessary foundations for successful businesses, such as a functional infrastructure and an educated and healthy labor force; by urging policy and regulatory reforms that create a supportive environment for private enterprise; and by establishing externally funded mechanisms that directly benefit domestic private entrepreneurs by providing them with training, advice, and financing.

Financing micro-enterprises has been a high priority for several decades, as governments have increasingly used direct interventions to reduce poverty in the poorest segments of society. An increased emphasis on small and medium-sized enterprises became evident in the 1990s, with the end of socialism in Eastern and Central Europe, Russia, and Central Asia. U.S. policy makers sought to promote SMEs as a means of hastening economic and political transitions in former socialist countries. Recently, promoting SMEs has again become a focus of U.S. policy—this time in the Middle East, as the Bush Administration seeks ways of encouraging economic progress and political reform in that region.

This study examines three of the most prominent approaches to using public concessional resources to further SMEs in developing and transition countries. These approaches are establishing enterprise funds and funding equity funds, and NGOs that provide advice to SMEs. All three have received relatively little attention from scholars, development practitioners, and evaluators. In 2005 alone, however, the Bush Administration announced the creation of two enterprise funds—one in Georgia (as part of a com-
pact with the Millennium Challenge Corporation), and one, called the “Fund for Freedom,” in the Middle East. Given the rising interest in strengthening the private sector in developing countries as an essential means of furthering growth and reducing poverty and as a key element of the President’s “freedom agenda,” it is timely to ask how these approaches have fared in the past, and whether and under what circumstances they might be useful in the future.

This chapter briefly describes the nature of enterprise funds, equity funds, and stand-alone technical assistance provided to SMEs and sometimes mid-market firms by non-governmental organizations (NGOs). It then situates these approaches within the broader context of U.S. aid policies and programs, and of the programs of other governments and international organizations that support private enterprise in developing and transition countries. Chapter 2 analyzes in detail the nature and trajectory of enterprise funds. Chapter 3 analyzes the experience of equity funds. Chapter 4 assesses the experience of stand-alone technical assistance provided by NGOs. The final chapter then draws together the conclusions of the analytical chapters and examines the potential of these approaches for promoting SMEs in the future.

**Enterprise Funds, Equity Funds, and Technical Assistance Programs**

An enterprise fund is an organization that is set up and initially funded by the U.S. government, but that has an independent board of directors and professional staff. It is designed to promote the expansion of the private sector in developing and transition countries by providing financing and technical assistance to locally owned small and medium-sized enterprises, and often to mid-market firms, as well. The U.S. government provides the initial capital to the enterprise fund; additional capital may be raised from the private sector. Enterprise funds lend or take equity positions in SMEs, much as venture capital firms do in the
United States. They may also offer technical assistance to investors, and engage in institution building by financing and advising financial organizations in recipient countries that on-lend to support SMEs. At times, they may also provide policy advice to host governments on issues related to the private sector and economic growth. Eleven enterprise funds have been set up since the late 1980s: ten in Eastern Europe and the former Soviet Union, and one in Southern Africa. Two more—in Georgia and the Middle East—are currently in the works. To date, the U.S. government has transferred nearly $1.5 billion to these funds.²

Equity funds are privately owned, privately managed investment vehicles that are partially supported by long term loans and U.S. government guarantees. These loans and guarantees are issued by the Overseas Private Investment Corporation (OPIC), the U.S. government agency charged with promoting U.S. investment abroad. The first such fund was created in 1987; a total 37 have been established since then. These funds primarily provide equity financing and technical assistance to SMEs in emerging markets (sometimes called “frontier” markets) where the need for equity finance is not being fully met, where risks may be substantial, or where it is considered to be in the interests of the United States to promote rapid growth and development. Some of these funds are focused on specific sectors, such as agriculture or infrastructure. OPIC-supported funds also alert international investors to opportunities in emerging markets that may be unfamiliar to them.

Equity funds have several functions in common with enterprise funds. Specifically, they help finance SMEs through loans, equity investments, and the provision of technical advice. There are, however, important differences between the two kinds of funds. Equity funds are intended to be profitable as investment vehicles. Enterprise funds, by contrast,
tend to have a much higher political profile, and, while profitability is regarded as a worthy achievement, it is not a performance requirement. They are more closely identified with the U.S. government, as the chairs and many of the members of their boards are chosen by the White House. Board chairs of enterprise funds have thus often had access to senior government officials and can exert influence both in Washington and with host governments in a way that equity fund managers cannot. And because enterprise funds are only expected to break even, rather than to produce a profit, they can take more risks in their investments than equity funds.

*Technical assistance* to help SMEs develop skills and strengthen business systems and practices has long been funded by the United States Agency for International Development (USAID). Such assistance is often part of equity and loan arrangements offered directly to SMEs by USAID. But considerable technical assistance is also provided on a stand-alone basis according to SMEs’ particular needs. Traditionally, such assistance has been offered through NGOs—such as the International Executive Service Corps (IESC)—which often rely on retired U.S. business executives as advisors to foreign firms. Though data are not available regarding the total amount of stand-alone technical assistance offered to SMEs through NGOs, USAID contributions to IESC—one of the oldest and largest NGOs that provides such services—amounted to approximately $20 million in 2002 (IESC, 2002).

How successful have these approaches been in promoting SMEs, as well as the private sector more generally, in developing and transition countries? Before turning to this question, we shall briefly situate these three approaches within the broader context of the policies supporting enterprise development abroad that are held by the U.S. government, other governments, and international financial institutions.
Enterprise Development: U.S. Policies and Programs

The U.S. government has long considered private enterprise to be the main engine of growth and poverty reduction. Rather than supporting firms directly, however, most U.S. foreign assistance has been used to create the prerequisites for private investment and growth by expanding infrastructure, health, and education; financing economic and political reforms; promoting the expansion of agriculture and rural development; and providing micro-finance for the entrepreneurial poor. Nonetheless, early in its efforts to promote development, the United States did initiate two programs of direct support to the private sector in developing countries. First, in the mid-1960s, the United States provided several non-governmental organizations, for example, the IESC and Volunteers in International Development (VITA), with a modest amount of aid to enable them to advise businesses and entrepreneurs in developing countries. Both of these organizations still exist and continue to work in these areas.

Second, a program was initiated in the 1960s to provide funding for development finance institutions (DFIs) in developing countries. These were usually public agencies that made loans—often at subsidized rates—to private enterprises. This initiative is largely considered to have been a failure. DFI loans frequently failed to reach the small farmers and businessmen that were their intended beneficiaries. Instead, the loans wound up in the hands of large enterprises and powerful individuals, who, naturally, found subsidized lending attractive. Few DFIs achieved financial sustainability; they failed to mobilize local savings and their borrowers often did not repay the loans. Finally, DFIs had little impact on the development of financial markets. Problems with DFI lending included subsidized interest rates that undercut rather than strengthened financial markets, the weakness of public sector management, and the often conflicting agendas of the aid donors that funded
them. There are few failures in aid-giving as clear as the funding of DFIs (see, for example, McKean, 1990).

The 1980s saw an expanding interest in emerging markets. The greater attention given to these markets is reflected in the establishment of equity funds by the International Finance Corporation, an arm of the World Bank; in addition, OPIC established its own program of support for equity funds. The number of these OPIC-supported funds was rapidly increased during the Clinton administration, largely in response to the transitions in Eastern Europe and the former USSR. A broader type of fund—enterprise funds—dates from the late 1980s, when the first Bush administration created several in countries in transition. Eleven enterprise funds were eventually established, including one in Southern Africa after the end of apartheid.

The challenge of economic transitions in former socialist countries also stimulated an expansion in aid funding for technical assistance for businesses. Such funding often went to establish business centers to provide information and advice to enterprises in transition and developing countries. The number of aid-supported NGOs involved in providing assistance to businesses also increased. From one or two during the 1960s, there are now several dozen U.S. NGOs involved in delivering technical assistance to SMEs, seventeen of which are members of the Volunteers for Economic Growth Alliance (VEGA).

In the mid-1990s, the U.S. government moved away from establishing enterprise funds, but continued to combine credit for SMEs, technical assistance, and training and advice to governments on policy reform through its aid-funded activities abroad. The United States relied on local governments and organizations, U.S. consulting firms, and NGOs to implement these activities. At times, USAID used local banks and organizations to handle loans and advice, as in the case of the Alexandria Small Business Association in Egypt, and USAID’s Business Development Program in Bosnia-Herzegovina. In addition, efforts were made to ex-
pand the voice of SMEs within developing and transition countries by creating and strengthening business associations.

In the second half of the 1990s, the focus of aid in support of private sector development shifted once again. USAID began to center much of its enterprise development around two goals: to expand the competitiveness of the private sector in developing countries, and to help private enterprises take advantage of the new trade opportunities that were expected to develop as a result of the African Growth and Opportunity Act, the Free Trade Area of the Americas, other bilateral free trade arrangements, and the Doha Round of WTO trade negotiations. As a result of continuing disappointing levels of investment in many developing countries, combined with the growing prominence of “competitiveness” as a lens through which to assess business opportunities, aid-giving agencies began to focus on improving microeconomic policies in an effort to encourage investment. Such efforts included policies to limit the number of procedures necessary to establish a business, labor laws affecting hiring and firing, impediments to business in particular sectors (like retailing or furniture making), and the elimination of corrupt practices. USAID also began to finance research and aid projects targeting microeconomic impediments to investment, to exploit the opportunities for business “clusters” or agglomerations, and to examine the opportunities for enterprises to move up the “value chains” (linked stages of production and marketing of goods that added value in each stage). The insights that led to these changes came from research on competitiveness that suggested that enterprises with related activities could create a critical mass (economies of scale and positive externalities) that would improve their business prospects by locating near each other, collaborating, and competing together.

In places as diverse as Guatemala, Namibia, Macedonia, Jamaica, Sri Lanka, and Mongolia, projects were devised to inform and advise firms about opportunities to improve
competitiveness through collaboration (e.g., through business associations of firms in clusters), to provide training for entrepreneurs to help them improve their business skills, to help business service organizations to strengthen their services to local firms, and to advise governments on policies that would improve the climate for business. Most of these activities were familiar to USAID as strategies for promoting SMEs, but an emphasis on trade, competitiveness, and the importance of business clusters provided them with a new focus.

Finally, as mentioned above, the U.S. government has recently returned to the idea of enterprise funds as part of its efforts to further economic and political reforms. This return is evident in its commitment to establish such a fund in Georgia, along with its decision to invest another $50 million in a “Fund for Freedom” intended to provide investment financing and advice in the Middle East. The Egyptian and Moroccan governments have each promised to contribute another $20 million to the latter fund, while Denmark has committed an additional $1 million, for a total capital base of just over $90 million.3

Enterprise Development: Other Governments and International Organizations

The United States is only one of many nations whose governments have programs to support the growth of SMEs in developing and transition countries. Most European governments have investment funds that provide equity funding for enterprises—usually, like the United States, by financing the equity funds that make the investments rather than directly providing the investments themselves. The United Kingdom, for example, operates through the Commonwealth Development Corporation; in France, PROPAR-

3 The Fund for Freedom was described as being modeled on the earlier Polish-American Fund, but few details are available as of the time of this writing. See U.S. Department of State (2005).
CO is associated with the Agence Française de Développement. Many other countries, including Germany, Finland, the Netherlands, Denmark, and Belgium, have similar programs. In most of these cases, the government provides some or all of the investment capital in equity funds (in contrast to the United States, where OPIC primarily provides investment guarantees), with the expectation that it will eventually be repaid and that the funds will function on a non-profit basis.

The most important international organization currently providing equity and loan capital to private enterprises in developing countries is the International Finance Corporation of the World Bank Group (IFC). The IFC offers some loan and equity finance and even a small number of grants for pilot projects directly to SMEs, but its primary focus is on providing loan and equity finance to financial institutions that serve SMEs. It also offers a range of services and advice to private enterprises in developing and transition countries. For example, it has established eleven field-based project development facilities to assist SMEs in preparing bankable projects while they seek financing. The IFC estimates that, in 2004, it spent nearly $900 million on a range of activities supporting SMEs (IFC, 2004, p. 33).4

Several other international organizations have a similar mission. The European Bank for Reconstruction and Development provides loan and equity capital to SMEs in Eastern Europe and the former USSR. Like the IFC, it prefers to rely on intermediary institutions—primarily financial institutions, such as the Polish-American Enterprise Fund—to manage its funding. In 2003, it provided approximately $150 million to SMEs (this figure includes contributions provided to micro-enterprises) (EBRD, n.d.). Similarly, the Inter-American Investment Corporation, part of the Inter-

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4 Other elements of the World Bank Group—the IBRD, the International Development Association, and the Multilateral Investment Guarantee Agency (MIGA)—put another $677 million into SMEs in 2004. (It is not clear, however, how much of these transfers were actually for micro-enterprises, which are often included in the category of SMEs.)
American Development Bank, provides loans and equity investments to SMEs and to the intermediary organizations that support them in Latin America and the Caribbean. In 2004, it lent or invested $165 million (IIC, 2004, p. 9).

A number of aid agencies, like USAID, also provide funding for NGOs to advise SMEs. In the United Kingdom, for example, the main agency is the Department for International Development (DFID). Denmark has a program for linking SMEs in developing countries with Danish firms by facilitating contacts and providing subsidies for feasibility studies for such joint arrangements. Canada has set up joint Canadian and locally directed funds in developing countries to finance SMEs in those countries. In short, most aid agencies, both bilateral and multilateral, currently have programs to promote SMEs in the areas of financing and the provision of technical assistance. Most aid agencies also support the establishment of business-friendly environments in developing and transition countries. A brief review of a selection of government aid agencies and associated investment funds’ websites, however, suggests that the United States is among the most active sources of funding and advice to SMEs abroad.

Findings of the Study: A Preview
This study offers a number of findings about the impact of enterprise funds, equity funds, and technical assistance from NGOs, based on publicly available data related to performance and interviews. (Due to limitations of time and resources, the study did not attempt to generate original data on the performance of these programs and organizations.) The findings are most robust for enterprise funds, where considerable data are available for assessing past performance. They are less robust for equity funds, where relevant data on performance are not publicly available, and they are the least definitive with regard to NGOs, as there have been few systematic efforts to evaluate their performance. A brief summary of our findings follows.
Enterprise Funds:

- Enterprise funds can be effective tools for promoting private enterprise in developing and transition countries, provided they are led and managed by an experienced and competent board and staff. Where the selection of board members or senior staff is based on political patronage rather than competence, these funds are likely to perform poorly.

- These funds can make an important contribution to private sector development when they are adequately funded, usually requiring a capitalization of several hundred million dollars. When funding falls below $100 million, the fund will have less financial and political clout, and administrative costs will be proportionally higher. (Administrative costs tend to be significant no matter how large or small the fund; thus, the smaller the fund, the higher such costs are relative to the total budget.) This finding suggests that the new enterprise funds planned for the Middle East and for Georgia may be inadequately funded to achieve their goals.

- The more business-friendly and supportive the political environment is in the host country, the more immediate the impact of an enterprise fund is likely to be. Even in a difficult environment, however, enterprise funds can have an impact; for example, they can exert pressure on governments to reform. In the most favorable environments—all else being equal—a positive impact may be evident in a few years; in less favorable environments, or where there are other difficulties, a positive performance (including returns on investments) may take more than a decade. In short, it may take a decade or more—rather than a few years—for any positive impacts of enterprise funds to become evident. This
lesson should be included in the planning and evaluation of future enterprise funds.

**Equity Funds**
- When managed well, OPIC equity funds can have a positive impact on enterprise development in host countries. *Where the management is chosen on the basis of political patronage rather than competence and experience in managing equity financing, however, there is considerable danger that these funds will perform poorly.*

- Poor performance for this reason appears to have been a problem in OPIC’s equity funds, but it is difficult to be sure of this, since OPIC does not publish any data on the performance of the funds themselves. *Public accountability would be best served if OPIC published data on the performance of its equity funds. Such accountability would, in turn, increase pressure for good performance and discourage appointing fund managers based on purely political considerations.*

**Technical Assistance through NGOs**
- Anecdotal evidence suggests that technical assistance to enterprises in developing and transition countries can be helpful to their development. But no systematic evaluations of these programs on which to base a definitive assessment are available. *Aid-financed NGO technical assistance to enterprises should be the focus of a systematic evaluation, with a common evaluation framework applied to the NGOs operating such programs. Considerable public monies have been spent on these programs over the last five decades; it is important to know what they have accomplished, what they have found difficult, and why.*
References


In November 1989, the fall of the Berlin Wall introduced private sector engagement into the mainstream of development policy. The question facing U.S. policy makers was how to directly support private entrepreneurs in ex-communist countries while also encouraging a broader national process of market-oriented transition. Enterprise funds were a major component of the policy solution that emerged.

The following analysis confirms earlier assessments of enterprise funds, which found that they were mixed in their effectiveness. Some, like the Polish-American Enterprise Fund, were highly effective, and their positive performance was evident within several years of their establishment. Others, like the Central Asia Fund, cannot be considered successful. Still others, such as the Russia Fund, took a decade or more before their positive effects became evident.

This chapter evaluates the performance of these funds in terms of their private sector development objectives, individually and as a whole. The U.S. commitment of $1.1 billion to ten funds over a period of fifteen years supported numerous initiatives, which resulted in a variety of outcomes across nineteen countries in Eastern Europe and the former Soviet Union. According to the performance standards of this analysis (defined below), four of the enterprise funds executed their objectives very well, three more had acceptable results, and three funds failed to execute their objectives. The experience of the enterprise funds can teach policy analysts a great deal about the required preconditions for an enterprise fund, the accountability issues inherent in such public-private policy tools, and the difficulties of dealing with corruption.

Enterprise funds represented a policy innovation in re-
spouse to a distinct political moment. They were a new form of organization; unlike most existing models of foreign assistance, they relied heavily on private sector management. They represented an extensive devolution of power to the business community, a situation that approached more closely than ever before an outsourcing of foreign aid. This controversial use of U.S. foreign aid created tension between U.S. government officials and fund managers, but it also produced some outstanding successes, leading the current Bush administration to establish enterprise funds in the Middle East and Georgia in its efforts to promote private sector development in those areas.

**Background**

In a speech in Warsaw in June 1989, President Bush announced the creation of an enterprise fund for Poland. Shortly thereafter, he announced the creation of a similar fund for Hungary. This new use of public funds to promote the private sector abroad was not universally applauded. Criticism of the enterprise funds came from both the left and the right. Conservatives criticized government interference in free markets, while liberals lamented the allocation of U.S. development assistance to for-profit corporate bodies instead of social causes. The two sides converged in criticizing the funds as corporate welfare (see, for example, Tammen, 1990 and Copeland, 1993). Nonetheless, Congress went ahead with a comprehensive package of aid to support economic and political transitions in Eastern Europe. It passed the Support for East European Democracy (SEED) Act to authorize the establishment of enterprise funds for Poland and Hungary. President Bush signed the bill into law on November 28, 1989. These enterprise funds, the first two of seven such funds authorized for Eastern Europe, went into operation the following year. Following the breakup of the USSR, a second batch of funds was authorized under the Freedom Support Act passed by the Clinton administration in 1994. These funds were established for Russia, the
Western New Independent States, and Central Asia.

The funds were intended to demonstrate the United States’ support for countries undergoing the transition to a free market by providing capital and technical assistance to private enterprises, leveraging additional private capital for private sector investment, and planning other activities that would “promote policies and practices conducive to private sector development” (SEED Act, Title II, Section 201). Underlying the establishment of the funds was the assumption that these ex-communist countries had many potential entrepreneurs, but that a lack of capital and business experience prevented their development. Another assumption was that foreign investors lacked an adequate knowledge of market opportunities in transition economies, making them hesitant to commit capital. Enterprise funds, which would be set up quickly and run by experienced businesspeople and financiers, would help address these problems, and eventually—it was hoped—at least break even on their investments. While the fund concept was novel, it was partially based on the Small Business Investment Corporation Act of 1958, which stood as a successful precedent for directing government-funded venture funds into potentially promising areas that were cut off from mainstream capital markets (interview with Jerry Feigin, Director, Macklin Institute Center for Entrepreneurship, Montgomery College, July 2004).¹

By 1995, enterprise funds had been created for the following ten countries and regions: Poland, Hungary, the Czech Republic and Slovakia,² Bulgaria, the Baltic States, Romania, Albania, Russia, Western NIS, and Central Asia.

¹ The law directed the Small Business Administration to finance and oversee U.S.-sponsored investment funds (SBICs) aimed at small entrepreneurial firms in capital-starved, technically deficient markets within the U.S. economy. While many of the funds performed poorly, the larger initiative played an important role in the formation of the venture capital industry.

² The Czech and Slovak American Enterprise Fund (CSAEF) was incorporated on March 6, 1991. With the dissolution of Czechoslovakia on January 1, 1993, the board of directors of CSAEF created two separate subsidiary funds: the Czech-American Enterprise Fund (CAEF) and the Slovak-American Enterprise
All together, these funds incorporated nineteen countries transitioning from socialism. The Baltic fund covered Estonia, Latvia, and Lithuania. The Western NIS fund included Belarus, Moldova, and Ukraine. The Central Asia fund operated primarily in Kazakhstan, Turkmenistan, and Uzbekistan, with authority in Kyrgyzstan and Tajikistan, as well. As of 2005, only two funds had terminated operations—Poland and Central Asia—while the other eight anticipated the establishment of termination dates by or around the end of the decade.

<table>
<thead>
<tr>
<th>Country/Fund</th>
<th>Authorizing Legislation</th>
<th>Founding Date</th>
<th>Capital Authorized ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Poland</td>
<td>SEED Act</td>
<td>April 1990</td>
<td>262.2</td>
</tr>
<tr>
<td>2 Hungary</td>
<td>SEED Act</td>
<td>April 1990</td>
<td>72.5</td>
</tr>
<tr>
<td>3 Czech &amp; Slovak</td>
<td>SEED Act</td>
<td>March 1991</td>
<td>65.0</td>
</tr>
<tr>
<td>4 Bulgaria</td>
<td>SEED Act</td>
<td>November 1991</td>
<td>58.1</td>
</tr>
<tr>
<td>5 Baltic States</td>
<td>SEED Act</td>
<td>July 1994</td>
<td>50.0</td>
</tr>
<tr>
<td>6 Romania</td>
<td>SEED Act</td>
<td>July 1994</td>
<td>61.0</td>
</tr>
<tr>
<td>7 Albania</td>
<td>SEED Act</td>
<td>February 1995</td>
<td>30.0</td>
</tr>
<tr>
<td>8 Russia</td>
<td>Freedom Support Act</td>
<td>May 1995</td>
<td>440.0</td>
</tr>
<tr>
<td>9 Western NIS</td>
<td>Freedom Support Act</td>
<td>August 1994</td>
<td>150.0</td>
</tr>
<tr>
<td>10 Central Asia</td>
<td>Freedom Support Act</td>
<td>September 1994</td>
<td>150.0</td>
</tr>
</tbody>
</table>

Source: U.S. Agency for International Development

An eleventh fund, the Southern Africa Enterprise Development Fund, adapted the new model for the post-communist state into a traditional development setting. It was set up after the end of the apartheid regime in South Africa and the election of Nelson Mandela, and was intended to promote small and medium-sized enterprises in South Africa.

Fund (SAEF). The new board of directors discontinued operations in the Czech Republic and closed the Prague office on December 31, 1996, focusing all of its efforts on the Slovak Republic. We will refer to the fund as the Czech and Slovak Fund (when discussing it in the aggregate) or the Slovak Fund (when discussing the reorganized entity post-1993).
and a surrounding ten-country region, focusing on black entrepreneurs with little access to capital. In contrast to the process for the first ten funds, USAID set up the Southern Africa fund itself and managed it directly on the basis of existing authorization. The enterprise development fund thus did not take on the full-scale private sector management approach of the SEED and FSA funds, and it also faced country conditions that differed from those confronted by the other funds. Because of its difference from the other enterprise funds, we will not be addressing its performance in our analysis.\(^3\)

**Organizational Structure**

The same organizational features have been standard for all ten funds. Under the SEED law, the President appoints the board of directors, including the chair, for each fund. The law stipulates that directors should have experience and expertise relevant to the activities of the fund, and that U.S. directors should form a majority of the board. Each board can have between three and twenty-seven members. From 1989 to the present, an average of thirteen directors, eight from the United States and five from the host country, have served on the boards. Members have tended to be high-profile Americans with relevant business experience and, on occasion, connections to the White House. Country directors have generally been selected for their local experience and influence. Each board serves for three years, after which the chair, in consultation with the White House and State Department officials, convenes the board to (re)elect directors as required. On average, board meetings have been held two to four times a year, at least once in the host country and once in the United States.

The board selects the management team. The top management has tended to be high-profile Americans, who hire

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\(^3\) In addition, we were unable to obtain information on the Southern Africa fund, since the fund did not respond to our requests for information. The USAID Inspector General was to conduct an internal review of its operations in 2005.
and oversee local managers investing in the host countries.
“Reverse diaspora” growth in various countries, including Russia, has introduced a new positive dynamic into the personnel pool of the funds in recent years.

The law established the funds as U.S. non-profit organizations exempt from federal taxes. Their board members are thus not U.S. government agents but, rather, the principals responsible for directing the investment of the funds’ assets.

Funding levels for each fund were determined on an ad hoc basis by Congress and the White House. Factors involved in negotiations between the Congressional appropriations and the executive branch were country population, the size of the funds, start-up costs and scale, and deal size. Table 1 shows the capital originally authorized for each of the funds. These monies could be used to promote private sector development through a variety of measures, including loans, grants, equity investments, the funding of feasibility studies, technical assistance and training, and the provision of insurance and guarantees.

Objectives
The enterprise funds were hybrid organizations, funded with public monies and accountable to Congress and the White House, but run by private individuals, much like private sector venture capital operations (Koppell 2003, pp. 57, 127, and 209). The Original SEED Act authorizing legislation specified the mission of the funds as follows:

1. to promote the development of the private sector, including small businesses, the agricultural sector, and joint ventures with U.S. and host country participants; and

2. to promote policies and practices conducive to private sector development (SEED Act, Title II, Section 201).
This mission statement stipulates a dual mandate for the funds: to assist private entrepreneurs and firms directly, through investment, lending and technical assistance; and to catalyze change toward market-oriented practices and policies at the business sector level.

The funds’ dual objectives directed their boards and managers to extend their capital to promising private ventures that would serve as a catalyst for broader economic liberalization and private sector growth. The resulting growth would support a series of self-reinforcing objectives: the demonstration of profitability; the emergence of an entrepreneurial segment and its encouragement and tutelage through training programs organized by the enterprise funds; advocacy for the reform of host government policies that affect the business climate; the creation and strengthening of those institutions required for an effectively functioning market, such as access to credit, accounting standards, and legal reforms; and the leveraging of increased external investments into the private sector. Because the funds are also concerned with the host country’s business sector as a whole, the funds are to take on public goals beyond simply helping individual businesses get up and running. These public goals require the funds to maintain the standards of probity and prudence normally expected of those responsible for public expenditures.

Assessment
How well have the funds achieved the goal of stimulating private sector activity, and to what extent have their activities had the “catalytic effect” of promoting a private business ethos and support of free market systems in the host countries? In the section below, we outline the parameters for measuring each fund’s performance in these areas, followed by a summary of our main findings.

Our review concentrates on the direct business-sector effects of the funds’ activities. Broader economic and social policy goals, such as poverty reduction and job cre-
ation, while related, are separate matters. As a U.S. policy program, the enterprise funds were part of a larger strategy of assistance in the transition from communism, and their activities contributed to a large-scale historical shift. Socioeconomic spillovers from fund activities are difficult to measure, however, and exceed the goals of the mandate. The job of an enterprise fund is to make high-quality investments in and loans to local entrepreneurs and firms that would be capable of demonstration effects and sustainable growth.

The unique nature of enterprise funds, which cannot be fruitfully compared to other forms of assistance, made it difficult to reach definite conclusions about their effects. As with most social science research, we do not have a control sample to tell us what would have happened in the absence of the enterprise funds. Our approach has been to study each fund’s record in executing its stated mandate, to compare each fund to the ten-fund performance range and mean, and then to consider the performance of the funds as a whole. This study establishes the narrative of each fund’s lifecycle, while also considering country condition dynamics as an independent background variable. Our assessment adapts standard policy impact criteria to the unique standard of the dual mandate, pairing these criteria—when appropriate—with basic private sector financial benchmarks for fiscal solvency and profitability. Our conclusions rest on a consideration of the imagined counterfactual case—the likely environment for local entrepreneurs in the absence of the enterprise fund program.

**Assessing Investment-Generation Impact**

How well did each fund promote private sector activity? In

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4 If anything, causal effects may have been reversed, as large-scale societal changes established constraints on what a fund would be able to do. Later in this chapter, in our explanation of the funds’ impact, we discuss how the broader country environments affected fund activities.

5 Sustainable growth, here and throughout the chapter, refers to the long-term profitability of firms as going concerns free of both foreign and domestic public aid.
our case-by-case performance review, the outcome of each fund’s activities reveals evidence of varying degrees of programmatic impact in pursuit of private sector development across seven areas. (The table in the Appendix presents a detailed overview of the funds’ activities.) The first three areas represent the core business activities in which each fund directly assisted local firms and entrepreneurs:

- creating sustainable financial institutions;
- lending programs; and
- equity investments.⁶

Each fund undertook investment promotion activities.⁷ Most funds established stand-alone financial institutions such as banks, credit unions, mortgage companies, and small business funds. Designed to be sustainable beyond the life of the fund, these stand-alone financial institutions have become a central success of the enterprise fund program.

In the majority of cases, the lending institutions proved to be the funds’ sturdiest and most effective initiatives. These institutions engaged in a variety of lending activities, such as micro-loans (Poland, Romania, Albania, and Hungary); small and medium enterprise lending (all funds); consumer credit and mortgage finance (Poland, Baltics, Russia, Bulgaria, and Romania); real estate lending (Bulgaria); leasing (Bulgaria, Romania, and Russia); mezzanine finance, securitization, and syndication deals involving foreign public and private banks (Baltics); and acquisition and restructuring of existing banks (Poland, Romania, Russia, and

⁶ Activities in these areas are described in the first three columns of the table in the Appendix.

⁷ The analysis of the investment record of each fund is based on the following sources: annual reports for each enterprise fund through 2003; U.S. government documents provided by USAID and other departments; third party reports on enterprise funds in the news media, policy journals, and related academic literature; and interviews with individuals who were involved in the enterprise funds project, including members of several of the funds’ boards and management.
Western NIS). As a result, many funds developed high-value lending businesses that were to be sold to private investors at the time of wind-down.

The enterprise funds that focused on financial institutions were able to extend credit to tens of thousands of firms and individuals, while achieving high recovery rates and building value in support of their overall programs. The Poland fund was the leader in lending activities. The Bulgaria, Albania, and Baltic funds also developed large, well-managed lending programs. The Russia fund introduced and developed a leasing fund of similarly wide reach. The Romania fund acquired and restructured the country’s leading state bank, Banca Romaneasca, which it sold in 2003 for $34.8 million to the National Bank of Romania, as an early part of its wind-down procedure.

By contrast, the Czech and Slovak, Hungary, and Western NIS funds opted for strategies that concentrated capital and effort on equity investments. These funds did not develop effective lending franchises. Their decision to neglect the development of lending franchises meant that they ultimately lacked the effectiveness, financial returns, and policy influence that the other fund-created banks enjoyed.

Overall, the funds’ experience with equity investments was mixed. Several funds were able to engage in successful equity programs; these investments had the effect not only of supporting the growth of the most able private firms, but also of nudging national capital markets ahead with successful “first-ever” exits. Such was the case for the Poland and Russia funds, where equity investments generated net gains. In the Western NIS (Ukraine), Bulgaria, Romania, and Hungary, the enterprise funds engaged in successful equity programs, but had net losses on their equity investments. The Czech and Slovak and the Central Asia funds suffered even greater losses from these investments.

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8 An equity exit refers to the complete sale of a shareholder’s equity stake in a company to a new third-party owner/investor, usually in an aggressive growth/high-risk asset class, such as venture capital, private equity, or emerging market investments.
eral sources commented that, for some funds, an emphasis on equity as the primary private sector development tool may have been misguided, since most of the host countries have little experience with such investments, and lack the infrastructure for them. At the same time, however, the cases of Russia and Poland and, to a lesser extent, those of the Western NIS, Bulgaria, Romania, and Hungary, show that a partial focus on equity may be entirely appropriate, and that enterprise funds may be uniquely qualified to push for national progress in the development of such experience and infrastructure.

**Assessing the “Catalytic Effect” on the Business Environment**

The record of the funds’ activities in the areas beyond direct business lending and investment reflect the extent to which they achieved a catalytic effect on general attitudes towards private business and on market systems in host countries. The funds’ core activities—creating sustainable financial institutions, lending programs, and equity investments—are important to the second, broader component of the mandate; we can reliably infer that successful loans and equity investments were likely to have had a broadening effect on the host country’s environment. More concretely, however, the fund’s other activities inform us about the degree of their catalytic effectiveness. These activities can be summarized as follows:

- leveraging investments by recruiting external capital, public or private;

- influencing advances in business laws and national market institutions;

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9 See www.watsoninstitute.org/foreignaid for a discussion of aspects of investment policy such as the number and type of investments, with attention to whether each fund has achieved successful exits.
running technical assistance programs in support of education and investment-related skill transfer; and

the status of legacy institutions and fund finances at wind-down.¹⁰

Most of the funds had some success in leveraging foreign capital, although the results varied significantly. The Poland fund’s activities leveraged more than $1 billion in foreign investment, mainly in the form of private investors purchasing shares in the private equity funds managed by its affiliate enterprise investor, in addition to bank lending and direct investment by multinational firms. The Baltic and Russia funds have also had considerable success in leveraging investment. Although Hungary, Bulgaria, Romania, and even Albania managed to solicit some external funds for investment, the scale of that investment has been relatively low. The Western NIS, Czech and Slovak, and Central Asia funds have been largely ineffective in their attempts to leverage foreign investment.

Several funds successfully stimulated policy reform to enhance the legal structures and regulations in areas such as mortgage lending and securitization, bankruptcy, bank charters, and private equity transactions. Seven of the ten funds enjoyed distinct achievements in advising on and lobbying for specific reforms pertaining to market institutions related to their activities. The Hungary, Czech and Slovak, and Central Asia funds did not lead a push for reform, and as a consequence suffered lapses in financial diligence due to the poor management characteristic of relatively corrupt environments.

Many of the funds also had a catalytic effect on the business environment through technical assistance and training programs. A more detailed analysis of findings in this area

¹⁰ Activities in these areas are described in the last four columns of the table in the Appendix.
can be found at www.watsoninstitute.org/foreignaid.

The status of the wind-down process informs us about the major institutional and financial legacies of each fund. The general assessment for all of the funds is positive, but with a large degree of variance.

Table 2 summarizes our assessment of the enterprise funds. This table shows the funds falling roughly into four groups, ranked ordinarily on a four-point scale. The Poland and Baltic funds were highly effective, combining direct assistance to businesses with a positive influence on business policies and institutions. At the other end of the scale was the one failed fund, Central Asia, which is currently in liquidation. Of the two intermediate groups of funds, the successful “turnaround stories” include Albania, Bulgaria, Romania, and Russia; these are funds that have rebounded from inauspicious early years to demonstrate increasing effectiveness both in direct business assistance and in catalyzing positive developments above the firm level. Three “effective but weakened” funds suffered bigger early losses, and, while not crippled, lack the wherewithal to exert a significant influence.

<table>
<thead>
<tr>
<th>Relative Performance</th>
<th>4-Point Scale (0-3)</th>
<th>Enterprise Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highly Effective</td>
<td>3</td>
<td>Poland, Baltics</td>
</tr>
<tr>
<td>Increasingly Effective</td>
<td>2</td>
<td>Albania, Bulgaria, Romania, Russia</td>
</tr>
<tr>
<td>(Turnarounds)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective but Weakened</td>
<td>1</td>
<td>WNIS, Hungary, Slovakia</td>
</tr>
<tr>
<td>Failed</td>
<td>0</td>
<td>Central Asia</td>
</tr>
</tbody>
</table>

Calculated by the author from data available as www.watsoninstitute.org/foreignaid.

**Explanation of Results**

What factors explain how the funds performed with regard to the dual goals of stimulating private sector activity and providing a catalyst for business development in their host countries? What general lessons and conclusions can we
draw from these factors regarding how enterprise funds can be better used to promote private sector growth in developing and transition countries? In our analysis, we consider the following four factors: the funds’ financial performance, the quality of their leadership, the impact of the host countries’ environments upon the funds, and the funds’ scale and design.

**Financial Performance**

First, we must consider the sound financial performance of the funds as a proximate cause of success. Our analysis shows a strong correlation between a fund’s retained capital and its programmatic impact. An unstated expectation underlying the concept of the enterprise fund was that fund managers would be prudent in their investment activities and even turn a profit, if possible. A financial breakeven or profitability would not only enable the funds to meet their core objectives, but would also strengthen the hands of their supporters back in Washington. In that regard, financial performance is relevant to the issue of the program’s sustainability. But how do we measure financial results for an enterprise fund? In the analysis that follows, we employ a measure that is developed around two questions:

1. How did fund activities affect the value of the original capital?

2. Were overhead expenses reasonable, or did they “crowd out” assistance?

The first question relates to the fund’s original capital—its ability to retain and enhance the value of fund assets over the lifetime of its operations.\(^1\) The second relates to the fund’s record of investment management and admin-

\(^1\) The figures for Retained Capital in Table 3 are the net asset value at the end of FY 2004 as a percentage of the total capital disbursed to the fund in its lifetime. For five of the funds, total disbursements to date have been less than the total authorized: the disbursement totals for the Czech and Slovak fund were $58.1
istrative expenses. The managerial talent and logistical overhead required to run an enterprise fund starts at $2-3 million per year (Birkeland, 2001); over the course of ten years, the level of expenses proportional to capital can significantly affect the value of a fund’s capital base, and thus its capacity to implement its program. Table 3 presents basic financial information for each individual fund and for the group as a whole.

The overall financial picture for the enterprise funds program has been positive. As an aggregate through 2004, the ten-fund combined asset value stood at $860 million—equal to 83.1% of the total lifetime governmental contributions of $1.1 billion.

Three of the enterprise funds (Baltic, Poland, and Bulgaria) have increased the value of their capital, with a fourth (Romania) very near to 100%. Albania’s 78% figure reflects its retained capital status through 2002 only, and does not include the recent financial success of its Albanian-American Bank business, which will likely put it above 100% when the 2004 accounting is made available. The Poland and Baltic funds both advanced steadily, with financial growth matching program successes over the ten- to fifteen-year period. By contrast, Bulgaria and Albania saw initial stagnation in their results, as negative national environments retarded their funds’ activities and depressed their asset values. In both of the latter cases, however, the board and management adapted their strategies in response to changing local conditions. Following a civil war in Albania and a complete blockage of reform in Bulgaria, the two funds increased lending activities and consolidated the leading banking business in each country. In recent years, these two franchises have driven up their asset values. By

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million, for Albania (through FY 2002) $21.8 million, for Western NIS $113.6 million, for Central Asia $106 million, and for Russia $303 million. Thus, for the Russia fund, the analysis and calculations focus on the ten-year experience of the TUSRIF fund.

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12 As of December 2005, the Albanian-American Bank financial report was still unavailable.
<table>
<thead>
<tr>
<th>Rank</th>
<th>Enterprise Fund</th>
<th>Date of Incorporation</th>
<th>Retained Capital&lt;sup&gt;c&lt;/sup&gt;</th>
<th>Net Asset Value, FY 2004 ($ millions)</th>
<th>Annual Average</th>
<th>Total Lifetime Operating Expenses ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Operating Expenses ($ millions)</td>
<td>Expense Ratio&lt;sup&gt;d&lt;/sup&gt;</td>
</tr>
<tr>
<td>1</td>
<td>Baltics</td>
<td>July 8, 1994</td>
<td>241.8%</td>
<td>116.8</td>
<td>3.0</td>
<td>5.9%</td>
</tr>
<tr>
<td>2</td>
<td>Poland&lt;sup&gt;a&lt;/sup&gt;</td>
<td>April 27, 1990</td>
<td>130.8%</td>
<td>317.7</td>
<td>3.0</td>
<td>1.2%</td>
</tr>
<tr>
<td>3</td>
<td>Bulgaria</td>
<td>November 5, 1991</td>
<td>107.8%</td>
<td>59.4</td>
<td>1.7</td>
<td>3.0%</td>
</tr>
<tr>
<td>4</td>
<td>Romania</td>
<td>July 14, 1994</td>
<td>95.3%</td>
<td>55.5</td>
<td>3.1</td>
<td>5.0%</td>
</tr>
<tr>
<td>5</td>
<td>Albania&lt;sup&gt;b&lt;/sup&gt;</td>
<td>February 28, 1995</td>
<td>78.3%</td>
<td>16.2&lt;sup&gt;b&lt;/sup&gt;</td>
<td>0.6</td>
<td>2.8%</td>
</tr>
<tr>
<td>6</td>
<td>Russia</td>
<td>May 9, 1995</td>
<td>65.4%</td>
<td>187.3</td>
<td>10.4</td>
<td>3.4%</td>
</tr>
<tr>
<td>7</td>
<td>Hungary</td>
<td>April 27, 1990</td>
<td>55.8%</td>
<td>34.9</td>
<td>2.7</td>
<td>3.7%</td>
</tr>
<tr>
<td>8</td>
<td>Western NIS</td>
<td>August 26, 1994</td>
<td>45.9%</td>
<td>47.7</td>
<td>5.2</td>
<td>4.6%</td>
</tr>
<tr>
<td>9</td>
<td>Czech &amp; Slovak</td>
<td>March 6, 1991</td>
<td>16.4%</td>
<td>8.5</td>
<td>1.9</td>
<td>3.4%</td>
</tr>
<tr>
<td>10</td>
<td>Central Asia</td>
<td>September, 1994</td>
<td>15.0%</td>
<td>15.7</td>
<td>4.5</td>
<td>4.3%</td>
</tr>
<tr>
<td></td>
<td><strong>TOTAL - ALL FUNDS</strong></td>
<td></td>
<td><strong>83.1%</strong></td>
<td><strong>859.8</strong></td>
<td><strong>36.0</strong></td>
<td><strong>2.4%</strong></td>
</tr>
<tr>
<td></td>
<td><strong>MEAN</strong></td>
<td></td>
<td><strong>85.2%</strong></td>
<td><strong>86.0</strong></td>
<td><strong>3.6</strong></td>
<td><strong>3.7%</strong></td>
</tr>
</tbody>
</table>

<sup>a</sup> as of 9/30/01 and prior to wind-down of fund.

<sup>b</sup> as of 9/30/02.

<sup>c</sup> Retained Capital = Net asset value as a percentage of total capital disbursed to the fund in its lifetime.

<sup>d</sup> Expense Ratio = Annual average operating expenses as a percentage of total capital disbursed to the fund in its lifetime.

Source: Individual funds’ annual reports.
contrast, the Romania fund pursued broader business activities with an emphasis on equity investments and privatizations while remaining diversified, and managed to avoid major losses despite suffering volatility in the valuation of its assets. The Romania fund recently realized large profits on a few of its investments, such as the National Romanian Bank, thereby increasing its retained capital in relation to total government contributions.

Of the five funds with the lower retained value figures, three had very troubled starts, and two essentially melted down. Russia shows its retained capital at 65.3%, with large capital losses in the wake of the 1998 Russian economic crisis. The Russia fund’s asset values have increased considerably since 2002, following the election of a new board chair and chief executive. (The Russia fund’s recent success demonstrates that the country environment is not always a determining factor in a fund’s likelihood of success.) Similarly, the Hungary and Western NIS funds suffered significant capital losses on the equity investments made during the initial years of their operation; also like the Russia fund, they have rebounded, shoring up management and recording important positive achievements. The Western NIS and Hungary funds had smaller capital bases than the Russia fund, however, and this magnified the impact of management fees and early losses.

The two failures among the enterprise funds—the Czech and Slovak Fund and the Central Asia Fund—suffered overwhelming losses to their capital bases through mismanagement and scandal. Neither has recovered. USAID ceased disbursements to the Central Asia fund in 2000, forcing it into gradual liquidation as the United States instituted fraud charges against two of its officers. After the disclosure of similar mismanagement in 1996, the Czech and Slovak fund was forced to make sweeping personnel changes in its board and management, and it rededicated the fund’s mission and remaining capital to Slovakia. In 1997, USAID called a three-year halt to further disbursements, and the
capital base eroded further, with the fund’s managers confined to small-scale projects.

The total expenses of the entire ten-fund U.S. enterprise fund program, across nineteen countries, over its fifteen-year lifetime, have been $399 million, or approximately $27 million per year. Considered in terms of overall U.S. assistance budgeting, $399 million for a fifteen-year program is a minimal amount. The figure is also reasonable in terms of the industry standard for private equity, once allowance is made for the higher costs of “first-ever” startup operations in these countries.¹³

In the analysis of the individual funds, mean expense spending was $3.6 million a year, which is equal to 3.7% of the average total disbursement. Five enterprise funds managed their programs at ratios below the group mean: Poland (1.2%), Albania (2.8%), Bulgaria (3.0%), Czech and Slovak (3.4%), and Russia (3.4%). Differences in expense ratios are explained in large part by scale differentials. In other words, funds face similar fixed costs regardless of their size, so that smaller funds will have a higher expense ratio. Expense ratios are also affected by the investment strategy and operations chosen by the board and management. Thus, a regional or large-country fund with multiple satellite offices that pursues equity investments as a main part of its program will have high operating expenses; the average operating expense for Russia, for example, was $10.4 million per year.

Quality of Leadership

The enterprise fund experience shows that certain qualities and capacities among a fund’s leadership are critical to its

¹³ According to one enterprise fund CFO, the annual cost of a fully operational enterprise fund is currently between $3 million and $4 million, factoring in salaries and benefits for management (two U.S. executives plus staff), travel expenses and liability insurance for the U.S. board directors, honoraria and insurance for the national board directors, overhead and rental costs for the host country operations office and a U.S. executive suite, and fees for U.S. lawyers and audits.
success. The two key levels of a fund’s leadership are the board of directors—beginning with the chair—and the management staff of the fund. The board chair is instrumental in forming and leading the board of directors, and he or she also heads the selection of the management team, including the president and top investment officers for each fund.

The designation of the board chair is the single most important personnel choice affecting a fund’s performance. The chair is instrumental in putting together the board of directors, and he or she steers the board’s guidance of the fund over the course of its lifetime. Characteristics that proved to be valuable among board chairs were both obvious and subtle:

- a successful career as a top U.S. investment or business executive with some international experience;
- sufficient seniority and financial accomplishment to be able to commit significant time and energy pro bono;
- a deep commitment to promoting private sector development according to the U.S. free market model; and
- an awareness of Washington politics, including the ability to deal with the administration and Congress.

Chairs of successful funds had different styles: some struck a collegial relationship with the U.S. government, while others were more independent. Political connections

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14 In addition to the independent effect of fund leadership, the leadership variable also interacted with the country’s environment, which is discussed below. Fund personnel and entrepreneurs are responsible for a program’s outcomes, but they must act within a range of environmentally determined opportunities and constraints that can seriously affect the effectiveness of a fund.
were secondary to them, a part of the job but not a leading qualification. Nor did they make excessive use of these connections to control or administer their funds. Among underperforming funds, the noteworthy characteristics of board chairs included a hands-off management style, an overtly political approach, and micro-management from a distance.

An active and able chair was also essential to the establishment of an effective board. Effective enterprise fund boards were active, meeting regularly and communicating with management and among themselves when not in session. Members of the boards of successful funds also had in-depth knowledge of business and local conditions. Some directors were high-profile individuals, but those familiar with the workings of the funds repeatedly said in interviews that business knowledge was more important than political recognition. In practice, the chair first coordinated with the White House to select the U.S. directors; a second critical component was the set of national directors from the home country.

The characteristics of the management among successful enterprise funds were essentially fourfold: successful investment experience, effective management skills, ready adaptability to foreign environments, and an ability to work well in collaboration with the board.

**Country Environment**

“Country environment” refers to the levels of political freedom, economic freedom, and rule of law in a host country’s business environment. Country environment factors determined transaction costs and affected the ability of a fund to achieve its investment and transition goals.

Interviews with policymakers and fund directors emphasized the importance of a core set of economic, legal, and political conditions for the successful operation of an enterprise fund. One AID official described the optimum conditions for a fund:
For an enterprise fund to work, first you need basic if not total rule of law—enforcement of contracts—adjudication, responsibility, basic contract law. The foundation for adjudication needs to be fair and transparent. You need some level of bankruptcy law—so you don’t spend years chasing debts—some real effectiveness of the bankruptcy regime. (Interview with Don Pressley, USAID, July 27, 2004)

In addition to the rule of law, at least a minimal degree of macroeconomic stability is essential if an enterprise fund is to succeed. A positive economic environment spurs growth, while negative trends, such as inflation, diminish the effectiveness of private sector support (Lieber, 1997). Finally, political freedom, including electoral competition and multi-party systems of government, provides some guarantee against arbitrariness and state predation upon private entrepreneurship. Together, these three indicators reflect a country’s willingness to embrace liberalizing reforms and to develop the private sector.

The data across these three indicators reveal that the countries fall into three distinct sets in a hierarchy of investment friendliness. The SEED Act countries were relatively open and transparent; Russia and the Western NIS were significantly less so; and the countries of Central Asia defined the low end in all three measures.

The three groupings of fund environments can be characterized as follows:

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15 The level of inflation and the stability of the currency affect investor confidence, which is required for long-term private investment, both financial and real. For example, the decline in Poland’s inflation rate from 40% in 1993 to 13% in 1997 permitted the establishment of a liquid market for Polish Treasury bonds, the benchmark security that effectively determined the lending horizon for all private lending in the country.

16 This data represents an index constructed by the author. For more information on the construction of the index and the country climates’ change over time, see www.watsoninstitute.org/foreignaid.
Country environments in Poland, the Baltics, and Hungary were relatively supportive.

Environments in Slovakia and Bulgaria improved between 1997 to 2003, becoming relatively supportive. Albania saw significant improvement in its country climate from 1998 to 2003: as political stability returned, it joined Romania as a somewhat supportive country climate.

Less supportive country conditions in Russia and the Western NIS fund reflect the high levels of corruption in Russia and the Ukraine, while the Central Asia region was the least supportive country environment.

**Fund Design and Scale**
The amount of capital provided to an enterprise fund was another factor that affected its overall chance of success. The fund size, as noted above, was decided on an ad hoc basis with some consideration of the country’s population.

<table>
<thead>
<tr>
<th>Enterprise Fund</th>
<th>Initial Authorization (millions of dollars)</th>
<th>Population (millions)</th>
<th>Capital Ratio ($ per capita)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>30.0</td>
<td>3.5</td>
<td>8.6</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>58.0</td>
<td>7.5</td>
<td>7.7</td>
</tr>
<tr>
<td>Baltics</td>
<td>50.0</td>
<td>7.0</td>
<td>7.1</td>
</tr>
<tr>
<td>Poland</td>
<td>240.0</td>
<td>40.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Hungary</td>
<td>60.0</td>
<td>10.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Czech and Slovak</td>
<td>65.0</td>
<td>15.0</td>
<td>4.3</td>
</tr>
<tr>
<td>Central Asia</td>
<td>150.0</td>
<td>51.0</td>
<td>2.9</td>
</tr>
<tr>
<td>Romania</td>
<td>60.0</td>
<td>22.0</td>
<td>2.7</td>
</tr>
<tr>
<td>Russia</td>
<td>440.0</td>
<td>144.0</td>
<td>3.1</td>
</tr>
<tr>
<td>Western NIS</td>
<td>150.0</td>
<td>71.0</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>130.3</strong></td>
<td><strong>37.1</strong></td>
<td><strong>3.5</strong></td>
</tr>
</tbody>
</table>

Source: Individual funds’ annual reports.
Political concerns, as well as pressures to limit budgetary expenditures for what was already a controversial use of public funds, meant that the amount of financing was generally modest. For most funds, low levels of capitalization relative to the size of the host country’s population may have undermined a fund’s ability to have a catalytic effect even where the opportunity to do so may have existed. Table 4 shows the “capital ratio,” or per capita fund size, which is the ratio of the amount that was initially authorized to the host country’s population.

A higher capital ratio can indicate the overall importance of an enterprise fund in terms of the country and its economy. Of the five top-performing funds, only Romania had a capital ratio below 5.0. The prevalence of high capital ratios among the more successful funds suggests that a higher capital ratio is a relevant consideration. This conclusion is further supported by the fact that regional funds with low capital ratios performed poorly, and that funds with large country populations and lower capital ratios have been the least efficient performers. One possible reason for the greater success of funds with higher capital ratios is their increased political clout; the greater the importance of the fund, the more influence it has in promoting the institutional reforms necessary for effective investment. This particular advantage of a higher capital ratio can be seen in the case of the Albania fund, which illustrates the influence that comes with being the biggest investor in a given country. The Albania fund used its relative size and prestige to good effect: it gained access to the full span of the Albanian government and opposition, and it lobbied for a non-partisan consensus in favor of economic reform and business-oriented policies (interview with Michael Granoff, July 21, 2004).^{17}

^{17} Granoff is the chair of the board of the Albanian-American Enterprise Fund. As head of the leading foreign investor in the country, he has been received for personal visits by the Prime Minister and the opposition leader on each of his two annual official trips to Albania.
Recommendations

What does our analysis tell us about the performance of the ten enterprise funds in supporting enterprise development? In aggregate, the enterprise funds have proven to be a cost-effective use of U.S. foreign aid aimed at private sector development. The total allocation for enterprise funds over the lifespan of the program—$1.1 billion—breaks down to an average annual outlay of only $86 million. The resources used by the U.S. enterprise funds during this period have therefore been equal to approximately 0.5% of the total U.S. yearly foreign aid budget.

The evidence from this study thus suggests that, for a small investment of U.S. resources, this program has had an impressive impact. The funds assisted thousands of entrepreneurs, launched dozens of self-sustaining institutions, and advanced important policy reforms for the economic transition processes. Also, the U.S. Treasury received a return of $120 million from the original grant to the Poland fund, and is expected to receive approximately $400 million in total proceeds from all ten funds. Policy analysts inside and outside the U.S. government have also gained experience regarding an effective private sector development policy and institution-building in transition economies, including knowledge about the best conditions for and structure of an enterprise fund.

Clearly, by every standard, the Poland fund was a success. It fully invested its capital in a variety of sectors, made a profit, returned $120 million to the U.S. Treasury, and used its additional earnings to fund a Polish philanthropic foundation. It was also catalytic: it helped strengthen Polish financial institutions by establishing the first bank to finance residential mortgages. It created a micro-lending fund that was imitated elsewhere in the region. And finally, it mobilized private U.S. capital for enterprise investment in Poland.

Five other funds were also demonstrably effective, even if their successes were not as immediately apparent as those
of Poland. Despite their small size, the Baltic and Romania funds performed well, creating new financial institutions in their countries. The Romania fund also mobilized additional private equity capital, and both funds appear to have contributed to attracting FDI. The Albania fund created a successful new high-impact banking institution in Tirana. Finally, both the Bulgaria and the Russia funds survived initial difficulties, emerging years later as effective institutions at the leading edge of their respective sectors. It seems fair to credit all of these funds with success.

The Western NIS, Hungary, and Czech and Slovak enterprise funds were less successful because of costly early missteps, but they at least partially rebounded, stabilizing and resuming their activities. Ultimately, they were able to become more effective organizations, although they remained weaker than the others. In the case of Hungary, early problems with the fund’s management resulted in its essentially halting operations for a year, until the leadership could be changed. The fund became quite active later, however, and contributed to the establishment of a number of local financial institutions, as well as a small parallel fund. Of these three effective but more weakly performing funds, the Czech and Slovak fund suffered the greatest relative damage, as a result of mismanagement by the board in 1993. But, despite their troubles, these three funds remain actively operating. By contrast, the Central Asia fund has been inactive since 1999, and USAID continues to oversee efforts to dispose of its assets.

Based on the analysis we have undertaken, we submit the following recommendations:

**Standardize Board Selection Process**

Our analysis reveals that a fund’s performance tends to mirror the quality of its board and management. The board selection process is therefore an essential part of preparing for success. To give boards the requisite clout, the White House should retain its role in selecting the board chair
and directors for each enterprise fund. The selection process should not be influenced by political considerations, however. Rather, it should focus on competence, integrity, and commitment. First, then, the most basic requirement for board members and top management is investment experience and relevant management experience. These, rather than political connections, should be the sine qua non in the selection of fund directors and managers.\textsuperscript{18} Second, the leaders of a fund should possess knowledge of or influence in the host country. Third, successful enterprise fund chairs should be able communicators, capable of advancing the project’s political goals by using private sector methods, speaking across cultures, and inspiring their management, staff, and clients to create and seize free market opportunities in new places. Finally, we note that a degree of political adroitness, including some knowledge of Washington, sometimes helped various funds to avoid oversight problems. This capacity includes the ability to deal effectively with members of Congress, Congressional staff, and executive branch officials on fund issues.

**Standardize Policy on Return**

One issue that has yet to be resolved is how to dispose of assets upon the dissolution of an enterprise fund, which, in most cases, occurs fifteen years after its establishment. This matter was raised by the success of the Poland fund, whose assets were valued at $300 million. The enterprise fund directors, arguing that the funds were a “gift to the Polish people,” proposed leaving the funds in Poland to finance a new Polish-American Freedom Foundation dedicated to the support of Polish rural development and education. This foundation would be set up and overseen by the fund’s board (GAO, 1999). U.S. government officials, however, disagreed, arguing that the funds ultimately be-

\textsuperscript{18} An interesting and eminently successful example of non-partisanship can be found in the Polish-American Enterprise Fund, where the Republican president and administration selected three Democrats and only two Republicans for its initial board of directors.
longed to the U.S. taxpayer and should be returned to the U.S. Treasury. In the end, the U.S. government agreed that $120 million—one half of the original grant of $240 million—would be returned to the U.S. Treasury, and the remainder used to fund the proposed foundation.

Based on the decision regarding the Polish fund, we suggest that the U.S. government establish a policy of returning 50% of a dissolved fund's original authorization back into the U.S. Treasury. The remaining 50% could be used, as was the case in Poland, to support further economic development in the host country.

**Improve Oversight**

In order to maintain the appropriate degree of public accountability, it is essential that each fund file its annual reports with the U.S. Securities and Exchange Commission and make them available to the U.S. public. All funds should adhere to the standards of publicly traded private companies, which list their annual reports online. Several funds, such as the Russia fund, have already begun to do this. The consequences of more widely distributed information could only be beneficial, establishing a larger comfort zone around interactions between fund managers and U.S. government officials. Such transparency would also shine a necessary light on possible conflicts of interest or excessive expense “premia,” and permit monitoring of the funds’ performance by independent policy analysts.

**Select Countries Carefully and Standardize Fund Capitalization**

A policy dedicated to financial and economic reform and an operative legal framework for business are the two country conditions needed for a fund to be effective. There must be a consensus within the country’s government, as well as within its broader political leadership class, that a private sector orientation is the way to move ahead. Along with that stance must be a minimal institutional base; as one
fund CFO stated, “the single most important element needed before an enterprise fund can be set up is a reasonably effective legal system, i.e. enforceability of contracts” (CFO interview, August 3, 2005). This important criterion need not be unduly limiting: a rudimentary legal system can be adequate (as it was in Albania), provided its structure is sufficient for simple transactions and that the country is committed to developing market economy institutions.

How much total capital should be authorized for a new enterprise fund in a given country? It would be desirable to establish a multi-factor framework, ideally including minimum capitalization ratios, for setting the funding level of each new fund. Because visibility and a positive impact on the population are among the funds’ goals, the per capita capitalization ratio should be taken into account. Cumulated inflation in the value of the U.S. dollar since 1989 is 36%. In addition, the scale of private equity funds has increased dramatically, generating the desire to maintain and increase management efficiency and to provide for minimum operating expenses on a scale of no more than 2-3% of capital. This calls for funds larger than the $50-60 million which characterized most past experience. At least as important in establishing the size of a fund are internal country factors, such as per capita income, aggregate investment across the country, the extent of private industrial development, total foreign assistance received, and the likely type and scale of investment projects to be pursued. Consistent with these guidelines, a few examples of projected budgets for some of the sixteen Millennium Challenge Account countries would be as follows: Morocco $350 million; Sri Lanka $250 million; Senegal $150 million; Honduras $100 million.

**Emphasize Lending-Oriented Investment**

A critical means of enhancing the impact of enterprise funds is to de-emphasize equity investing, especially in new funds. Emphasis should instead be placed on lending-oriented investment strategies, and on the importance
of matching fund projects to local needs and conditions. Available and disciplined credit is the essential ingredient for all developing countries, and enterprise funds are structurally well equipped to provide this. Establishing a bank or other credit institution proved to be a central part of the investment strategy of all of the successful enterprise funds, and was often these funds’ single most important investment. By contrast, equity investments were central to the two or three most significant failures among the ten enterprise funds.

**Cut Losses Early**

Finally, when a fund is clearly failing to function, the record suggests that an early shutdown would save the government money and forestall the embarrassment of a situation’s unraveling. The establishment of warning points and shutdown points would alert the board to consider management and/or policy changes. To preserve the possibility of taking risks, however, it is important that the trigger points be set generously, at, for example, financial losses of 35% and 50%, respectively, or even higher, at 40% and 60%. The basic point is that, while profit is not an overriding concern of the funds, the sudden loss of more than half of a fund’s money would be a costly failure. Aside from the financial loss to the United States, there is the cost to the U.S. image, the opportunity cost of not using the money in another way, and the moral hazard of possible fraud and theft. Undoubtedly, the risk of incurring such costs is part of the undertaking; the goal is simply to contain that risk. Further, implementing a policy that would require the ultimate return of at least 50% of the fund’s original authorization to the U.S. Treasury upon the fund’s dissolution would impart additional discipline, prevent costly meltdowns, and provide valuable political legitimacy to future enterprise funds.
References


# Appendix - Individual Enterprise Funds

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<td></td>
<td>▲ Enterprise Credit Corporation.</td>
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<td>▲ 7 successful exits in 1999.</td>
<td>▲ Led total FDI surge $53.8 from 1990-2003.</td>
<td>▲ PAFF grants to neighbor states thru “Polish model.”</td>
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**KEY**

☐ Marginally important venture

✚ Positive progress in standard enterprise fund activity

▲ Significant achievement for entire enterprise fund project

△ Significant achievement for specific fund

▼ Significant failure for specific fund

★ Significant failure for entire enterprise fund project
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<td></td>
<td>□ 1997 launch of Hungarian Equity Partners (HEP) $50 mill. fund attracted EBRD funding, but is flat.</td>
<td>□ Hungarian-American Credit Corporation not a major undertaking as HAEF devoted use of capital to equity activities.</td>
<td>✤ Participation in 8 IPOs.</td>
<td>□ Over 40 exits closed to raise $20.5 mill.</td>
<td>✤ Over 40 exits closed to raise $20.5 mill.</td>
<td>□ Dispensed $9.6 mill. in technical assistance thru Hungarian-American Assistance Corporation.</td>
<td>△ MAVA Investment Management established as parallel fund for private equity growth.</td>
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<td>CZECH &amp; SLOVAK</td>
<td>□ SAEF plans to create legacy institution upon wind-down, but no specific entity is in place.</td>
<td>△ $17 mill. lent through Direct Investments program.</td>
<td>▼ Large-scale losses from direct investments 1993-96.</td>
<td>□ Total FDI to Slovakia 1990-2003 modest at $8.8 billion.</td>
<td>▼ Founding member of Slovakian Venture Capital Association.</td>
<td>▼ Business Plan Contests.</td>
<td>□ SAEF did not refer to any plans or progress on wind-down arrangements in 2004 annual report.</td>
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<td>△ $4 mill. lent to 51 companies thru Small Loan Program.</td>
<td>▼ $20 mill. equity to 45 enterprises.</td>
<td>▶ Value Growth Fund with EBRD.</td>
<td>▶ Anti-corruption monitoring with Transparency International.</td>
<td>▶ Technical Assistance as needed by investee firms.</td>
<td>□ Stabilized Slovak fund free of most liabilities but operating on small capital base.</td>
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<td>△ $2 mill. lent to 36 private enterprises with Polnobanka.</td>
<td>▶ Sold wood firm Nove Horehronok, for $1.1 mill. (2004).</td>
<td>△ 49% of capital in 6 equity investments, 50% in wood industry.</td>
<td>□ 49% of capital in 6 equity investments, 50% in wood industry.</td>
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<td>BULGARIA</td>
<td>▲ Bulgarian-American Credit Bank (BACB) is leading private bank in country, financed with long-term loans, not deposits. △ BACB’s total assets grew to €153.3 mill. in ’04, with long-term loans from EBRD, IFC, Germany’s DEG, Holland’s NMO.</td>
<td>▲ $380 mill. lent in total over 12 years to more than 4,800 small firms.  © Lent $10 mill. for 550 mortgage loans in 2004.  ▲ Real estate project finance Bulgarian-American Property Management.  © BM Leasing unit.</td>
<td>▲ $73 mill. equity and debt investment, $20 mill. equity to 45 enterprises.  © 4 successful exits in 2003 and 2004 with positive returns including two over 20%.  ▲ Has raised €33 mill. in financing for BACB.  © Led first syndicated loan for 12 mill. with seven foreign private banks.  © 4 successful exits in 2003 and 2004 with positive returns including two over 20%.</td>
<td>▲ Lead writer $3.5 mortgage bond issue.  © Main lobbyist 2000 legislation.  ▲ Introduced Bulgaria’s first-ever corporate real estate-backed securities in 2004 Special Purpose Investment Vehicle (SPV).  ▲ Bulgarian Incubator for Economic Development.  © $1 mill. in grant funding to start-ups.  © Hotel management company.</td>
<td>□ BACB makes BAEF well-set for wind-down, but fund has not announced plans to steer the wind-down process as the 15-year mark approaches. □ Appro. liabilities equal to $10 mill. unlikely to affect reform and growth agenda.</td>
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<td>Baltics</td>
<td>▲ Baltic-American Mortgage Holdings LLC (BAMH) one of two financial institutions founded and wholly owned by the Baltic Fund. △ Hanseatic Capital leads Baltic region in mezzanine finance, also strong in commercial leading.</td>
<td>▲ Lent over $83 mill. in 2004, more than 4000 loans for mortgages and home improvement - up from $57 mill. in 2003. △ Low delinquency rate on repayment of loans, compared to U.S. and EU rates. □ 90% of loan portfolio dedicated to mortgages in Latvia.</td>
<td>▶ Full ownership of BAMH and Hanseatic Capital. ▶ Equity holdings of $4 mill. in 5-10 firms, mainly in Estonia. ▶ Additional $6 mill. committed as subordinated debt (commercial loans with equity options). ▶ 4 successful exits 2003 and '04, two with returns &gt; 20%.</td>
<td>▲ Began 2005 with $120 mill. in external financing commitments, including EBRD loan. ▶ $10 billion in net FDI inflows in thee Baltic states, 1990-2003.</td>
<td>△ Mortgage securitization underway to issue, market Baltic mortgage assets to a wider pool. ▶ Packaged and sold $36 mill. in mortgages to other Baltic banks. ▶ Setting standards in mortgage sales by licensing, qualifying and monitoring sales agents.</td>
<td>□ Awaits a termination date prior to 7/8/09 from USAID. □ $75 mill. in long-term liabilities, owed to external funders, including IFC and various private Baltic banks. △ Is nevertheless positioned for large returns.</td>
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<td>Romania</td>
<td>✤ Micro-lending program MLP</td>
<td>△ 27,000 micro-loans totaling $30 million made through 2004.</td>
<td>✤ $150 million in equity investments, with exits on 30% total equity invested at 20% profit.</td>
<td>✤ Raised $17.5 million in additional foreign private equity capital.</td>
<td>✤ Advised state on privatization of Banca Agricola, also re. electric, banking industries.</td>
<td>✤ Technical assistance with International Executive Service Corps.</td>
<td>✤ Parallel fund RCM established.</td>
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<td>strong despite fund’s tilt towards investment banking.</td>
<td>✤ $8 million in micro-loans made in 2004.</td>
<td>✤ Small Business Investment Fund - 4 exits in 2002.</td>
<td>✤ Attracted Austrian bank Raiffeisen to purchase Banca Agricola in largest foreign purchase of year.</td>
<td>✤ Domenia Credit is Romania’s first mortgage lender.</td>
<td>✤ $5 million energy efficiency partnership with EBRD.</td>
<td>✤ Balkan Accession Fund aims to raise $75 million.</td>
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<td>✤ VC-scale Small Business Investment Fund est. 1997, but marginal due to size.</td>
<td>✤ Business loans through MTP focus on restructuring, buyout finance.</td>
<td>✤ Sold quarry firm Titan MM in 2004.</td>
<td>✤ $10.6 billion FDI 1990-2003.</td>
<td>✤ Estima Finance established to market consumer credit.</td>
<td>✤ Awaits a termination date prior to 7/14/09 from USAID.</td>
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<td>✤ Major transaction Program (MTP) 47% in financial services.</td>
<td>✤ Cash-flow lending started at Banca Romaneasca during RAEF management.</td>
<td>✤ Sold Banca Romaneasca to National Bank of Greece.</td>
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<td>✤ Domenia Credit launched as new mortgage finance institution.</td>
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<td>Delta Bank</td>
<td>+</td>
<td>+ Delta Credit Bank est. 1997 by TUSRIF as a commercial bank.</td>
<td>+</td>
<td>+ Delta Credit has a 50% share of Russia’s fast-growing home mortgage business.</td>
<td>△</td>
<td>△ High-visibility legal suits for shareholder rights, battling recent rule of law slide in Russia.</td>
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<td>Delta Leasing Fund est. 2000 with $6.0 million in equity and $2.3 million in loans from DRF.</td>
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<td>+ Delta Russia Fund (DRF) est. 2004 as parallel fund.</td>
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<td>+ Delta Private Equity Partners (DPEP) manages DRF, soon to be Delta Capital Mgmt.</td>
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<td>+</td>
<td>△ 14 total exits, 17% return since 2001, with 6 additional equity exits in 2004.</td>
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<td>△ Delta Russia Fund portfolio invested in financial services (49%), telecom and media (21%) and retail (5%).</td>
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<td></td>
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<td>△</td>
<td>△ Capital flight following 1998 crisis denied fund environment for influence, leverage.</td>
<td>△</td>
<td>△ High-visibility legal suits for shareholder rights, battling recent rule of law slide in Russia.</td>
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<tr>
<td>ALBANIA</td>
<td>▲ Albanian-American Bank (ABA) the nation’s leading financial institution.</td>
<td>✚ ABA employed 186 staff and earned $3 mill. profit on $188 mill. in assets in 2002.</td>
<td>✚ Made partnership with Agricultural Bank of Greece.</td>
<td>▲ Branch offices of ABA established throughout country.</td>
<td>▲ Difficult country environment.</td>
<td>▲ Participated in Albania’s first-ever syndicated loans with ABN-Amro to raise €34 mill. for Tirana airport; to upgrade a cement factory; and to rebuild Tirana railway to airport.</td>
<td>▲ Participation in Albania’s political elite.</td>
</tr>
</tbody>
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**KEY**

☐ Marginally important venture

✚ Positive progress in standard enterprise fund activity

▲ Significant achievement for entire enterprise fund project

○ Significant failure for entire enterprise fund project

△ Significant achievement for specific fund

▼ Significant failure for specific fund
| Fund            | Financial Institutions                                                                 | Lending                                                                 | Equity Investments                                                                 | Leverage                                                                 | Institutional/ Legal Reform                                                                 | Assistance/ Training                                                                 | Wind-Down                                                                                          |
|-----------------|----------------------------------------------------------------------------------------|-------------------------------------------------------------------------|------------------------------------------------------------------------------------|--------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|
| Western Nis     | ✦ ProCredit Bank and ProCredit Moldova est. on base of micro-lending program (with IFC and EBRD). | △ $15 mill. to 2,000 small firms in Ukraine, $2.1 mill. to 440 Moldovan Firms. | ✦ Committed $61 mill. in 12 companies.                                                | △ Assisted its portfolio firms to raise external funding.                | ✦ Active in American Chamber efforts on reform agenda, especially corporate governance and transparency. | ✦ Fund has distributed $9.5 in technical assistance programs.                                   | △ Established Horizon Capital, a parallel fund entity.                                              |
|                 | ✦ Moldova Agri-onbank ($1.7 mill. equity).                                              | ✦ Small Business Loan Fund.                                             | ▲ Made 2 first-ever equity exits in 2003-04, including sale of cement firm SBK for $13.5 mill. | ▲ Total loans generated at $100 mill., from EBRD, private banks, Ukrainian government. | ✦ Helped found Ukraine’s national mortgage association in 2004.                              | ▲ Awaits a termination date of not later than 2009 from USAID.                                  |
|                 | ✦ Small Business Loan Fund.                                                              | ▲ Minority owner of International Mortgage Bank, Ukraine’s first mortgage specialist. | ▲ Investments focus on equity holdings, currently in 12 companies.                   | ▲ Pushed for new laws on mortgages, privatization, corporate bond markets. | ✦ Pushed for new laws on mortgages, privatization, corporate bond markets.                   | ▲ Awaits a termination date of not later than 2009 from USAID.                                  |
|                 | ✦ Est. private equity management firm Horizon Capital in 2004.                           | ▲ Fund emphasizes employment effects; its firms employ 17,000 jobs.       | ▲ Fund emphasizes employment effects; its firms employ 17,000 jobs.                   | ▲ Pushed for new laws on mortgages, privatization, corporate bond markets. | ▲ Fund emphasizes employment effects; its firms employ 17,000 jobs.                            | ▲ Awaits a termination date of not later than 2009 from USAID.                                  |

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Asian Cross-Roads Loan Company (ACLC) was the fund’s lending branch.
- Fund ran a micro loan program.

More than 400 loans to SMEs including large loans of $1 to $3 mill.
- More than 2600 micro-credit loans.

CAAEF lost most of the $77 mill. spent on loans and investments in equity purchases made prior to 1998.

Committed bulk of its $100 mill. capital within 3 years from 1995 founding.
- Fund sought to enhance the Kazakhstan Stock Exchange.

Fund encountered difficult logistical situation and corrupt business climate.
- Rapid commitment of funds and loose management controls enabled commission of wire fraud by two fund employees.

USAID has taken over the liquidation of the CAAEF after operations ended in 2000.
- AID-sponsored audits report total net assets valued at $16 mill.; however, exits have proven difficult.
Chapter 3
OPIC Equity Funds
Todd Johnson

The history of U.S. government involvement in private equity funds begins with the Overseas Private Investment Corporation (OPIC), which was founded by Congress in 1971. Its mission was to mobilize and facilitate the participation of United States private capital and skills in the economic and social development of less developed countries, and countries in transition from non-market to market economies, thereby complementing the developmental assistance objectives of the United States.... The Corporation shall especially: be guided by the economic and social development impact and benefits of a project...give preferential treatment to less developed countries...[and] support those developmental projects having positive trade benefits for the United States. (U.S.C. Title 22 §2191)

Congress also required OPIC to operate on a self-sustaining basis, to avoid any projects that would reduce U.S. employment or have detrimental environmental effects, and, where possible, to prioritize projects involving U.S. small businesses. While the tools and specific guidelines used by OPIC have changed over the years, this overall strategy of promoting development and economic transitions through U.S. investments abroad has remained constant. (See appendix for an overview of OPIC-sponsored equity funds.)

Background
Initially, the mechanism employed to carry out this strategy centered on providing political risk insurance and a small
amount of financing in order to support foreign direct investment (FDI) by U.S. companies in developing nations. At the time, FDI was a risky proposition. Few, if any, insurance companies could handle the difficulties of underwriting the risks of expropriation, the impediments to the repatriation of profits, and the other political hazards of projects in developing economies. The political risk insurance provided by OPIC was therefore a useful service. OPIC also offered financing in the form of loans to American businesses that were expanding their operations into developing markets. Again, project financing for FDI in these countries was not easy to secure, and OPIC sought to fill the void. OPIC prioritized providing these services to small and medium-sized U.S. firms, which were the companies most in need of support as they expanded internationally. These firms also made up an important political and economic constituency in the United States to provide political support for OPIC’s work.

In 1987, OPIC introduced a new tool to further its objectives: investment funds. As the Government Accounting Office (GAO) explained in a 2000 report on the funds:

> These funds aim to promote broad U.S. foreign policy and strategic goals by investing in countries or regions that are making the transition to market economies or are otherwise of foreign policy interest to the United States. According to agency officials, investment funds also serve as a catalyst for private sector development by providing incentives for investment in countries where U.S. investors might be unwilling or unable to invest without U.S. government support. (GAO, 2000)

OPIC viewed the lack of private equity flows into the developing world as an obstacle to private sector growth and political transition. The specifics of private equity will be discussed in more detail below, but the underlying rationale for supporting private equity was that companies and en-
entrepreneurs in the developing world lacked access to capital and managerial expertise, and private equity could help fill these gaps while making a profit for the equity fund. Equity funds provided scarce capital to businesses and entrepreneurs in developing countries, with the expectation that this capital could spark economic growth—not just because of the performance of the invested companies, but also through follow-on investment and the development of a more advanced financial community.

During the 1990s, critics attacked OPIC—and the funds in particular—as a form of corporate welfare, arguing that private fund managers and large companies were benefiting from U.S. public monies. These critics further argued that OPIC had lost its development agenda, had placed a considerable risk on the U.S. government’s balance sheet, did not have any positive effect on U.S. businesses, could not demonstrate profitability, and, in many cases, actually competed with the private sector. While OPIC never fully lost its political support, these criticisms did force the Corporation to improve some of its programs and processes and make its workings more transparent. In 1998, for instance, OPIC changed its procedure for selecting fund managers. It established a competitive bidding system to select its funds, as opposed to the rather opaque process that had been in place up until then. An additional element of opacity was the absence of any public reporting on the funds’ performance; this absence has not been rectified, however.

Partly in response to these critiques, and partly as an initiative conceived by the new administration, OPIC announced a change in its strategic direction in 2001. Peter Watson, who had newly been selected as president and CEO of OPIC, argued that the Corporation needed to focus more on its development mission and ensure that it did not compete with the private sector (OPIC Press Release, July 18, 2001). In testimony to Congress, Watson explained the motivation for this shift:
In the post-September 11 world, our mission is acutely more important than ever to U.S. foreign policy. OPIC plays a key role in the development of regions where instability poses foreign policy and national security challenges to our nation. Uniquely foreign assistance programs do indeed accomplish this role at no net cost to the United States taxpayer. A critical element in our success has been our effort to refocus OPIC on its historical development mission. (*Renewing OPIC*, 2003)

OPIC implemented this new strategic plan based on an evaluation report and a “development impact matrix” instituted to measure the effectiveness of its projects. The result was a somewhat more transparent and accountable corporation. Overall performance also improved, as will be explained below.

**Objectives**

The primary objective of the OPIC funds is to support the local private sector in developing regions while furthering U.S. interests in their development and transition to market economies. In 2002, OPIC introduced a new strategic plan and evaluation guideline, which included general goals and performance indicators that OPIC now uses to assess its investments (OPIC, 2003). Three broad categories of goals can be inferred from the strategic plan: the promotion of economic development in host countries; the promotion of social advancement in host countries; and the provision of support for U.S. trade interests and foreign policy goals.

- **Promotion of Economic Development** The economic benefits that OPIC equity funds hope to bring to their host communities include: creating more and better jobs, promoting the development of markets, promoting sound financial performance, increasing tax revenue for host countries, improv-
OPIC Equity Funds

Promotion of Social Advancement  Along with a positive economic impact, OPIC funds also aim to produce solid social benefits, including the following: implementing skill/technology training programs that support the development of skilled jobs and new technologies, supporting the emergence of an entrepreneurial class, promoting environmentally safe technologies, and promoting business practices that are consistent with human and labor rights.

Support for U.S. Trade Interests and Foreign Policy Goals  Support for U.S. economic goals overseas generally includes the following: facilitating the entry of U.S. business entities into foreign markets, promoting mutually beneficial trade between the host country and the United States, and supporting other U.S. foreign policy objectives.

Organizational Structure
Before assessing OPIC’s success in achieving its goals, it is necessary to describe private equity funds in more detail. Private equity is a very specific form of investing. Both in the developed and in the developing world, private equity involves three primary parties: the fund manager (also called the General Partner), the equity investors (the Limited Partners), and the companies in which the fund invests (Portfolio Companies). The fund manager typically comprises a firm of investment professionals that raises money from institutional investors—pension funds, insurance companies, endowments—to create a pool of committed capital. Once it has raised this capital, the fund manager seeks companies to purchase. Its intention when it purchases a company is to take a large stake in it, improve its operations, and then sell it to another financial player, to a corporation, or on public equity markets. Private equity can range from multi-billion-
dollar leveraged buyouts to a $500,000 venture capital investment. But the overall premise remains the same: buy a company, improve it, then sell it for a profit. Profitability is a key element in the performance of equity funds.

The distribution of returns in private equity funds is also important, since this determines the payoffs for its investors and managers. Typically, the first claim on a fund’s returns belongs to the equity investors; they are entitled to recoup the money they placed into the fund. Any profits remaining after this distribution are split between the investors and the fund manager, normally with about 80% going to the investors and 20% to the manager. The fund manager also receives an annual management fee, regardless of returns, of approximately 2% of the fund’s size. The motivation behind this return structure is to align the incentives of the fund manager and the investors: both parties can make significant gains if the fund is profitable. If the fund does not make a healthy return, there is a high probability that the investors will not make any profit on their committed capital. The historically high returns of private equity in developed countries, however, have tended to offset this added risk, and it remains a very attractive investment choice in well off, mature economies. They are less consistently successful in developing countries.

Private equity creates economic value for the companies in which it invests in a number of ways. In order to grow, firms often need an influx of capital, and this capital may not be readily available to them, particularly in developing countries. Private equity can provide essential expansion capital to firms that are trying to grow. Venture capital funding, for instance, allows early-stage companies to develop their businesses and introduce new products. For more established enterprises, private equity can fund expansion to new geographies and markets. The capital can also help combine separate businesses, creating synergies and offering better and lower-priced products to the marketplace.

Private equity can be a catalyst for improving efficiency.
Fund managers often have operational expertise, and, when they purchase a company, they may bring in new management talent to help run the company, or innovative technology to improve its operations. In this way, private equity can transform uncompetitive, bloated companies into successful private enterprises. This is very important in economies where formerly state-run businesses have been privatized and need assistance in order to become competitive and sustainable. Access to capital and managerial talent, two things that are often lacking in developing countries, can be very helpful in creating viable businesses.

In addition to operational expertise, financial expertise can also be brought to developing countries through private equity. The International Financial Corporation (IFC)—the branch of the World Bank Group that is responsible for providing equity and debt funding to private enterprises—initially used private equity not as a way to support portfolio companies, but, rather, as a means of modernizing the financial sectors that did not have enough investing capability (IFC interview). One of the funds set up by the IFC, for instance, introduced the first convertible debt offering to a developing country. Thus, while the focus of private equity today is on improving portfolio companies, it also provides financial expertise, which is still an important skill needed in emerging markets.

Despite these benefits, however, private equity flows to developing countries have been slow to develop. Many institutional investors and fund managers are reluctant to invest in developing countries due to uncertainty and a lack of information about their markets. Several international financial institutions (IFIs), including the IFC and the European Bank for Reconstruction and Development (EBRD), have joined OPIC in taking measures to promote equity investments. These organizations have focused on encouraging investment in countries where attractive opportunities for profit-making seem to exist, in the hope that once the international financial community sees that returns can be
made on these investments, and once some of the growing pains of private equity have passed, private funds will flow and there will no longer be a need for IFI sponsorship. Many of the fund managers that we interviewed agreed wholeheartedly that public support for their initial equity funds helped them gain the experience that later enabled them to raise follow-on funds entirely from private investors. Public support for the funds thus not only brings about the benefits described above, but also serves as a catalyst for increased investment.

OPIC sponsors private equity as a development tool by providing loan guarantees to fund managers who focus on developing regions. OPIC offers loan guarantees to an eligible investor to commit money to the fund. This OPIC loan guarantee covers 30-65% of the total fund size, with the remainder coming from other equity investors. If the fund is profitable, the investor is paid from the fund’s returns, and the U.S. government is not liable for any debt repayments. If, on the other hand, the fund is not profitable, the U.S. government’s guarantee is called to repay the investor her money, plus interest. The investor thus has the backing of the U.S. government, and, in the worst case, will receive her money plus interest from the government.

The situation of the U.S. government, however, is much less favorable. OPIC receives a portion of the financial return of the fund as well as fees for guaranteeing the loans. In contrast to the typical private equity structure described above, the priority of payments within OPIC is as follows: first, the fund repays the loan, plus interest and fees; second, if there is money remaining, the fund returns committed capital to the equity investors; and third, the fund distributes profits to the equity investors and the fund managers, with a small share going to OPIC. OPIC therefore has payment priority above the equity holders, but only receives a small portion of the upside profits if the fund performs well: it takes on a lower risk, and, thus, can expect a lower return. The equity holders will only see a return if the fund makes enough
profit to repay the OPIC loan, but, if it is profitable, they retain a large portion of the upside: hence, their higher risk can yield a higher return.

As of 2003, OPIC had issued more than $2.5 billion in financial guarantees to 37 equity funds in 40 countries in the developing world (interview with Ken Gray, Manager, OPIC). While this was down from $3 billion in exposure in the late 1990s, it still represented nearly 40% of OPIC’s credit exposure. Twenty-eight of these funds are legacy funds, which were formed prior to 2002, and nine are new funds. The legacy funds have $3.2 billion in committed capital, $1.8 billion of which is from OPIC, while the newer funds have $2 billion in committed capital, with $700 million coming from OPIC. Also as of 2003, the largest regions supported by the funds were the Newly Independent States, with 21% of the capital, Africa, with 18%, and Eastern Europe, with 16% (Moran, 2003).

Assessment
To what extent has OPIC succeeded in meeting its goals? To answer this question, we will consider how the funds have performed with regard to the three goals discussed above: economic impact, social impact, and the promotion of U.S. trade interests. In order to determine the success of a program, we considered its comprehensive impact in these three areas vis-à-vis the specific goals it was originally designed to accomplish. When the impact and the goals coincide, a fund has been successful.

Assessing Economic Impact
From an economic perspective, OPIC as a whole has done quite well. Between 1969 and 2003, OPIC supported some $145 billion of investment in developing countries, generating more than $11 billion in host-government revenues and 680,000 host-country jobs. OPIC has accomplished this at virtually no additional cost to the American taxpayer: it has operated on a self-sustaining basis for more than
three decades and even accumulated about $4.2 billion in reserves (Moran, 2003). We do not know how well or poorly OPIC’s equity funds have performed, however, since information on their performance is not publicly available.

Anecdotally, equity fund managers claim that their portfolio companies have made great strides and had a positive economic impact. In Colombia, for instance, ACON Investments has grown a supermarket into the third largest in the country, tripling revenue and profits and vastly increasing employment. Many of the managers of the company are local Colombians or come from neighboring countries, and the skills that they have acquired are impressive. Other success stories include a Ghanaian generic pharmaceutical company, a Kenyan flower exporter, and numerous cellular service companies across Africa. In each of these cases, jobs have been created, local talent trained, and businesses improved and rendered self-sustaining (interviews).

The single most important outcome of the funds has been the development of viable businesses that increase the demand for skilled and high-paying jobs, but this is not the only positive impact that OPIC funds have had on developing economies. A 2003 Institute for International Economics report argued that OPIC funds have had several other beneficial effects. For example, banks have improved auditing and transparency standards, and OPIC participation has resulted in a multiplier-effect for additional funding (Moran, 2003).

Fund managers argue that OPIC has played an important pioneering role by entering regions where private investors were reluctant to invest. Moreover, now that these funds have been established, they—and other funds—are better able to raise follow-on funds without OPIC’s support. The manager of the Modern Africa Growth Fund recently launched a new fund, Pan-African Capital, that will focus on investment banking and asset management in West Africa without the use of OPIC. The manager acknowledged that he would not have been able to create the Modern Af-
rica Growth Fund without OPIC; nor would he have been able to set up this new fund without that prior experience. Therefore, OPIC can serve—and, indeed, has served—as a catalytic force by bringing capital into the developing world.

Assessing Social Impact
The social impact of the funds is closely tied to their economic performance. The jobs that the funds have helped to create, along with the training and experience associated with them, have had important social consequences as well as economic benefits. The employees that have benefited from the funds’ impact on job creation enjoy enhanced career opportunities both within the portfolio companies and beyond. In addition, local partners benefit by providing support services and interacting with well-trained business professionals. Finally, OPIC’s requirements regarding human and labor rights confer upon the funds an obligation to conduct business responsibly and to respect the requirements of OPIC. As one fund manager explained, when investing in Africa, “there are obligations that you need to respect, and this changes how you do business…. You do not operate your firm [merely] to maximize quarterly profits because, if you do, you damage your own reputation” (interview with Thomas Gibian, Emerging Markets Partnership).

Some OPIC funds have also contributed positively to their regional environments. One of the most successful deals for TDA Capital, a fund operating in Poland, was a real estate project in which it funded the reconstruction and revitalization of a dilapidated port area in downtown Gdansk, Poland. Tremendous economic value has been provided by this project, which rejuvenated an entire area and brought new training and skills to the local population. And, because of OPIC’s involvement and additional financing, the project went far beyond local environmental standards in order to ensure that the construction would be ecological-
ly sound (interview with Joe Saldutti, TDA Capital). Such successes highlight the win-win potential of private equity, which can promote better companies, trained workers, and improved social conditions. Nevertheless, many potential obstacles to these effects do exist, creating problems that can undermine an otherwise positive impact, as we explain below.

Problems
Although some of the funds, such as those described above, have been successful in achieving all three of OPIC’s goals, many OPIC-supported funds have not fared well. As of 2000, only 13 of the 26 funds had positive returns, and only 16 met OPIC’s required risk rating, which measures the likelihood of a fund’s repaying its loan. OPIC argued that, at the time of the report, many of the funds were still early in their investment cycles (GAO, 2000). Many of the funds that OPIC founded in the mid-1990s should liquidate soon, however, and their returns may well be below what OPIC anticipated. OPIC expected returns in the vicinity of 20%, and that seems improbable given the investing climate in most developing countries. In fact, many of the fund managers with whom we spoke anticipated that recent OPIC fund performance would be poor and that the portfolios would show losses. The overall performance of these funds has yet to be evaluated, and, for unstated reasons, OPIC has been unwilling to disclose data on their individual performances (earnings and losses).

As an indication of these financial difficulties, OPIC instituted a brief moratorium on new funds in 2001 in order to reassess its fund strategy. OPIC then altered its selection process for a second time, and also revised its equity requirements in an effort to minimize its exposure in individual funds. In addition, it reevaluated its overall asset allocation plan so that it could better manage its risks across sectors and regions. Since then, OPIC has supported a number of new funds, and is in the process of sponsoring more.
Nevertheless, the moratorium underscored the financial risks and struggles that the funds have experienced.

**Explanation of Results**

As can be seen, OPIC funds have had a mixed performance outcome. What factors explain this mixed performance? What performance areas need improvement to ensure overall success? To answer these questions, we consider the impact of four intervening elements: the strength of fund concepts and structure, the quality of fund managers, the state of the local economy, and the availability of political support. The first two variables relate to OPIC’s internal dynamics, while the latter two reflect dynamics that are external to OPIC and beyond its control.

**Strength of Fund Concepts and Structure**

One important determinant of success is whether the funds are designed to allow for efficient management and execution. Two key aspects of this question are the clarity of the funds’ mission and the appropriateness of the funds’ structure.

**Clarity of Mission:** OPIC equity funds, like OPIC itself, are tied to a set of objectives that are not always mutually consistent or reinforcing. The funds must be self-sufficient and should not become a drain on OPIC’s resources. They must promote private enterprise as a means of furthering economic development and the transition to free markets abroad, but they cannot invest in “sensitive” economic sectors, such as manufacturing, textiles, apparel, electronics, agribusiness, or industrial products. These restrictions stem from concerns about the possible negative impact on U.S. businesses should the funds invest in these areas (Moran, 2003). Furthermore, the development mission implies the aim of bringing about social and economic progress in the host country, even though this can sometimes lead to losses on investments. Finally, the funds are to further U.S.
foreign policy goals, an aim that can entail making investments in strategically important regions that have limited developmental or private enterprise potential.

Proponents of the current mission argue that OPIC must continue to cater to all of these constituencies—especially U.S. businesses, foreign policy advocacy groups, and Congress—in order to retain political support. The problem is that the goals of appeasing these constituents and satisfying the profit requirements of investors and managements may be mutually exclusive.

One telling illustration of the problems with trying to satisfy both profit requirements and U.S. foreign policy goals can be found in the case of Zephyr Management. In 1998, OPIC approached the firm, asking it to take control of an African fund whose management could no longer handle its investments. Instead of writing off the entire fund, OPIC hoped that Zephyr could turn it around and at least recoup the invested capital. Six years later, Zephyr has nearly recovered all of the lost capital. OPIC is holding fast to its requirement that its guaranteed loans receive payback priority to avoid taking a loss, however, and so the other equity investors will not be repaid their full capital, nor will Zephyr receive a portion of the carried interest. While OPIC’s stance is legally correct according to the Limited Partnership agreement, it demonstrates an unwillingness to allow private equity funds and their investors to earn a return, even in a case when the managers’ actions and the investors’ patience are what enabled the fund to turn a profit. If OPIC is to truly act as a catalytic force in the marketplace, it must bolster private firms’ incentives to enter these countries by making the countries more attractive than they currently are. Today’s mission, with its strict requirement for self-sufficiency, does not fulfill this goal.

**Appropriateness of Fund Structure:** OPIC’s complicated mission gives rise to several problems within the fund structure. Fund managers and IFIs highlight a number of conflicts
in the partnership agreements that restrict the funds’ ability to have the greatest possible economic and developmental impact. First, some of OPIC’s funds are geographically limited. While it might seem appropriate to focus the funds on particular regions, sometimes these areas are too small to support their own dedicated funds. Newbridge Andean Partners was limited to investing in the Andean region, and had to maintain its presence there even when financial crises hit that area. This inflexibility in scope and the fund’s concomitant reliance on a few geographic markets may have prevented the fund’s managers from diversifying and avoiding negative returns.

Second, U.S. job guidelines and the restrictions against investing in “sensitive” economic sectors, such as manufacturing and industrial products, have a detrimental effect on the funds’ financial and developmental performance. Due to potential competition with U.S. firms, OPIC funds are unable to support promising businesses that other IFIs would be willing to support. This not only harms returns to OPIC and the equity investors, since profitable deals are rejected, but it also stifles companies that have the potential to create jobs and transfer skills to developing countries. It might also prevent the U.S. economy from leveraging its own competitive advantage in the global economy.

A third problem is that the funds’ structure discourages co-investment. Many investors, particularly IFIs, work to co-invest and develop a coordinated strategy to use private equity in development, yet OPIC is rarely involved in these efforts. There are two reasons for OPIC’s lack of involvement. First, IFIs do not want their funds to have the U.S.-based restrictions described above. Benefiting the U.S. economy is not a part of the IFIs’ mandate, and so they would not want to limit their funds to the sectors approved by OPIC. Second, OPIC typically guarantees more than 50% of the committed capital of a fund. This usually prohibits other large investors from participating, since there is not enough room for both public and private sources. By investing
alone, without IFI coordination, OPIC effectively deprives itself of access to some of the best fund managers that currently work in this field. OPIC also does not participate in the sharing of best practices that many IFIs coordinate as a means of improving private equity in developing regions.

Guaranteeing such a large percentage of individual funds means that OPIC is assuming a great risk. Because it has a limited capital base, OPIC is not able to diversify its portfolio across many funds, and is therefore vulnerable to financial problems if a few funds cannot repay their loans. After the moratorium of 2001, OPIC opted to decrease its share of individual funds and, at the same time, to rethink its asset allocation. These are both important steps that will help OPIC manage its risks in a more professional and responsible manner.

The final problem with the partnership agreements pertains to OPIC’s return schedule. As is typical in cases of debt, a guaranteed loan from OPIC has payment priority ahead of the equity investors. This means that, in order for equity investors to at least recoup the capital that they initially committed, the fund must return enough to pay back the OPIC guaranteed loan, plus interest, plus fees. While this arrangement works with other forms of debt (e.g. U.S. private equity, SBA loans), in OPIC loans, equity investors may not recoup any of their capital unless the fund performs very well. With 50-60% of capital in the form of debt, plus interest and fees, the profit rate for an equity investor to recoup his committed capital is in the high single digits. The returns for private equity in developing countries average -2.2%, however (Dinneen, 2004), meaning that, with an OPIC loan, a fund will need to greatly outperform the market in order for the equity investors to earn a return. Given these circumstances, sophisticated private investors and fund managers are reluctant to partner with OPIC.

**Quality of Fund Managers**

The selection of fund managers are among the most impor-
tant decisions that OPIC makes. The fund manager has a profound effect on the investment return. A good manager is an asset, just as a poor manager can doom a fund to failure (Barger, 2000). The typical procedure for selecting a manager is as follows. First, OPIC approves a fund concept—normally with a regional focus—and then solicits expressions of interest in managing the fund from current fund managers. It considers the applicants’ proposals and, using a third-party evaluator, is supposed to select the most experienced and qualified manager. The OPIC Board must approve the fund manager selected by the evaluator, and then OPIC negotiates the terms and conditions of the fund. Periodically, OPIC reviews proposed investments to ensure that they comply with OPIC objectives and regulations. While OPIC does have some input into investment decisions, and can veto investments that conflict with specific legislation, the fund managers otherwise retain control over all investment decisions.

What exactly makes a fund manager “good”? According to a portfolio manager at the IFC, the best fund managers have solid private equity experience in the developed world—meaning that they understand the various financial techniques necessary to effectively manage the equity fund’s investments—but also have local partners to help find an appropriate and robust deal flow (interviews with Anne Hawkins and David Wilton, IFC). The best fund managers understand what kinds of business will flourish in these areas, and they know how to structure deals to protect their investments and ensure profitable exit opportunities. Successful managers also know how to manage and train local talent, since the fund managers themselves may not have a day-to-day operational role in the type of business involved. Having the contacts and the ability to recruit and manage the best local employees is a key success factor for funds in developing markets.

Proven and able managers are generally unwilling to compete for OPIC guarantees, because they are able to raise
and supplement their capital through other means. Thus, OPIC must generally select its managers from “the bottom of the barrel.” This process can guarantee poor performance. Since OPIC is unwilling to provide information on results of this program, one must suspect the worst.

Poor managers in developing markets have made mistakes that have doomed their funds. For instance, some funds invested in early-stage start-up companies, hoping for exponential growth, but such expectations were unrealistic. Furthermore, the smaller deals typical of developing countries tend to take as much time to complete as the larger ones, while their returns, in absolute figures, are small. An IFC study concluded that, in developing countries, private equity deals of more than $5 million posted far higher returns than smaller investments (Leeds, 2004). More successful managers have tended to focus on larger companies in established industries with identifiable exit opportunities. Some managers have also erred by taking minority stakes in companies, which does not give them the control to sell the company when the time is right. Again, poor managers may lose discipline and patience as they invest, neglecting the fundamentals of private equity—and this will, in the end, harm returns. The incentive for a manager, when encountering problems, is to seek recovery by taking more speculative positions. And since the manager typically has no financial stake in the business, speculation or abandonment can be the result of a poor start.

Selecting the right manager is an important key to success, and this is also an area in which OPIC has struggled. In the past five years alone, OPIC has reviewed its selection process twice. According to many in the industry, the selection process before 2001 was often politically motivated and led to the appointment of poor managers. To rectify this, OPIC resorted to using professional gatekeepers to insulate the process from political pressure. While it will take a few years to determine whether the new process will yield better results than the old one, the fact that OPIC has part-
nered with a handful of premier international fund managers, including Advent, AIG, Texas Pacific Group, and Soros Private Funds Management, demonstrates that it has the ability to attract the best talent, depending on target country and financial conditions. The challenge remains, however, to communicate a compelling strategy for the overall fund program, and then to ensure that no program or fund be undertaken without proven and motivated management teams.

**State of Local Economy**
Investing in developing countries is an extremely difficult endeavor, and one cannot expect the same rate of success there as in more developed economies. According to a Cambridge Associates report, the average 10-year return for private equity/venture capital funds in the developing world is -2.2%; this compares to a 37% return for U.S. venture capital and 10% for private equity (Dinneen, 2004). While capital is scarce in emerging markets, and economic theory might suggest that returns should be higher there, the reality of the situation is different. The risks of investing in these markets are so severe—due to unstable political situations, a lack of scaleable opportunities, macroeconomic crises, inexperienced local management, corruption, weak legal systems, and few exit opportunities—that long-term investing takes great skill, luck, and timing. Indeed, many managers cite the macroeconomic climate as the greatest predictor of a fund’s success or failure.

While there are many obstacles to investing in developing countries, this does not preclude the possibility of success. The same country that has outstanding success stories might also have terrible failures. Some markets that seem ready for private equity flounder, while others that are mired in crisis offer interesting opportunities. Therefore, although many private equity investors in the developing world have had disappointing results, to claim that this is due entirely to inhospitable investing climates oversimpli-
fies the problem. Fund managers who adapt to their new environments may do well, despite the obstacles. (These managers, unfortunately, are those who generally don’t require OPIC support to raise capital or who may be altogether unwilling to operate in unpromising environments.) Investing in these regions is more difficult than investing in the developed world, and, even more importantly, investing in these regions is very different from investing in the developed world, but all that this means is that private equity in emerging markets requires sophisticated, experienced, and flexible fund managers.

**Availability of Political Support**

The viability of the OPIC program depends on its ability to maintain political support both in the United States and in the host country. While this is “softer” than the other determinants of success, it is becoming increasingly important, as legislatures demand accountability and transparency from such agencies, and local citizen groups call for input in developmental programs. The extent to which a program’s management practices financial prudence, observes proper risk management procedures, and avoids overexposure and catastrophic collapse are among the most important elements that determine the quality of its political support. Another important determinant of political support is the question of “additionality,” that is, the extent to which a fund is able to bring to a developing country new and incremental benefits that would not have come about otherwise. The additionality criterion has become even more important given OPIC’s new drive to complement, rather than compete with, the private sector. Insofar as OPIC serves a role that the private sector would serve anyway, the Corporation may not be fulfilling its mission. If, however, OPIC is capable of filling a void and helping a country to develop economically, socially, and politically, without excessive risk, then it should be considered a success.
Recommendations
How can OPIC improve its performance? What measures does it need to take to ensure sustainability and viability in the future? How can fund managers create a supportive environment for business in their countries of operation? Based on our analysis, we offer the following recommendations.

Clarify Mission and Objectives
Private equity is not a panacea for all developmental problems, nor can it be effective where it has to serve multiple and sometimes contradictory objectives. If OPIC and the U.S. government want these funds to have the developmental impact outlined in the founding legislation, OPIC must have clear and achievable goals. Specifically, OPIC’s mission should highlight the main objective of using equity to fund investments that make a developmental impact while operating its portfolio in a responsible and prudent manner.

De-Emphasize Self-Sufficiency as an Objective
OPIC’s objective of achieving financial self-sufficiency through its return policy makes it overly concerned with not losing money. This objective has had dire implications for its developmental goals. The current return-based strategy, while good in principle, does not do enough to impel additional capital into the developing world. As it stands, the risk/reward payoff is not attractive to many investors, who are comparing OPIC investments to other asset classes. OPIC can alleviate this concern by boosting, rather than limiting, the investor’s return. Such an action would bring more capital into underfunded areas. A possible downside of this move, however, may be to attract irresponsible managers motivated more by steady fee income than by investment results.

Furthermore, OPIC is alone among U.S. development agencies in adhering to a self-sufficiency requirement.
Hardly any of the billions of dollars of U.S. development aid has any hope of being recovered, and this is acceptable because of the positive social and economic effects of the programs. OPIC, whose effects could be as positive as these other forms of aid, is subject to an unnecessary financial hurdle that is out of line with its developmental mission. This is certainly not to suggest that OPIC funds should be permitted to invest imprudently, ignoring potential risks. Instead, it means lowering the interest rate and profit hurdle that OPIC currently requires, thereby providing cheaper money than available in the marketplace and increasing subsidies to management and investors.

This may mean that OPIC does not recoup all of its money, yet this should be considered an acceptable form of aid—an investment in the strategic and economic interests of the host country and the world community. In the end, OPIC must decide between operating a revenue-generating debt fund that has some developmental benefits, or an aid program that may cost some money but that has greater positive effects on development. The latter is consistent with OPIC’s core mission, and, more importantly, beneficial to the developing countries.

**De-Emphasize the Promotion of U.S. Interests as an Objective**

OPIC can increase its credibility in the marketplace—both with fund managers and with equity investors—by becoming less identified with U.S. economic interests. De-emphasizing U.S. interests would give fund managers the flexibility to make the best possible investments. In addition, equity investors would be more confident about receiving the best possible returns, and host countries would benefit from the increased influx of capital and expertise. A good example of a governmental organization that allows money to operate in the marketplace unfettered is CDC Capital Partners, originally founded by the British government as an emerging market investment fund. CDC recently
split into two entities, a fully independent management company and an asset holding company. The management company, Actis, now manages $2.7 billion, most of which is provided through government funding, but increasingly relies on third party investors. Unlike OPIC, Actis does the private equity investing itself. Actis recognizes its corporate citizenship obligations and balances them with its fiduciary responsibilities to its investors while operating independently of the United Kingdom’s business interests.

**Select the Right Managers**

Clearly, selecting the best possible managers is a top priority for OPIC, as managers play a major role in determining whether the program is going to be a success. OPIC must shift the decision out of the political realm and into the financial one, working to ensure that political pressures no longer influence personnel decisions. The Corporation has moved in the right direction by appointing gatekeepers to help in the management selection process. OPIC must also focus on recruiting managers who not only have a good track record, but who also have a clear strategy that will work in a developing country.

Managing a fund in a developing country is very different from managing one in the United States. In particular, access to and an understanding of local markets is critical for building deal flow, recruiting local talent, and identifying exit options; OPIC’s managers must all demonstrate this expertise in their prior work. Furthermore, investing in these markets requires flexibility, as country situations can change quickly. OPIC should therefore select managers who have relevant geographic and sector experience. Finally, OPIC must select managers who have demonstrated respect for the local constituents in the host countries, and who have experience developing businesses without neglecting environmental, labor, and human rights concerns. All of this means, of course, that proven managers may be extremely scarce—but without them, the risks are extraordinarily high.
Create a Consistent and Appropriate Support Structure

OPIC needs to create a consistent, transparent, and suitable structure of support for equity funds in order to attract the best managers and investors, ensure appropriate returns, and manage its own risk portfolio. This structure must also reflect the new goals of the funds as outlined above. There are three changes that OPIC should consider adopting to better match the interests of all of the parties involved.

First, from a risk perspective, OPIC is currently trying to diversify its capital base by contributing less capital to each individual fund: it now provides 10-50% of the fund size, as opposed to 30-65%. This is a sound financial strategy and should be maintained. In the first place, it allows OPIC to diversify across more funds with the same capital base. This will help OPIC manage its risk better, as the capital is spread over more funds, sectors, and regions. Second, it will open the funds up to more investors, including IFIs and large institutional investors. These investors have access to high-quality managers around the globe, and they have development strategies similar to OPIC’s. It would therefore be wise to invest in partnership with them. Reducing OPIC’s contribution to the funds will allow the managers to focus on what they do best—investing capital and adding value—rather than answering to one large investor. As one fund manager attests, “You can have private equity with some OPIC resources, or you can have an OPIC fund with some private equity. The former is the model that will work much better” (interview with Thomas Gibian).

One potential problem with decreasing OPIC’s leverage in each fund involves the additionality requirement. As OPIC provides less capital to a fund, it plays less of a pioneering role and more of a supporting one. The distinction is important, as one of OPIC’s goals is to sponsor only projects that would not have proceeded “but for” OPIC participation. If OPIC contributes 60% of a fund’s resources, this requirement is indeed met, but if OPIC provides 20%, it probably has not been met; the fund probably could have
raised that money from other sources. What, then, is OPIC’s role? The answer is that OPIC can support these funds and make them more effective with additional leverage, but it must also manage its own risks prudently. Furthermore, by offering cheaper capital to the marketplace, OPIC is in fact providing a service that would not be available otherwise.

The second recommendation is to alter the returns structure. OPIC complains that it takes large, equity-like risks but sees only debt-like returns; it therefore needs to find a way to increase its participation in the financial upside of deals (Moran, 2003). Specifically, OPIC officials have considered structuring more of the debt at a mezzanine level, in between equity and senior debt. The senior debt, as before, will have payment priority; the mezzanine debt will incur a greater risk of non-payment, but will see an equity upside if the fund is profitable. OPIC’s rationale is clear: the return on each individual fund is not enough to cover the losses if a few funds collapse. Normally, in a private equity setting, a fund can handle a few large losses, because some other companies in the portfolio make fantastic returns. Because it offers debt, however, OPIC will see no more than a single-digit return even on the best funds, and yet it will still incur the loss of non-performance on a loan. To remedy this, OPIC is trying to base its returns on the funds that do well to make up for potential losers. This is not an appropriate solution to the problem and will, in fact, damage OPIC’s reputation in the marketplace.

Third, OPIC must be careful to select for development only those countries that are ready for private equity. These countries must be large enough to benefit from a fund, and have in place a constituency of local companies that are interested in this kind of investment process. The countries must also boast international or large domestic companies that will be able purchase the portfolio companies when the funds are ready to exit. If the countries are not ready, OPIC and the U.S. government should look for other ways to support private sector development.
References


*Renewing OPIC and reviewing its role in support of key U.S. objectives.* (2003, June 10). Transcript, Hearing before Committee on IR, House of Representatives.
## Appendix - OPIC Supported Funds

<table>
<thead>
<tr>
<th>Fund Name</th>
<th>Fund Manager</th>
<th>Geographic Focus</th>
<th>Size of Fund (Mil US$)</th>
<th>Short Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advent International (fund not yet named)</td>
<td>Advent International</td>
<td>Central and Eastern Europe</td>
<td>$350</td>
<td>Equity investments for new business development and existing company expansion, restructuring, and privatization in the region.</td>
</tr>
<tr>
<td>Africa Growth Fund</td>
<td>Equator Overseas Services Limited</td>
<td>Sub-Saharan Africa</td>
<td>$25</td>
<td>Equity investments in mining, manufacturing, and financial services.</td>
</tr>
<tr>
<td>Africa Millennium Fund</td>
<td>Savage Holdings, LLC</td>
<td>Sub-Saharan Africa</td>
<td>$350</td>
<td>Equity or quasi-equity securities of companies that work in the Infrastructure Sector and that operate in countries eligible for investment in sub-Saharan Africa.</td>
</tr>
<tr>
<td>Agribusiness Partners International</td>
<td>Agribusiness Management Company, LLC</td>
<td>NIS/Baltics</td>
<td>$95</td>
<td>Equity investments in agriculture, food firms, infrastructure projects, privatizations, food storage, and distribution facilities.</td>
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<tr>
<td>AIG Brunswick Millennium Fund</td>
<td>American International Group/ Brunswick Capital Mgmt.</td>
<td>Russia, NIS, and Baltics</td>
<td>$289</td>
<td>Equity investments in large infrastructure projects, including power, transportation, natural resource development, and related industries.</td>
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<tr>
<td>Allied Small Business Fund</td>
<td>Allied Capital Corp.</td>
<td>All OPIC eligible countries</td>
<td>$20</td>
<td>Equity investments in basic manufacturing and service industries sponsored by qualifying U.S. small businesses.</td>
</tr>
<tr>
<td>Aqua International Partners Fund</td>
<td>Texas Pacific Group</td>
<td>All OPIC eligible countries</td>
<td>$238</td>
<td>Equity investments in operating and special purpose companies involved in the treatment, bulk supply, and distribution of water in emerging market countries.</td>
</tr>
<tr>
<td>Asia Development Partners</td>
<td>Olympus Capital Holdings (Asia)</td>
<td>Bangladesh, India, Indonesia, Korea, Laos, Philippines, Sri Lanka, Thailand, and Vietnam</td>
<td>$150</td>
<td>Telecommunications, consumer products, and financial services.</td>
</tr>
<tr>
<td>Asia Pacific Growth Fund</td>
<td>Hambrecht &amp; Quist Asia Pacific</td>
<td>Indonesia, Malaysia, the Philippines, Thailand, Taiwan, and Singapore</td>
<td>$75</td>
<td>Equity investments in light manufacturing, financial, construction, high tech, and telecom services.</td>
</tr>
<tr>
<td>Fund Name</td>
<td>Fund Manager</td>
<td>Geographic Focus</td>
<td>Size of Fund Mil US$</td>
<td>Short Description</td>
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<tr>
<td>Caucasus Fund</td>
<td>Caucasus Advisors, LLC</td>
<td>Azerbaijan, Armenia, and Georgia</td>
<td>$92</td>
<td>Equity investments in telecommunications projects.</td>
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<tr>
<td>Clearwater Capital Fund</td>
<td>Clearwater Capital</td>
<td>South Korea, India, Indonesia, Malaysia, Thailand, and the Philippines</td>
<td>$100</td>
<td>Investments in the credits of financially distressed small and medium-sized enterprises (SMEs).</td>
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<tr>
<td>Darby-BBVA Latin America Private Equity Fund</td>
<td>Darby Overseas Investments and Banco Bilbao Vizcaya Argentaria</td>
<td>Latin America</td>
<td></td>
<td>Equity investments in Latin American companies.</td>
</tr>
<tr>
<td>Draper International India Fund</td>
<td>Draper International</td>
<td>India</td>
<td>$41</td>
<td>Equity investments in information technology, telecommunications, and consumer goods.</td>
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<tr>
<td>Emerging Europe Fund</td>
<td>TDA Capital Partners, Inc.</td>
<td>Central and Eastern Europe</td>
<td>$60</td>
<td>Equity investments in sustainable development industries.</td>
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<tr>
<td>First NIS Regional Fund</td>
<td>Baring Asset Mgmt.</td>
<td>NIS/Baltic Republics</td>
<td>$200</td>
<td>Equity investments in natural resource-related companies, telecommunications, light manufacturing, and consumer products and services.</td>
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<tr>
<td>Global Environment Emerging Markets Fund I</td>
<td>GEF Management</td>
<td>All OPIC eligible countries</td>
<td>$67</td>
<td>Equity investments in environment-oriented sectors related to the development, financing, and operating or supplying of infrastructure relating to clean energy and water.</td>
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<tr>
<td>Global Environment Emerging Markets Fund II</td>
<td>GEF Management</td>
<td>All OPIC eligible countries</td>
<td>$120</td>
<td>Equity investments in environment-oriented sectors related to the development, financing, and operating or supplying of infrastructure relating to clean energy and water.</td>
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<tr>
<td>India Private Equity Fund</td>
<td>Indocean Capital Advisors</td>
<td>India</td>
<td>$140</td>
<td>Equity investments in consumer goods, basic manufacturing, banking, computers, and related industries.</td>
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<tr>
<td>Inter-Arab Investment Fund</td>
<td>InterArab Management</td>
<td>Jordan, West Bank/Gaza, and Oman</td>
<td>$45</td>
<td>Equity investments in basic industries that create intra- and inter-regional synergies.</td>
</tr>
<tr>
<td>Fund Name</td>
<td>Fund Manager</td>
<td>Geographic Focus</td>
<td>Size of Fund Mi US$</td>
<td>Short Description</td>
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<tr>
<td>Israel Growth Fund</td>
<td>Apax-Leumi Partners</td>
<td>Israel</td>
<td>$40</td>
<td>Equity investments in technology, telecommunications, consumer retailing, and consumer products.</td>
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<tr>
<td>Modern Africa Growth And Investment Fund</td>
<td>Modern Africa Fund Managers, LLC</td>
<td>Sub-Saharan Africa (excluding S. Africa)</td>
<td>$117</td>
<td>Equity investments with a focus on manufacturing, telecommunications, and natural resources.</td>
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<tr>
<td>New Century Capital Partners</td>
<td>NCH Advisors</td>
<td>Ukraine, Russia, Kazakhstan, Armenia, Belarus, Georgia, Romania, Bulgaria, Moldova, Estonia, Lithuania, and Latvia (no more than 25% in Baltics, 20% in Russia)</td>
<td>$250</td>
<td>Equity investments in diversified manufacturing, consumer products, and financial and service industries.</td>
</tr>
<tr>
<td>Newbridge Andean Partners</td>
<td>ACON Investments, LLC</td>
<td>Bolivia, Colombia, Ecuador, Peru, Venezuela, Argentina, Belize, Brazil, Chile, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Paraguay, and Uruguay</td>
<td>$160</td>
<td>Equity investments in diversified manufacturing, and financial and service industries.</td>
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<tr>
<td>Palador Realty (fund not yet named)</td>
<td>Palador Realty Partners</td>
<td>Latin America</td>
<td></td>
<td>Real estate investments in housing developments and other projects, particularly those designed for affordable and middle-income housing.</td>
</tr>
<tr>
<td>Poland Partners</td>
<td>Landon Butler &amp; Company</td>
<td>Poland</td>
<td>$64</td>
<td>Equity investments in manufacturing, consumer goods, distribution networks, merchandising, and related service networks.</td>
</tr>
<tr>
<td>Russia Partners A</td>
<td>Sigular Guff &amp; Company</td>
<td>Russia Fund ‘A’ may invest up to 25% in other OPIC-covered NIS states</td>
<td>$105</td>
<td>Equity investments in natural resource-related companies, telecommunications, light manufacturing, and consumer products and services.</td>
</tr>
<tr>
<td>Russia Partners B</td>
<td>Sigular Guff &amp; Company</td>
<td>Russia</td>
<td>$50</td>
<td>Equity investments in natural resource-related companies, telecommunications, light manufacturing, and consumer products and services.</td>
</tr>
<tr>
<td>Fund Name</td>
<td>Fund Manager</td>
<td>Geographic Focus</td>
<td>Size of Fund (Mil US$)</td>
<td>Short Description</td>
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<tr>
<td>Russia Partners II</td>
<td>Russia Partners Management</td>
<td>Russia and Eurasia</td>
<td>$210</td>
<td>Equity investments in fast-growing consumer services industries, including telecommunications, cement and construction materials, forest product, broadcasting, and food processing.</td>
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<tr>
<td>Soros Investment Capital Ltd.</td>
<td>Soros Private Funds Management, LLC</td>
<td>Albania, Bosnia &amp; Herzegovina, Bulgaria, Croatia, FYR Macedonia, Montenegro, Romania, Slovenia, and Turkey</td>
<td>$200</td>
<td>Established to provide equity capital to Southeast Europe as part of the international recovery effort.</td>
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<tr>
<td>South America Private Equity Growth</td>
<td>Baring Latin America Partners, LLC</td>
<td>South America, with a focus on Argentina, Brazil, Chile, and Peru</td>
<td>$180</td>
<td>Equity investments in diversified manufacturing, and financial and service industries.</td>
</tr>
<tr>
<td>The Great Circle Fund, L.P.</td>
<td>Great Circle Capital, LLC</td>
<td>All OPIC eligible countries</td>
<td>$200</td>
<td>Equity and quasi-equity investments in companies operating in the maritime transportation, logistics, and service industries that are new, expanding, or in the process of being restructured or privatized.</td>
</tr>
<tr>
<td>West Bank/ Gaza &amp; Jordan Fund</td>
<td>International Capital Advisors</td>
<td>West Bank/ Gaza and Jordan (at least 60% in West Bank/Gaza)</td>
<td>$60</td>
<td>Equity investments in basic service and manufacturing companies.</td>
</tr>
<tr>
<td>ZM Africa Investment Fund</td>
<td>Zephyr Management, LP</td>
<td>South Africa and regional SADC countries</td>
<td>$120</td>
<td>Equity investments in diversified manufacturing, and financial and service industries.</td>
</tr>
<tr>
<td>PBO Fund</td>
<td></td>
<td></td>
<td>$240</td>
<td></td>
</tr>
</tbody>
</table>
Newly established firms or aspiring entrepreneurs often lack the skills and experience to organize, finance, manage, and market their products effectively. In many poor and transition countries, the business services that are provided by accounting, law, and consulting firms in mature economies are limited and expensive. Training and advice on production and information technologies can also be hard to come by.

To address these needs, the U.S. government has long funded a variety of non-governmental organizations that bring in experienced businesspeople from the United States to train and advise entrepreneurs abroad. A secondary purpose of some of these efforts is to promote U.S. exports by familiarizing foreign entrepreneurs with them. Finally, an unstated goal of the technical assistance provided by these NGOs has been to promote volunteerism by engaging a portion of the U.S. business community in supporting development and transitions abroad, thereby creating a broader constituency for U.S. government involvement in these tasks. This chapter examines the nature and impact of a selection of standalone technical assistance and training programs funded by USAID and provided by NGOs, both to individual firms and to sectors or other collective operations.

Background

USAID has a long history of funding technical assistance to SMEs through NGOs.\(^1\) In the early 1960s, the Johnson administration decided that one way to help meet the need for business know-how among entrepreneurs in develop-
ing countries was to encourage experienced U.S. executives to volunteer as technical advisors to such firms. This approach drew on the American tradition of volunteerism, engaged U.S. businesspeople in development work abroad, and provided foreign firms with expert advice in such areas as business planning, organization, marketing, and financing. To systematize this effort, in 1964 the U.S. government supported the establishment of the International Executive Service Corps (IESC), which was intended as a “Peace Corps” of business executives advising firms abroad.

Since the 1960s, other NGOs with similar aims have been created. These NGOs have often focused on problems particular to SMEs. In the 1970s, Appropriate Technology International was established to support the use of technologies relevant to small businesses in developing countries. (This organization is now called Enterprise Works.) Later, in 1989, the first Bush administration supported the creation of a Citizens Democracy Corps (later renamed the Citizens Development Corps) to channel technical assistance from U.S. executives to SMEs in the transition countries of Eastern Europe and the former USSR. CDC later expanded its activities beyond transition countries to developing countries more generally. In the mid-1990s, a Financial Services Volunteer Corps was set up with the support of the White House to draw on volunteer experts in finance, who would advise central banks, commercial banks, governments, SMEs, and others on business finance and effective financial systems. A “Geek Corps” was also created to provide advice regarding information technologies to firms in developing countries. As will be discussed below, in 2004 USAID created an association involving a number of these NGOs, entitled Volunteers for Economic Growth Alliance.

1 For-profit U.S. consulting firms, like Chemonics, Booz Allen Hamilton, Development Alternatives, Inc., and many others also provide technical assistance for business development in developing and transition countries. What differentiates their activities from those discussed here is that NGO-sponsored technical assistance tends to be free-standing, rather than part of broader development programs and projects, and draws on U.S. volunteers.
Organization and Budgeting

Technical assistance continues to grow, and is a prominent part of many USAID private enterprise support projects abroad. The agency currently has enterprise development projects in some 36 developing countries and in 18 of the 27 post-socialist transition countries. These programs are implemented through various arrangements with non-profit non-governmental organizations (NGOs), for-profit consulting firms, government entities (both host country and U.S. government agencies), and public international organizations (such as UN agencies) (GAO, 2002, p. 3).

Three main types of funding mechanisms—grants, contracts, and cooperative agreements—have traditionally regulated the agency’s use of non-governmental bodies to implement projects overseas. Grants enable NGOs to execute agreed-upon projects without much USAID involvement. In contrast, contracts allow USAID to retain a significant level of involvement in project planning and implementation. Under the terms of a contract, the agency retains responsibility for determining the “requirements and standards for the assistance activities and frequently provides technical direction during contract implementation.” The third funding mechanism, cooperative agreements, accords considerable freedom to the implementing body, but USAID retains significant control in certain areas, including planning, the

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2 The World Bank’s World Development on-line database shows that USAID operates enterprise development projects in the following developing countries: Angola, Benin, Ethiopia, Ghana, Guinea, Mozambique, Uganda, Kenya, Madagascar, Namibia, Nigeria, Tanzania, Zambia, Zimbabwe, South Africa, Honduras, Haiti, Jamaica, Nicaragua, Paraguay, Bolivia, El Salvador, Guatemala, Guyana, Egypt, Jordan, Lebanon, Morocco, West Bank/Gaza, Bangladesh, Laos, Vietnam, Philippines, and Sri Lanka. USAID also runs the Caribbean Regional Program. The post-socialist transition countries where USAID operates enterprise development programs are Bosnia and Herzegovina, the Kyrgyz Republic, Macedonia, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, Yugoslavia (Kosovo and Montenegro), Armenia, Georgia, Kazakhstan, Romania, Albania, Azerbaijan, Bulgaria, and Croatia.

3 The GAO defines “NGO” as including “for-profit firms, educational institutions, cooperative development organizations, and private voluntary organizations.”
selection of key personnel, and the approval of monitoring and evaluation plans (GAO, 2002, p. 4).

These funding arrangements have allowed USAID to maintain flexibility in its relations with NGOs that implement technical assistance projects overseas. Over the past two decades, increasing demands for technical assistance, coupled with external pressures to improve delivery, has forced USAID to make innovations in managerial style and relations with their contractors, including NGOs. In February 2004, USAID created VEGA, an association of organizations engaged in implementing technical assistance programs overseas to “help USAID mission officials assess and evaluate the economic priorities of the host country, and formulate effective technical assistance projects to encourage economic growth and development in transition and developing countries” (USAID, 2004b). VEGA, which currently has some 17 member organizations, works directly with USAID country missions to design, develop, and implement technical assistance projects in host countries.

Technical assistance for enterprise development is intended to respond to entrepreneurs’ needs and demands for specific types of assistance, either in direct contact with individual firms, through assistance to organizations providing business development advice to firms, or as part of larger projects that directly or indirectly benefit enterprise. (In this analysis, we focus primarily on NGO-to-enterprise assistance, as this is the most common kind of assistance provided by NGOs that use volunteer experts.) Once an enterprise need is identified, USAID invites VEGA to help design a project and to recruit an organization to implement

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4 These organizations include ACDI/VOCA; CDC; Citizens Network for Foreign Affairs; Coffee Quality Institute/Coffee Corps; International Real Property Foundation; International Senior Lawyers Project; Land O’ Lakes, Inc.; Opportunities Industrialization Center International; Florida Association for Volunteer Action in the Caribbean and the Americas, Inc.; Financial Services Volunteer Corps; International City/Country Management Association; Partners of the Americas; Volunteers in Technical Assistance; Winrock International; and IESC (which absorbed Geekcorps, an NGO providing advice on information technologies).
it. VEGA’s outreach officials also sometimes tour needy countries to consult with business groups and USAID field officers as part of a needs-assessment exercise for proposal development.

**Projects for Technical Assistance**

While neither USAID nor NGOs maintain data that specifically reports the amount of technical assistance for enterprise development channeled annually through NGOs, we can identify several traits common to the USAID-funded technical assistance programs that these NGOs implement. Typical projects incorporate skill training and technical advice, simultaneously emphasizing several aspects of enterprise development. They also tend to be implemented jointly by several NGOs under VEGA’s “leader with associates” scheme. Projects usually fall broadly within one or several of the following categories: general business development, agribusiness and rural development, business associations and institution building, and the development of financial services.

**General Business Development Projects**

General business development projects target two of the major obstacles to enterprise growth in poor countries: weak planning and the poor business management capacity of private sector entrepreneurs. They usually involve USAID-funded NGOs that provide peer-based training and technical advice to help small and medium-sized entrepreneurs to improve their information and financial management systems, revamp human resource management, learn modern product branding, and improve their inventory-management processes. Scores of SME operators have also received technical advice on upgrading machinery and equipment, improving marketing techniques, and preparing for partnerships with U.S. firms and larger multinational corporations.

A key assumption underlying these projects is that it is
possible to stimulate private enterprise growth by exposing entrepreneurs to market-based business practices and U.S. trade standards. Volunteers with U.S. business and industry experience therefore play a major role in the implementation of general business development projects. For example, Winrock International, a Virginia-based development NGO currently executing several USAID-funded projects abroad, recruits, trains, and deploys American volunteers to help entrepreneurs in developing and transition countries address specific business management problems. Winrock’s volunteers have helped veterinarians establish private clinics in Uzbekistan, and assisted auto-repair businesses in Russia to introduce safer and cleaner tire disposal technology (Winrock, 2002, p. 5). Other NGOs, such as Geekcorps, an IESC–operated technology and communication development organization, have also successfully employed volunteers. Like Winrock, Geekcorps relies heavily on volunteers to provide business development advice and technical training to IT sector entrepreneurs in developing countries. So far, Geekcorps has placed more than 100 technical volunteers in twelve nations.

The Citizens Development Corps (CDC) is another NGO currently executing similar USAID-funded projects. CDC teamed up with Chemonics International, Inc. to implement the Kosovo Business Support Program, which is dedicated to promoting greater employment and increased private investment in Kosovo by providing advice and training that will “improve the business acumen and management skills of SMEs and business associations” (CDC, b). CDC is also a major player in the Iraq Private Sector Development Initiative, a recent USAID project intended to promote the expansion of a competitive and efficient private sector in Iraq. Under the contract awarded by USAID/Baghdad to VEGA, CDC will join IESC in conducting industry assessment and sectoral surveys to establish the needs of entrepreneurs. In addition, these organizations will work together to support the development of at least three business training centers
strategically located in various Iraqi towns to channel services to entrepreneurs, and provide training to improve and modernize Iraqi banking and micro-credit practices. Finally, the two NGOs will also prepare SMEs for contracting with local large firms, multinational firms, and donors currently operating within the country.

Preparing SMEs for contracting and partnering with bigger entities is one of the more challenging tasks being tackled by the NGOs that are working to promote private enterprise development in Iraq and elsewhere. This undertaking is motivated primarily by the conviction that supplier contracts, partnerships, and other linkages with larger firms will be beneficial to SMEs. In turn, the expanded demand for their products and services that will arise from such linkages will give these SMEs an opportunity to grow. To help equip SMEs for such linkages, USAID funds several NGOs to provide training in contract management, international accounting practices, and international standards and certifications. In Azerbaijan, for example, CDC is executing the USAID-funded Supplier Training Initiative (STI), which is dedicated to training local small enterprises to do business with oil giants such as BP, Agip, and Exxon. The main objective of the STI project is to increase the quantity of goods and services that the oil companies purchase from Azeri SMEs. A complementary objective is to facilitate the integration of oil companies and other multinational firms into the local economy in a manner that supports the overall development goals of host communities. So far, training done under the STI has been geared towards enhancing the quality of products and services supplied by local SMEs and developing their ability to participate in international procurement processes (CDC, 2002). The success of the Azerbaijan project has led CDC to plan a similar project in Angola, another country where local SMEs need technical assistance to develop the capacity to partner with the oil industry (CDC, a).
Agribusiness and Rural Development Projects
USAID also funds projects dedicated to building the private sector’s capacity to play an enhanced role in those sectors that are considered vital to poverty alleviation and overall economic development. For some time, farming and agribusiness have received special attention because of their importance in the rural economies of most aid-receiving countries. Some rural-based non-agricultural SMEs have also received USAID-funded technical assistance as part of wider attempts to stimulate economic activity and increase rural incomes.

Farming and agribusiness concerns remain the central focus of these projects because, despite the fact that agriculture is the leading employer in most developing states, many farmers still lack adequate access to farming inputs, improved technology, and support services. All of these assets can boost productivity and raise incomes. Inadequate information, along with poor access to profitable domestic and international markets, also hampers productivity. To help alleviate some of these bottlenecks, USAID funds projects that channel technical assistance and advice to smallholder farmers and agribusinesses. The projects, which are executed by various NGOs, typically involve the deployment of American volunteers with agribusiness and enterprise development expertise. These volunteers help farmers to expand and modernize their production process as well as adopt a business-like approach to planning and marketing. NGOs currently executing projects in this area include the Agricultural Cooperative Development International and Volunteers in Overseas Cooperative Assistance (ACDI/VOCA), the Citizens Network for Foreign Affairs (CNFA), TechnoServe, and the Florida Association for Volunteer Action in the Caribbean and the Americas (FAVACA).

An implicit goal of these projects is the alleviation of poverty. The underlying assumption behind USAID-funded assistance to farming and agribusiness is that stimulating agribusiness and rural enterprise will produce the
better jobs that are needed to boost rural incomes. CNFA, for instance, is currently assisting several farmers and rural entrepreneurs in Zimbabwe through the USAID-funded Rural Agricultural Input Supply Expansion (RAISE) program. RAISE’s goal is to increase smallholders’ incomes by helping farmers develop more efficient distribution systems while helping them to move from subsistence to commercial farming. To do this, CNFA targets problems that prevent modern farming inputs from reaching smallholder farmers in rural Zimbabwe. Since inadequate distribution networks and high distribution costs are the two main obstacles preventing major input suppliers like Monsanto, Cargil, Novotis, and Pioneer from serving rural areas, the RAISE program includes business management training for village-level retailers. An additional challenge faced by the smallholders is securing more supplier credit to village retailers by providing guarantees for such credit.

In addition to inputs, farmers also need reliable markets in order to appreciably raise incomes. One way to enhance market pull is to diversify one’s product base by adding value to current stock or developing completely new production lines. Agro-processing provides farmers with a way to explore some of these options. Agro-processing adds value to farm produce, extending its shelf-life and enabling farmers to sell overseas for much higher returns. This is another area where NGOs provide technical assistance. TechnoServe, for instance, runs agro-processing support projects for SMEs in several countries. To give one example of how they have provided this kind of support, TechnoServe helped Antonio Felipe Miranda, a rural-based entrepreneur in Mozambique, open a cashew nut processing plant in the northeastern town of Namige. TechnoServe’s assistance went beyond the mere provision of technical and business operating advice to include supporting the local design and manufacture of the cashew processing equipment. TechnoServe also helped Mr. Miranda secure a loan guarantee from the Mozambican Cashew Institute towards
the purchase of an abandoned cashew plantation and 2,000 hectares of land in Namige. At present, Mr. Miranda’s 1,000-ton-capacity cashew factory is a major buyer of raw cashew nuts from local producers, purchasing up to $30,000 worth of raw cashews from local growers over a 4-month period in 2002 alone. The firm also employs hundreds of rural workers, thereby helping stem the flow of unemployed youth to Mozambique’s cities, where employment opportunities are even fewer (“Rebuilding,” 2004).

To ensure maximum efficiency, NGOs have explored a range of options for channeling technical assistance to farmers. FAVACA, for instance, employs a farmer-farmer approach that involves placing American farmer-volunteers to assist farmers overseas. The strength of the model lies in its narrow focus, which allows volunteers to concentrate exclusively on the problems facing an individual farmer. Such a focused approach increases the probability of task-completion. This was the case in two examples from Belize, where American volunteers Wayne Odegaard and Eddie Boston successfully applied their skills and experience to help members of local farmers’ cooperatives solve production problems. Odegaard, who was the director of extension services for Florida’s Hernando County at the time of the project, was attached to the Macal Dairy Cooperative in Belize. There, he successfully provided training in dairy farm management and addressed problems such as herd health, calf-rearing, feeding, record-keeping, and milking. In the second case, Eddie Boston, a veteran pig-farming consultant, was attached to the Double Head Cabbage Village Pig Raisers’ Cooperative in Belize. He trained several co-op members to improve sanitation and general swine health and production, helping to increase the market weight of pigs by more than 300% over several years (FAVACA, n.d.).

In contrast to the narrow approach taken by FAVACA, NGOs like TechnoServe and ACDI/VOCA tend to engage with several enterprises at a time so as to maximize the
impact of the training and technical services they provide to farmers. TechnoServe, for instance, has helped several smallholder Kenyan dairies increase productivity by providing training in financial management, inventory and record keeping, and effective marketing techniques to managers and senior staff. As part of USAID’s $1.2 million Dairy Enterprise Initiative for Kenya, which was launched in 2001, TechnoServe also provided technical advice to help smallholder dairies improve their outdated dairy processing technology, as well as training the local farmers that supply milk inputs to the dairies in how to properly handle fresh milk.

Unlike organizations such as CNFA and CDC, which rely almost exclusively on volunteers to implement their technical assistance projects, TechnoServe deploys its own experts to help clients solve problems. The organization collaborates with other NGOs that have expertise that complements its own. For example, it collaborated extensively with two other American agribusiness development NGOs, Land O’ Lakes and WorldWide Sires, to implement the Dairy Enterprise Initiative for Kenya.

Another strategy that has been successfully adopted by some of the NGOs that are engaged in industry-level intervention is to channel technical assistance to institutions that service farmers and rural entrepreneurs. Assisting these institutions enables the NGOs to extend their reach and improve the quality of their services. In addition to the advantages of scale, this approach has been effective in generating local ownership, thereby improving the likelihood that projects will survive the departure of the volunteers. One organization that has employed this institutional approach is ACDI/VOCA, which has been helping farmers solve production and marketing problems in Malawi since 1995 through the USAID-funded Smallholder Agribusiness Development Project. The organization has established several Agribusiness Development Centers in key smallholder areas to train farmers in modern business management,
marketing, quality control methods, and improving access to modern farming inputs.

A common manifestation of the institution-building approach can be seen in several NGOs’ commitment to promoting the creation of business associations as part of rural enterprise development strategies. In addition to engendering local ownership, such associations can perform important advocacy functions that foreign NGOs, for reasons of strategy or lack of capacity, are either unable or unwilling to take on. In Malawi, for instance, ACDI/VOCA, which believes strongly that smallholder farmers can best address most of their problems collectively, helped farmers to form associations such as the National Smallholder Farmers Association of Malawi, which lobby for improved services and changes in government policies.

**Business Support-Network Projects**

The idea of developing business associations as part of a general strategy to build the institutional capacity to support enterprise development extends beyond the agribusiness sector. USAID has long funded NGOs to implement projects that build the capacity of local business support networks—such as business associations, chambers of commerce, and consultants’ networks—as a part of programs that are aimed at building an enabling environment for entrepreneurs.

The argument for building business support networks is essentially one of economies of scale. When NGOs encourage private entrepreneurs to start or join such networks, they do so because of the benefits that accrue, not only to the entrepreneurs, but also to the NGOs themselves. For entrepreneurs, benefits come from lesson-sharing and resource-pooling. Benefits also come from the enlarged market size that confers greater bargaining power in the purchasing of inputs and in negotiations with investors, labor, customers, and government officials. The Smallholder Farmers Association of Malawi, for example, helps members reduce trans-
port cost and delays by negotiating Secured Transport Contracts on their behalf. In 2001, the association negotiated transportation contracts worth $800,000 for their members, reducing these costs by half (by eliminating bribes and tips) and shortening delivery times by more than 60% (ACDI/VOCA, a).

For technical assistance providers, business support networks provide different kinds of opportunities, including a wider audience for knowledge dissemination, and an institutional basis for ownership and project continuity. Technical assistance providers also benefit from business support networks’ ability to assess the needs of local entrepreneurs and to make suggestions regarding how best to respond to those needs. Technical assistance NGOs can look to such associations for estimations of an industry’s needs. For example, business associations have been a prominent feature in the Jamaica Cluster Competitiveness Project, a USAID-funded project seeking to enhance the competitiveness of Jamaican businesses in domestic and foreign markets. On the Frontier Group, Inc. (OTF), the Watertown, MA-based NGO that is leading this project, often relies on business associations to gauge the particular needs of entrepreneurs in the three clusters participating in the project: tourism, entertainment, and the export of sauces and spices.

NGOs currently involved in similar projects include CDC, which is implementing a business support/services industry capacity building program in Western Russia and Siberia, and ACDI/VOCA, which is helping farmers build associations in Malawi and Mozambique. NGO intervention in this area usually aims at helping business support networks develop “the tools they need to become financially self-sufficient and deliver needed business development services on a competitive and profitable basis” to local entrepreneurs (Kroneman, n.d.). Where such associations are already in existence, NGOs provide technical support and administrative training to help strengthen them and make them more relevant to the needs of their members. ACDI/
VOCA, for instance, has provided technical assistance to help develop the management and planning skills of farmers’ associations in Malawi and Mozambique in an effort “to build economies of scale, increase marketing power, and facilitate business contracting” (ACDI/VOCA, a).

In some cases, NGOs have had to take the lead in introducing the concept of business networking and association forming as a way of encouraging local entrepreneurs to pool resources and find common cause with their peers. CDC, for instance, has supported the creation of such networks as part of its execution of the USAID-funded cross-border initiative, the Trading Regionally and Developing Expertise project, in Bulgaria. The goal of that project is to promote economic development in Central and Eastern Europe, and CDC’s networking arrangements are designed to enhance local consultants’ capacity to serve small and medium-sized enterprise sectors in their regions by facilitating cross-border collaboration and the exchange of ideas as well as of resources.

**Financial Services Improvement Projects**

In addition to helping SMEs improve management and business planning capacities, several USAID-funded NGOs also implement programs that support start-ups and business expansion projects by improving entrepreneurs’ access to credit and essential financial services. NGOs that have executed projects in this area include ACDI/VOCA, which is working to improve rural financial services throughout Eritrea, and Winrock, which deploys volunteers to help establish rural credit institutions in Central and Eastern European countries. ACDI/VOCA trains and provides technical advice to strengthen the operations of the Commercial Bank of Eritrea, particularly in rural areas. Under its Rural Finance Services program, the organization has helped develop bank employees’ managerial capacity by training staff in modern banking systems, cost-benefit and risk analysis, and how to plan customer outreach programs. ACDI/VOCA has
trained several rural credit officers to properly assess the needs of rural enterprises and the risks and benefits associated with lending to a rural clientele. The organization has also helped the Bank of Eritrea to develop a new credit and operations manual and to draw up a strategy for launching market-day kiosk banking systems throughout Eritrea.

In the agribusiness sector, NGOs work with farmers’ cooperatives to provide credit to farmers. For example, in 1996, CNFA teamed up with the Association of Russian Private Farmers and Agricultural Cooperatives to start the Private Agribusiness Development Fund, which promotes private commercial farming in Russia. The fund, which was initially capitalized at $1.3 million, provides loans to help private farmers acquire farming inputs and equipment for value-added processing (CNFA, n.d.).

To facilitate the work of financial service providers, some NGOs have also taken up public advocacy roles to push for the reform of government policies that affect institutions delivering financial services to private entrepreneurs. In Chad, for example, VITA has successfully pushed for a change in government interest rate policies in an effort to enable finance providers to “cover more of their operating expenses and move towards self-sufficiency” (VITA, n.d.).

**Assessment**

How can we assess the effectiveness of these NGO-implemented enterprise development programs in developing and transition countries? To answer this question, we must first consider the extent to which the various NGOs accomplish their goals, whether in terms of helping individual SMEs or furthering enterprise development in recipient countries more generally. To date, there has been no systematic evaluation of how NGOs have performed in the field or—even more importantly—of how beneficiary entrepreneurs and businesses regard their efforts, and how those efforts have affected their enterprises. The lack of such performance data makes assessing the NGOs’ effectiveness a
difficult task. Ideally, USAID, as the funding and supervising body, should have in place a rigorous and independent mechanism for measuring their impact. Unfortunately, no such evaluation strategy exists.

In lieu of any authoritative evaluations that would capture the actual extent to which various NGOs meet their stated objective of helping to develop private enterprises through the provision of technical assistance, the reports of individual NGOs become the main source of information regarding project activities and outcomes. Much of what the NGOs report is hard to verify, and hence constitutes a weak basis for a true evaluation of their impact. They nevertheless supply useful information regarding trends, opportunities, and possible outcomes that, when put together, can serve as anecdotal evidence of performance. Even more importantly, these accounts capture the NGOs’ sense of what constitutes success.

NGOs present various kinds of data to demonstrate their impact on private enterprises. These data include the number of volunteers engaged, the number of enterprises assisted, the number of new products introduced, and estimates of jobs created. The data supply a framework for the following review of their performance.

Meeting the Skill-Transfer Goal
Several USAID-funded NGOs cite as one of their objectives the transfer of business management skills to help entrepreneurs in developing and transition countries start and grow their businesses. NGO performance in this area is strong.

Helping Entrepreneurs Start Businesses: Several USAID-funded NGOs provide support for new entrepreneurs as part of enterprise development programs. The scope of that support tends to lie outside the direct assistance that enables entrepreneurs to start new businesses from the ground up. Instead, NGOs generally prefer to assist existing businesses, including some in their first years of operation. Limited
funding and the short span of intervention programs partly explain why NGOs prefer channeling technical assistance to functional businesses instead of supporting the creation of new businesses. For NGOs that rely on volunteers to implement technical assistance projects, another reason for focusing on “functional” businesses is the relative availability of volunteers willing to take up short trouble-shooting assignments to help a business that is already doing well but needs some specific type of assistance.

The pressure on NGOs to produce quick results also plays a major role in their choice of projects. The many risks and uncertainties associated with new business ventures make them less attractive to technical assistance providers, who tend to choose projects with a higher probability of immediate impact in order to be competitive for future USAID contract bidding.

For these and related reasons, the NGO record on helping entrepreneurs start new businesses is weak. The record on supporting functional businesses through the transfer of modern business skills, however, is much stronger, as the following section demonstrates.

Transferring Modern Business Management Skills: Many NGOs have exerted enormous efforts to promote private enterprise development through training programs that transfer modern business planning and management skills to entrepreneurs in developing and transition countries. The number and variety of programs related to this goal attest to the scope of their effort. The CDC MBA Enterprise Corps program, for instance, has deployed some 565 volunteers to deliver “management and technology training to well over 760 enterprises, business support organizations, and associations in 20 countries on four continents” since its inception in 1990 (Tutora, n.d.). IESC also estimates that, “in our 40 year history, we’ve managed 24,000 volunteer interventions, created more than one million new jobs, [and] donated a half a billion dollars in services to
clients” (IESC, n.d.).

In addition to the sheer number of programs engaged in these efforts, the topics covered and methods employed in such training programs also show that NGOs have a good grasp of the needs of private entrepreneurs in developing and transition countries. In Azerbaijan, for instance, CDC organized workshops and seminars on modern management processes, business ethics, and impact sales techniques for several Business Support Organizations that, in turn, trained their members nationwide. This technique of “training the trainers” has vastly extended the impact and extent of the training exercise (USAID, 2004a). A different approach is used in Ghana, where IESC/Geekcorps is implementing the Accra Technology and Skills Transfer Project. This project places information communication technology (ICT) volunteers from North America with SMEs that have a technological focus. The volunteers train staff in how to solve routine technology problems, use new ICT products, and develop software for domestic use and export. IESC/Geekcorps’ training methods have been so effective that within the first year of the 18-month program, 93% of assisted SMEs reported improved employee skills as a direct result of their assistance (Halleran, a).

Meeting the Growth Promotion Goal
Another major objective of the USAID-funded technical assistance programs implemented by NGOs is to promote the growth of private enterprise. Almost all intervention projects have growth promotion as a long-term goal. NGO performance in this area is strong, as can be seen along three parameters of growth, namely productivity, job creation, and the introduction of new products.

Improving Productivity: The ultimate test of the usefulness of technical assistance is the extent to which it enables recipients to improve productivity levels. Several NGOs have been able to do this through their training and advi-
sory services. In Kenya, for example, TechnoServe’s management training programs have helped beneficiary dairies such as Wakulima improve their production and delivery schedules, develop more efficient accounting and transport systems, and learn better marketing strategies. Notably, Wakulima reported an increase in output within twelve months of TechnoServe’s intervention, with daily production volume rising from 12,000 to 20,000 liters, and an increase in sales to over $1.4 million a year (TechnoServe, 2003). In Guinea, where Winrock’s volunteers helped introduce farmers to new mango cultivation and processing practices, annual fruit sales have increased from ten to 1,000 metric tons since the project’s inception (Winrock, 2002, p. 5).

An essential aspect of productivity is the elimination or minimization of waste. This is another area where NGO training programs have made an impact. In Kenya, TechnoServe helped several dairies minimize waste by training management and the farmers who supply their inputs in the proper handling of raw milk. The organization exceeded its target of a 5% reduction in farm spoilage at selected milk sheds: the Nyala and Wakulima dairies achieved a 90% reduction in spoilage, and the Embu dairy also exceeded the target (Land O’ Lakes, 2003, p. 4). These reductions in farm spoilage significantly reduced the overall operating costs of the dairies. The Embu dairy, for instance, is reported to have lowered its operating costs by about 20% (Land O’ Lakes, 2003, p. 1).

Creating New Jobs: NGO technical assistance programs have led to the creation of many new jobs in developing and transition countries. New jobs are a good indication that the assisted firm or industry is actually growing. In Azerbaijan, CDC credits its intervention with the creation of 641 new jobs between June 1999 and June 2004 (MacArthur, n.d.). Similarly, IESC/Geekcorps reports that 46% of its clients in Ghana added or plan to add new employ-
ees as a result of assistance; among those of its clients that reported an increase, the average employment growth was 21% (Halleran, a). As with any anecdotal evidence, however, these numbers are difficult to confirm. There are also questions about the causal linkage between NGO programs and job creation in foreign countries. Nevertheless, the fact that other indices of productivity, such as sales and output volumes, are going up is a good indication that more jobs may also be created as part of the growth process.

**Introducing New Products to Entrepreneurs:** Another dimension of the growth of private enterprises is their ability to diversify their product base and introduce new goods and services. As part of their technical assistance functions, several NGOs have helped small and medium-sized enterprises explore such diversification. In Ghana, IESC/Geekcorps has enabled many ICT firms to increase their share of the domestic market by helping them to introduce new products. Within the first year of the Accra Technology and Skills Transfer Project, for instance, 87% of IESC/Geekcorps’ clients were reporting that they could offer new or improved products or services as a result of assistance (Halleran, a). One reason for this was IESC/Geekcorps’ introduction of the Intercom Data Network system, a wireless network that is cheaper than landline internet service, to its ICT clients. This new technology allowed ICT entrepreneurs to expand the range of services they provided to their own clients and to increase revenues. A similar case can be found in Nicaragua and El Salvador, where coffee growers have benefited from TechnoServe’s assistance to develop “specialty” coffees that are especially lucrative on the world market.

**Meeting the Marketing Goal**
In addition to transferring skills and providing technical advice to help SMEs improve business management systems and boost productivity, USAID-funded NGOs also strive to help SMEs improve their capacity for effective marketing.
NGO performance in this area is strong. Two parameters of that performance, increased domestic sales and increased exports, are considered below.

**Increasing Domestic Sales:** Introducing new products and services, by virtue of bringing in new clienteles, has increased the revenues of entrepreneurs in poor countries. Various NGOs have helped these entrepreneurs to develop vigorous marketing strategies to increase the sales of their new products and services. In their June 2004 evaluation of CDC’s Enterprise Development Program in Azerbaijan, for instance, MSI and MetaMetrics, Inc. found evidence that SMEs have realized “concrete improvements in sales and operating techniques” as a result of CDC’s technical assistance (USAID, 2004a). CDC itself also reports an overall increase in sales of approximately $4,148,000 among assisted Azeri SMEs (MacArthur, n.d.). Similarly, in Moldova, the better production and farm management skills introduced by CNFA has resulted in improved productivity and sales increases for smallholder dairy farmers such as the Lactica cooperative. In 2003, for instance, members of the cooperative sold 2,500 tons of milk worth $280,000—twice as much as they had sold in 2002 (Phillips, n.d.).

**Increasing Exports:** In addition to helping SMEs increase domestic sales, NGO technical support has enabled many firms to increase their share of profitable overseas markets. Jordanian entrepreneurs, for example, have benefited considerably from the training and technical support provided by IESC’s Jordan-U.S. Business Partnership (JUSBP) program. JUSBP’s principal aim is to help entrepreneurs in Jordan increase their share of international markets, particularly the U.S. market. Through programs such as the Export Fast Track Activity, IESC exposed Jordanian entrepreneurs to international standards and measurement systems and better product packaging, and also arranged export fairs and linkages with U.S. customers. The results have been
remarkable. Between October 2002 and December 2003, total export transactions “rose to 1,447 with a verified value of $60,151,477,” with 214 export transactions (valued at $14,798,115) going to the United States alone (Halleran, b).

A similar impact was felt in Jamaica, where On The Frontier Group, Inc.'s Jamaica Cluster Competitiveness Project helped export-oriented businesses increase their share of foreign markets. In August 2004, the Statistical Institute of Jamaica reported a 33% growth in non-traditional exports (tropical fruits, vegetables, beverages, and chemicals) during the first five months of 2004. Traditional exports (manufactured goods and re-exports) also grew by 22% to $489.8 million. Dr. Andre Gordon, president of the Jamaican Export Association, praised the “successes of the Jamaica Cluster Competitiveness Project within existing and new clusters” and urged the Jamaican government and stakeholders to institutionalize “the JCCP approach to ensure sustainable benefits for the Jamaican economy” (“JEA pleased,” 2004).

Meeting Policy Reform Goals
Promoting private enterprise growth also involves helping to create a policy environment that supports business development. Meeting this goal requires policy advocacy efforts from the NGOs that are implementing USAID-funded technical assistance. The NGOs’ performance in this area is weak. The reasons for their inefficacy in policy-related reform are partly strategic and partly the result of U.S. government and USAID policy guidance. There is also the question of capacity: few NGOs have the resources and leverage required to influence governments to change policy. These drawbacks notwithstanding, however, some NGOs have taken on governments and succeeded in pushing for the reform of policies that affect their clients. To give one example, VITA’s advocacy efforts in Chad succeeded in getting the government to change its interest rate policies, allowing microfinance providers to “cover more of their op-
ering expenses and move towards self-sufficiency.” VITA also scored an important victory in Morocco, where its Al Amana program participated in the drafting and introduction of a new microfinance law (VITA, n.d.).

**Explanation of Results**
What factors explain the NGOs’ overall performance in the various tasks associated with private enterprise development? What unique factors explain the degree of success that the NGOs have enjoyed in the implementation of technical assistance programs? Three variables that shape outcomes are discussed below. They are (1) the design of particular technical projects (i.e., how a project is structured, the type of intervention activities planned, and the manner of its execution); (2) the impact of host-government policies; and (3) the impact of USAID/U.S. government policy guidelines. The extent to which outcomes are affected by these intervening factors is considered below.

**Project Design**
A major determinant of success for NGOs delivering technical assistance to small and medium-sized entrepreneurs abroad is the design of the project and how it fits not only with the needs of the receiving parties, but also with the general development goals of the community in which those parties operate. Issues such as the appropriateness of training, scale, and timing all contribute to whether a project is sustainable and successful in the long run. Also crucial to success is the extent to which a project incorporates needs assessment and impact evaluation surveys in its design and execution. Surveys are essential because they enable NGOs to estimate the exact needs of their clients, and to determine the extent to which the technical assistance provider’s programs are meeting those needs. For example, OTF used such surveys to identify the needs of each of the three clusters it covered in the Jamaica Cluster Competitiveness Project. By using surveys, OTF was able to
identify communication skills, contract negotiation skills, and accounting and marketing skills as some of the areas in which the Jamaican music industry needed to improve in order to be competitive.

Another design element that can shape outcomes is the extent of a project’s flexibility. A flexible approach to designing and implementing technical assistance projects allows NGOs to correct errors and adapt quickly to changing conditions when new information dictates that strategies be reviewed to increase their efficiency. Groups that build such flexibility into their projects tend to be more successful. Two successful examples can be found in Ghana, where IESC/Geekcorps’ ability to quickly adapt programs to reflect local conditions helped salvage its Accra Technology Skills Transfer Project. First, in its first year of operation, the organization changed its focus from teaching computer programming skills to software development. It had initially hoped to teach computer programming skills in Ghana; it quickly changed course, however, when field managers realized that local programmers already knew many common programming languages, but lacked the requisite skills for building appropriate software. The organization decided to refocus its mission to provide training in software development instead (interview with Ethan Zuckerman, founder, Geekcorps, August 2004).

In the second case, IESC/Geekcorps realized that many alumni of its ICT training programs were leaving their current jobs for higher paying positions after they had been trained. The negative effect that this had on assisted SMEs had further implications for the overall impact of IESC’s intervention in the Ghanaian ICT sector. Flexibility in the project’s design, however, allowed IESC to develop measures to correct this problem. The project now trains at least two staff members of a host firm in anticipation that one might move on to a higher-paying job (interview with Ethan Zuckerman, July 2004).
Host Government Policies

Host government policies and regulatory practices are another major determinant of success for most of the NGOs that focus on providing aid to small and medium-sized enterprise development abroad. In countries where government policy is generally supportive of private sector growth, technical assistance projects have fared well. But such supportive environments have been the exception rather than the rule. In many countries, governments still view private entrepreneurs—and the foreign institutions that support them—with suspicion.

Even in countries where the government means well, excessive taxation and bureaucratic red tape can be stumbling blocks both for entrepreneurs and for the NGOs providing them with technical assistance. In Ukraine, for example, CNFA officials noted that many cooperatives have wilted under a policy of double taxation (interview with Donald Philips, CNFA, February 2005), and, in Azerbaijan, many of CDC’s small business clients have had to wait for up to a year to complete a cumbersome registration process (interview with Amanda MacArthur, CDC, February 2005). A red-tape culture invariably increases rent-seeking opportunities for government officials, and this necessarily affects the transaction costs (and hence, quite possibly, the impact) of technical assistance on both NGOs and beneficiary SMEs. In their evaluation of CDC’s Azerbaijan program, for instance, MSI and MetaMetrics found that “widespread corruption and a centralized bureaucracy are two of the important barriers faced by SMEs. Extra costs must be incurred in almost every business transaction, including registration, licensing and customs procedures” (USAID, 2004a, p. x).

Beyond bureaucratic red tape and corruption, host governments have also impeded the success of technical assistance programs with peculiar and sometimes unexpected policies that negatively impact business dynamics. Major aspects of ACDI/VOCA’s work in Eritrea, for instance, suffered due to unanticipated actions taken by the government
as part of its war effort against Ethiopia in the late 1990s. The government’s decision to close the country’s borders obstructed access to raw materials and markets and greatly undermined private sector growth. ACDI/VOCA’s work was also affected by the government’s decision to mobilize some of the banking sector officials it had trained for the war effort. In all, about 30% of the staff of the Commercial Bank of Eritrea, the main beneficiary of ACDI/VOCA’s training and technical assistance, were mobilized for the war (ACDI/VOCA, b).

USAID/U.S. Government Policies
The U.S. government’s foreign policy guidelines and USAID’s administrative procedures have also played key roles in determining the success of technical assistance programs overseas. As the agency that commissions, funds, and supervises these projects, USAID has an enormous impact on how a project is designed and executed. The agency’s guidelines determine which sectors of a qualifying country’s economy are eligible for NGO support, the kinds of training activities NGOs can develop and implement, and the extent to which the implementers can collaborate with each other and with other organizations that provide complementary technical services to entrepreneurs.

Through its financial awards, USAID also determines budget size, and, hence, the quantity (and perhaps quality) of the training resources available to NGOs. Budget size determines many success-shaping factors of the projects, such as the length of technical training sessions, the skill level of instructors and advisors, and follow-on visits. In addition, USAID guidelines regarding NGO-host government relations can affect outcomes, particularly for those technical assistance projects that require the success of host government policy action. USAID policies regarding NGO-host government interaction often reflect broader U.S. foreign policy interests and lessons from the agency’s aid-administration experience in that country.
Though such policy guidelines tend to be routine and quite innocuous in their impact on NGOs’ project implementation options, there have been instances where key aspects of technical assistance projects have suffered as a result of restrictions imposed by USAID. In Azerbaijan, for example, CDC’s policy advocacy options were severely limited by Section 907 of the Freedom Support Act (FSA) passed by the U.S. Congress in 1992. The FSA prohibits USAID contractors from engaging with Azeri government officials for any reason other than to work on humanitarian assistance projects. The problem with such USAID restrictions is highlighted in the MSI and MetaMetrics evaluation of CDC’s Azerbaijan program, which blames the limited impact of some of CDC’s enterprise development projects in part on the fact that volunteers and experts “could not actively engage government officials to promote the adoption of reforms conducive to a more friendly business environment” because of the FSA (USAID, 2004a, p. ix).

**Recommendations**

To help improve the effectiveness of USAID-funded technical assistance projects, we propose the following recommendations.

**Review the Contract Award Process to Ensure Efficiency**

USAID should review the current contracting process involving VEGA to ensure that NGOs are matched with projects that fit best with their capacities. Under the current system, VEGA selects NGOs to execute projects on the basis of past performance, which is often determined by evidence of quick impact. The unintended effect of this policy has been to steer NGOs towards projects that promise rapid and measurable success, even if they may not represent the best use of their funds in the long term.

This de facto emphasis on quick impact also encourages NGOs to avoid essential programs if they anticipate that they will yield slow returns. In Romania, for example,
CDC abandoned support for the garment industry because of fears that the expiration of the WTO protocols and the anticipated Chinese dominance of the market would make it hard for CDC to achieve the kind of quick impact that it would require in order to remain competitive for future USAID contracts (interview with CDC officials, February 2005).

To correct this problem, USAID should revise the contracting process to allow NGOs with specific skills and abilities to submit proposals directly to the agency for funding outside of the VEGA process. This will reduce the pressure on NGOs to take up projects that promise the quick impact they feel they need in order to compete for USAID and VEGA contracts.5

**Be Flexible about the Length of Contracts**

Flexibility in setting contract duration is another way that USAID can encourage NGOs to take up projects that require long-term efforts to show measurable results. The current practice of providing funds for an average of three years may not be suitable for all projects. Projects involving skill transfer and training, for instance, often require more time to have a visible impact. This is particularly true of projects implemented in countries where the business environment is hostile to private entrepreneurs and offers little incentive for trainees to apply their newly acquired skills locally. Institutional and capacity-building projects, such as efforts to develop business networks and financial services, are other examples of projects that only show results after a longer period of time. The long-term view of activities associated with such projects, and the fact that many require the co-

5 Most NGOs compete both directly for USAID contracts as well as indirectly through VEGA. This is so because USAID sometimes subcontracts to VEGA (which then recruits members to participate in execution), but USAID also directly awards contracts to NGOs, usually from country offices overseas. Whether these contracts are awarded directly (through USAID) or indirectly (through VEGA), however, NGOs must constantly compete for contracts, a situation which leads many to select only those projects that promise a quick and visible evidence of impact.
operation of various government departments to even take off, often means that the average three-year length of these contracts is insufficient for NGOs to have any significant impact. USAID should therefore consider instituting flexible contract execution timelines that would allow NGOs to reapply for contract extensions if necessary.

**Involve Beneficiaries in Project Development**

USAID should streamline its project selection process to allow for greater input from beneficiary businesses and communities. The current system defers too much to host governments, whose interests sometimes conflict with those of emerging entrepreneurs, and to other parties that may be well-meaning and genuinely interested in assisting small and medium-sized private entrepreneurs, but who may not fully understand their needs. This, in essence, reflects a top-down approach to project development that has tremendous implications for efficiency and the possibility of local ownership. Granting beneficiaries a greater role in project development will eliminate some of these concerns and ensure that projects respond more adequately to the specific needs of the beneficiaries. Such a bottom-up approach would also entail greater roles for local USAID officials, who could work with local entrepreneurs to identify areas for intervention. USAID country office personnel tend to be good judges of local needs and project implementation terrains. They are therefore a valuable source of information and expertise and should be given a greater role in project development and supervision. The current process allows such officials some input, but VEGA and USAID officials in Washington tend to have the final word on project development.

**Make Impact Evaluation a Priority**

USAID should make impact evaluation a top priority in the development of technical assistance projects worldwide. There is at present no systematic procedure to evaluate the
effectiveness of most of the USAID-funded projects that focus on assisting private enterprise development overseas. The NGOs that implement these projects submit reports citing “success stories,” but these are invariably hard to corroborate. They employ idiosyncratic and sometimes confusing standards of success that range from the number of jobs created to quotes in the local press praising the efforts of project implementers. These variations in standards of success make it difficult to conduct any comparative analysis of effectiveness. USAID should take the lead in standardizing measures of success and, more importantly, conducting regular impact assessment exercises to establish project viability and responsiveness to the needs of entrepreneurs. The reports produced by such impact evaluation exercises should be made public to all parties interested in how public funds are used in the promotion of economic development goals overseas.

**Tackle Policy Advocacy Directly**

USAID should consider using its country offices to implement the policy advocacy components of technical assistance programs whenever possible. This issue should be addressed by USAID because NGOs tend to be ill equipped to advocate policy reform. Several NGOs have deliberately steered clear of this area simply because they lack the requisite political muscle to influence host government policies. Yet policy reform is a necessary part of creating an enabling environment for private enterprise growth. USAID should therefore consider working with NGOs to develop policy advocacy programs that exploit the abilities of USAID country office personnel in pressuring host governments to undertake necessary policy reforms.

**Prioritize Needs Assessment and Progress Monitoring**

NGOs should conduct needs assessment exercises at the onset of their intervention to determine for themselves the exact nature of the assistance their clients require. They
should also frequently conduct progress-monitoring exercises to establish how their intervention is helping clients meet those needs. This is essential to ensure the relevance of the technical assistance projects executed by NGOs. Progress-monitoring efforts will also help NGOs identify the techniques that best meet particular needs, while isolating shortcomings as areas for improvement.

**Explore Cooperation with Other Institutions**

NGOs can improve their performance by collaborating with other organizations that undertake similar projects in their host countries. In addition to USAID-funded NGOs, most developing and transition countries receive technical assistance support from NGOs and volunteer organizations from other donor countries and experts from various international organizations. Many of these organizations and experts have specialized knowledge and abilities that could be beneficial to the efforts of USAID-funded NGOs if a cooperative arrangement were to be developed.

**Involve More Local Experts in Project Execution**

In addition to cooperating with other NGOs and experts executing similar technical assistance projects in a country, USAID-funded NGOs can enhance their effectiveness by involving more local experts and institutions in project execution. One promising example of such involvement can be found in Kenya, where TechnoServe successfully employed experts from local universities and research institutions to train farmers and dairy managers under the Dairy Enterprise Initiative. In addition to reducing expenditure on expatriates and helping to develop the local capacity to solve problems, giving a greater role to domestic experts—when feasible—helps to build local ownership for technical assistance projects and ensures their survival beyond the lifespan of USAID-sponsored activities.
References


We can now draw together the findings of our three case studies on the use of public resources to promote enterprise development in developing and transition countries by asking four questions: Were these approaches relevant to the problems they sought to address? Were they effective? Were they efficient? And how useful will they be in promoting enterprise development in the future?

Relevance
Each of the three approaches to private sector enterprise development faced different problems and challenges. Enterprise funds were set up to spur private sector development in the midst of major economic and political changes in former socialist countries. In the early stages of such reforms, investors are often hesitant, uncertain about opportunities in the transition country and concerned about the inaccessibility of both capital and advice. Governments may also be unsure about the reform process as it progresses. The high-profile U.S. enterprise funds were designed to address these challenges. Beginning with the Polish-American Enterprise Fund, the funds mobilized capital and provided loans and equity investments both directly to enterprises and through financial intermediaries; they provided advice to newly established firms and funding for business development centers; and they kept potential investors informed about opportunities in the recipient countries. Finally, because they were associated with the U.S. government—with prominent U.S. board chairs and members, who often had connections in the White House and among senior U.S. officials—their leadership could gain access to high levels of host governments, enabling them to quietly
remove obstacles to private sector development and nudge the reform process forward. When managed and led well, like the Poland and Baltic funds, enterprise funds can act at the forefront of enterprise development in regions where such development is beginning to unfold or expand. In effect, they have a potential political function in addition to their funding and advisory role.

Equity funds can be useful in supporting an expanding private sector in countries where there is the potential for SME development, but where knowledge about investment opportunities is limited and risk capital and advisory services to firms are scarce. According to most sources, the need for such capital and advice is “vast.” Managed well, equity funds can help fill that need, whether by providing resources and advice to firms directly or by providing it to intermediary organizations. Equity funds, when successful, can demonstrate to potential investors—both in host countries and internationally—that attractive investment opportunities exist in places that may be unfamiliar to the investment community. These funds, although they operate with U.S. government guarantees, do not usually have the high political profile or high-level access to U.S. and foreign governments that enterprise funds enjoy.

Stand-alone technical assistance from NGOs to enterprises appears to be most relevant when tailored to the particular needs of individual firms. For example, the technical assistance that Geekcorps volunteers gave to business enterprises employing information technologies in their operations was specially geared towards the particular needs of those enterprises. NGOs seem to be less effective when deployed to strengthen an entire sector of SMEs, or to organize them in clusters or value chains.

**Effectiveness**

All three of the approaches examined in this study made valuable contributions to promoting SMEs and the private sector generally in developing and transition countries. All
three have also suffered from weaknesses and failures.

Enterprise funds exhibited considerable effectiveness—but with some notable exceptions. Several, like the Poland fund, were highly effective, not just in helping individual enterprises, but in fostering new financial programs and institutions, mobilizing capital, transmitting knowledge about investment opportunities in Poland, and acting as a symbol of and advocate for economic reform and private sector development. Two enterprise funds—those for the Czech Republic and Central Asia—were failures, but the remainder improved over time to ultimately have a positive impact on their host countries.\(^1\) The main keys to the success of the enterprise fund approach are threefold: first, the political and economic environments need to be adequately supportive of a private sector, even if they are only at an early stage of economic reform; second, the leadership of the fund boards and management must be selected on the basis of their capacity to lead and manage, rather than on their political connections with U.S. administrations; and third, the funds must be capitalized at a level that enables them to have an economic and political impact in their host countries.

Equity funds may have the potential to achieve their goals of promoting enterprise development, overall economic development, and U.S. foreign policy goals while remaining profitable themselves. The absence of published data about individual fund performance, however, makes it impossible to evaluate their effectiveness. Their history suggests that there have been problems in their management and profitability. One source of problems has been the incompatibility of the funds’ various goals. This particular problem is apparent when, for example, a diplomatically important developing country has a risky investment environment, but U.S. interests argue for the establishment of an equity fund regardless. In addition, when fund managers

\(^1\) The Southern African Enterprise Development Fund, which we did not treat in this analysis, remains to be evaluated.
are chosen on the basis of political connections rather than competence, the funds are likely to face performance problems. Greater transparency in the selection of fund managers and in the performance of equity funds could help minimize these problems and provide for greater public accountability.

NGOs have clearly had a positive impact on the functioning of individual firms, as demonstrated in the case studies included in Chapter 4. Due to the lack of comprehensive evaluative data, however, we cannot ascertain the rate of success for this type of intervention. Thus, we cannot make firm assessments of the overall effectiveness of this approach in promoting SMEs.

**Efficiency**

On average, the U.S. government spent roughly $86 million per year on enterprise funds over a 15-year period. This is a relatively small amount in a U.S. bilateral aid program of around $8 billion per year, comparing favorably with USAID’s annual expenditure on micro-enterprises, which averages to just over $150 million. Further, as was pointed out in Chapter 2, $120 million has already been returned to the U.S. Treasury as revenue from the Polish-American Enterprise Fund, and up to $400 million is projected to be returned from all of the funds combined.

It is not clear how efficient the equity funds have been, and this will not be clear until OPIC publishes data on their earnings and losses. It is evident, however, that there have been problems with losses—or threatened losses—from the funds. In 2001, for instance, OPIC was sufficiently concerned by the funds’ performance and by criticisms of the structure of risk and return to the U.S. government that it imposed a moratorium on new funds. After restructuring

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2 This figure does not include the funding for the Southern African Enterprise Development Fund.

the risk/return arrangements borne by the U.S. government, OPIC lifted the moratorium, but we still do not have a picture of the funds’ overall performance.

Data are also lacking on the overall cost to the U.S. government of stand-alone technical assistance from NGOs. While this is not likely to constitute a large portion of USAID’s overall budget, and while these expenditures often leverage additional funding (in the form of volunteer time), it is not possible to evaluate the efficiency of these expenditures as a whole without much better and more comprehensive data on how much was expended for this purpose.

Towards the Future
This study suggests that the three tools of enterprise development present both opportunities and challenges that may affect their use in the future.

Opportunities
This study found that enterprise funds, when well managed, adequately funded, and led by competent and experienced professionals, can perform a unique and valuable function. In addition to the funding and advice that they provide to entrepreneurs, enterprise funds can serve as symbols of the U.S. government’s and financial sector’s support for private enterprise development in developing and transition countries. As such, they can function as a significant source of encouragement, while pressuring governments and markets to strengthen the environment for business development. Enterprise funds would thus appear to be most useful in countries that are important to U.S. foreign policy, and that are initiating major economic and regulatory reform programs that promise to open up new opportunities to SMEs and the private sector more generally.

Where, in the future, might conditions arise that would make enterprise funds an appropriate tool? Socialist countries that are just beginning an economic transition constitute one such area. At some point, Belarus, Cuba, and North
Korea may fall into this category. The same might be true of Viet Nam, as it expands the scope for private sector activity. Another group of countries where the use of enterprise funds might be appropriate is developing countries initiating major reforms that are intended to spur private enterprise. Two such countries might be Egypt, when that country’s government begins to implement real economic reforms, and Iraq, once the security situation is under control. Perhaps Venezuela, after Chavez, would be a candidate for an enterprise fund. Another possibility would be to establish enterprise funds in the poor areas of large developing countries, such as China or India—for example, in the western provinces of China, or in Mahdy Pradesh or the Bihar states in India. Funds have already been committed to new enterprise funds in the Middle East and Georgia.

Equity funds seem to be most appropriate for use in countries where the business environment is promising, but where capital, especially for small, medium-sized, and mid-market enterprises, remains scarce. These funds can help expand financing and strengthen financial institutions while raising awareness of opportunities in the host countries and mobilizing capital from potential investors. They may be particularly useful in countries or regions less familiar to international investors, such as, for example, the smaller countries of Sub-Saharan Africa or of Central Asia. They might also be usefully deployed after enterprise funds, once the business conditions in the recipient country are supportive of private sector development.

The future relevance of stand-alone technical assistance from NGOs to individual SMEs is most questionable. Opinions differ as to whether technical assistance is best provided directly to individual enterprises that can use it to enhance their business performance, whether it is more cost-effective to provide such assistance to groups or sectors of SMEs (rather than individual firms) to promote strategies that will make them more competitive or productive, or whether establishing clusters or value chains might be
more productive in terms of overall economic impact. It is not possible to resolve this issue on the basis of existing data regarding the effectiveness of these interventions.

One argument for the value of NGO technical assistance that relies on U.S. volunteers with business experience is that, because such programs involve U.S. citizens in helping firms abroad, they help to strengthen the domestic constituency for foreign engagement, and for foreign aid in particular. They may also generate support for stand-alone NGO technical assistance itself. If this is, in fact, an important consequence of NGOs’ involvement in fostering enterprise development—and it is often mentioned in the literature on volunteer assistance—then it should be made explicit in any future evaluations of this approach.

Challenges
This study of three ways in which public resources have been used to promote enterprise development has revealed three basic challenges: the question of accountability, the problem of multiple objectives, and the need for better data and evaluation.

The first issue involves the public accountability of government funds. Accountability is a requirement associated with the use of public funds in general. In the case of enterprise and equity funds, however, it has been a particularly challenging issue. This is because the funds require U.S. government funding to be transferred to private entities with broad goals for their use, but largely without the kind of oversight traditionally associated with the use of public grants or loans. Indeed, a relatively hands-off approach by the U.S. government has been a part of the arrangements of enterprise and equity funds. When the managers of several enterprise funds made decisions that seemed unwise or unwarranted to public officials in Washington, however (e.g., to pay themselves high salaries or to invest in dubious enterprises), the funds came under considerable criticism. Part of the problem involved the different expectations held by
those who were accustomed to public service and private investment operations, and a lack of clarity on the part of public officials and private fund directors and managers as to what their mutual responsibilities were. These responsibilities are particularly difficult to define when public monies are effectively being used as venture capital by private operators. Should more enterprise funds be established in the future, there should be greater clarity on both the public and private sides of the endeavor regarding what is permitted, what is not permitted, and to what extent the executive branch and Congress should oversee fund operations.

In the case of equity funds, there have been further criticisms related to a different aspect of accountability. This criticism is that the U.S. government bears far too much of the risk in these funds if they perform poorly, and reaps far too little of the gains when fund managers turn a profit. OPIC has sought to address this issue by restructuring how much support it provides to equity funds. It is not yet clear whether the right balance has been struck.

A related issue involves the multiple—and sometimes contradictory—objectives of these approaches to development. For enterprise and equity funds, in particular, it can be difficult to benefit U.S. foreign policy and development interests and simultaneously to make profits on investments in SMEs in risky environments. This dilemma can be especially acute in the case of equity funds. Turning a profit is an expected outcome of the equity funds’ investments, but the funds are prohibited from entering areas that might compete with U.S. firms. It is worth considering whether the stricture to make profitable investments should be eased where foreign policy considerations drive the creation of such funds and in especially difficult development environments, or whether these other objectives should be jettisoned to ensure more profitable investments—which would, in turn, profit the U.S. government.

NGOs face a related problem with their stated objectives. If building a domestic constituency for aid in the United
States is one of the objectives of NGOs that provide stand-alone technical assistance to SMEs, this objective should be made explicit. If it is not, then the administration should resist pressures from these organizations and from Congress for earmarks, directives, and the allocation of funds. The NGOs should be able to compete for the use of aid resources to further SME development like any other private entity.

This brings us to a third issue: the limited data on the operation of these entities, especially equity funds and NGOs. Given that the current administration is usually quite results-oriented, it is strange that there has been so little comprehensive information from which to evaluate the performance of these organizations. Several efforts to evaluate enterprise funds have been undertaken, but these, too, are limited. USAID has initiated no overall evaluation of either enterprise funds or stand-alone technical assistance from NGOs. And OPIC has yet to undertake an evaluation of the performance of the equity funds that it supports. In order to best use the public resources allocated to these potentially valuable approaches to private enterprise development in developing and transition countries, we need to be much better informed about how they have performed in the past.

In sum, the three approaches to using public resources to support private sector enterprise development in transition and developing countries have proven to be useful and important. They continue to be relevant when deployed under appropriate circumstances. They also have their limitations, as their past experience suggests. The challenge to the development community is to much better understand both their limitations and their capacities as we seek ways to support the development of private enterprises, which are important to economic prosperity and the reduction of world poverty. The challenge to the current Bush administration as it creates new enterprise funds is to ensure that the lessons from the past are reflected in these new funds.
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