ALTERNATIVE Emerging Investor

Issue 4 - December / January

Asian Frontier Markets

Bullish on Argentina?

Re-Emerging UK Real Estate

It is human nature to instinctively fear what we do not understand. This fear can embed itself within the psyche, becoming increasingly stubborn the longer it is held onto, fighting logic and fact. What are people, in general, more afraid of: sharks or lightning? Peter Benchley's Jaws, for example has created a global illogical fear of the big fish; on average there are 10-15 fatalities a year from shark attack worldwide, yet the U.S. alone averages 50 lightning strike fatalities per year. Media, social behavior, entertainment, and group mentality have all worked together to create an almost universal negative perception. We have seen the same phenomenon occur in emerging markets.

Past economic crisis, political instability and historic under-regulation have all played their part in propagating the culture of fear around emerging markets, but this is rapidly evaporating. The world's investors have been barraged with emerging market news at ever increasing frequency for the better part of five years, and some of this information and understanding is beginning to stick. More and more LPs are starting to ask the right questions, if not actually making moves into emerging markets. The increased availability of information is responsible to some extent, but there has also been an expansion of understanding that may be more important. Investors are starting to see trends and opportunities more clearly, and we can see emerging market correlation with the U.S. compared with frontier markets' reverse correlation. We can use capital flows to predict currency movements, so the location of the puzzle pieces is becoming clearer. This is going to make for an incredible 2014 for those looking outside of the developed world.

From the entire AEI staff, we wish you happy holidays and a prosperous new year.

Saludos,

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ALTERNATIVE Emerging Investor

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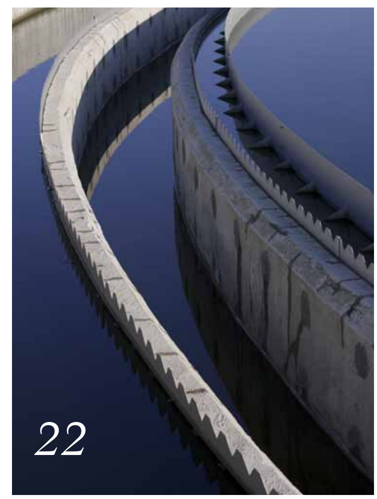

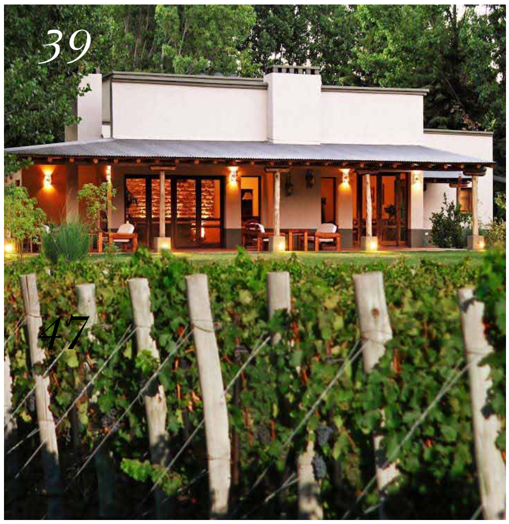

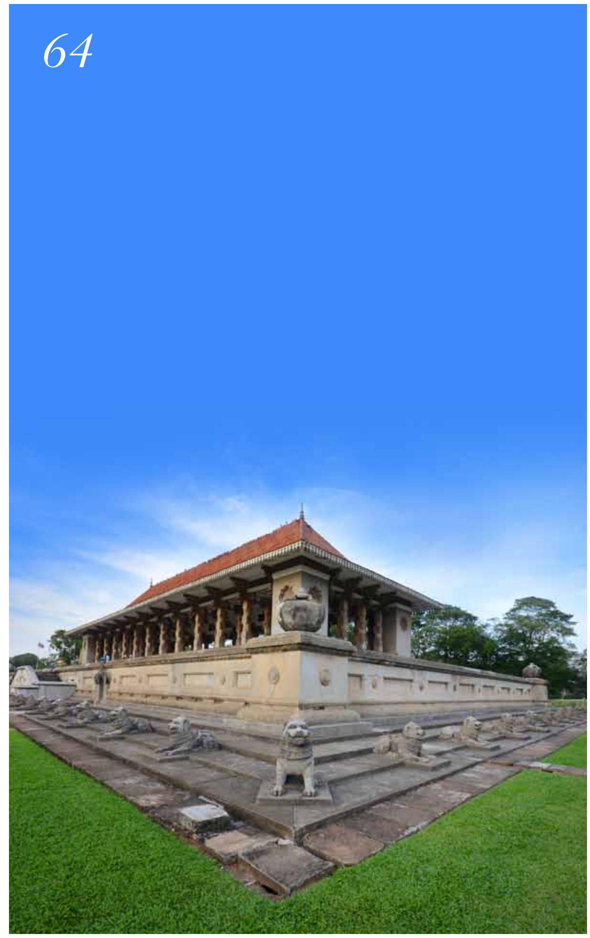

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Big Pineapple, Small Pineapple

Stephen Kaczor

Pineapples account for more than 20% of the world production of tropical fruit, and they are second only to bananas as the most important harvested fruit crop. Just 12 countries create 90% of global pineapple demand. While most pineapple is harvested and consumed as fresh fruit in the country of production, pineapple exports have been dominated by one country for more than a decade: Costa Rica.

“Panama’s stricter labor laws, with a higher minimum wage than Costa Rica’s, made it an ethical option.”

‘Costa Rica generated 85% of global pineapple exports in 2010’

In the last decade, Costa Rican exports have exceeded US$5 billion, and they have never represented less than half of the global export value in any one year. Other export industry players are tiny by comparison. Producers in Ecuador, Mexico, Ivory Coast and the Philippines have struggled with crop quality and export logistics. Costa Rica’s neighbors Panama & Honduras have recently begun ramping up to compete.

Only about 30% of worldwide production is exported, increasingly the MD2 variety, although the “Smooth Cayenne” variety is the most commonly grown worldwide. Major producers with few exports include Brazil, Thailand, Indonesia, India and the Philippines. Major importers are the U.S. and the E.U. Costa Rica’s success is notable given that its production represents less than 10% of global pineapple production.

Big pineapple production is highly industrialized by Dole and Del Monte, which brought the MD2 variety to Costa Rica from Hawaii in 1996. Growers use 20 kilograms of pesticides per hectare in each growing cycle, affecting soil quality, biodiversity, drinking water quality, and the health of workers and the local population. Most pineapple workers in Costa Rica are Nicaraguans who will work for very low wages. For more details on the downside of industrialized pineapple production, see Felicity Lawrence’s “Bitter Fruit” (2010, Guardian News, London).

Small pineapple is organic, fair-trade, and ecologically and socially sustainable. According to the Food and Agriculture Organization of the United Nations and the Export-Import Bank of India, demand for healthy and organically produced pineapples should increase considerably over the next 10 years. “Generally, the growth rate of organic markets is significantly higher than that of conventional markets, and that should hold true for the organic pineapple market too, demand currently outstrips supply. Retailers increasingly demand organic pineapples of the MD2 type.” Time from planting to harvest for a pineapple crop averages 18 months.

A recent United Nations Conference on Trade & Development (UNCTD) analysis of the evolution of the world market for fresh pineapples speaks to a fierce battle between global agricultural giants and grocery retail chains. “A new driver seems to be gaining strength, as firms awaken to the advantages of using private standards as a strategic tool and to reassure anxious consumers. This is evidenced through the explosion of private and business-to-business standards aimed at guaranteeing the quality/safety of food products.” For a full commodity profile, visit UNCTD.

Successful farming of organic pineapples requires raised beds with soil rich in organic nutrients at an elevation with a tropical climate with little variation from 23.5

degrees Celsius. There are more than 100 varieties, but only 6 to 8 of them are cultivated commercially. After the variety, logistical and crop standards are two forces shaping the world pineapple market. Access to a successful cold warehousing and shipping chain, which Panama is currently implementing nationally, is as essential as efficient port operations on both shipping and receiving ends.

Also important is immediate transfer to buyers who, ideally, have participated in advance with crop standard development. Grocery retailers are increasingly participating in grower/vendor alliances in the trade of tropical fruits such as pineapples and mangos, a trend that began in the 90s.
'A good small pineapple example is Panama'

Panama's pineapple exports to the U.S. and Europe are expected to double over the next seven years thanks to government subsidies of 3 cents per kilogram exported. Panama has 3,500 hectares devoted to pineapples compared with Costa Rica's 50,000 hectares and has only started exporting in the last six to eight years.

In Panama, Verba Fruit's President Paul Vergara believes his country can produce fruit that is sweeter and has minimal pesticide levels. "Panama has hillier terrain than Costa Rica's flat plains, and that is a significant advantage. The problem with flat land is it's good for production and picking but it's easy to have water accumulation which increases moisture and leads to more pests. We have hilly land so the water rolls off. Verba Fruit followed global GAP certification rules on pesticide use but in reality used very low levels. Costa Rica's pineapple industry is several decades older, so many of the pests have become resistant to initial pesticides, forcing the country to use different chemicals compared to Panama."

As Vergara told Fresh Fruit Portal (March 15, 2012), "Panama's most common variety, Golden, is the same cultivar as Costa Rica's but Panama's is sweeter with brix levels exceeding 13.5 and reaching up to 18." His company is currently diversifying, selling its La Dona de Panama label to medium-sized U.S. retailers on the West Coast, in addition to supplying Verba Fruit's long-term client Fyffes. "There are a lot of small regional chains where we can develop relationships. The color of our fruit is better as well as sweeter. We may be a smaller producer than Costa Rica but we are a viable alternative."

He adds that Panama's stricter labor laws, with a higher minimum wage than Costa Rica's, made it an ethical option. "The multinationals came into Costa Rica, they bought land and prompted rapid growth of the industry. I don't think this will ever happen in Panama. We cultivate a range of different fruit and our agricultural system is more diversified," he says. "Vergara sees frozen exports as a major avenue to explore extending shelf-life for up to six months, which would make shipments to locations such as Asia possible."

About the Author

Stephen Kaczor is a regular contributor to Alternative Emerging Investor and Chairman of the Big River Foundation, a non-profit focused on river and watershed ecology conservation initiatives throughout the Americas. He is an organic farmer, eco-entrepreneur, consultant, and a writer with a documentary film in production in Central America. As a Panama-based consultant, Mr. Kaczor's focus is sustainable organizational development, research & management.

www.BigRiverFoundation.org

Networks Make the Difference for Women Entrepreneurs

Susana Garcia-Robles

Some barriers are easier to see than others. The obstacles women face are overt throughout some cultures and corners of the world – laws against driving and owning property, rules barring them from certain social settings – while others are more subtle.

There are no hard-and-fast rules that prevent women in Latin America from starting their own businesses. Actually, with midsized-to-larger companies often reluctant to hire qualified women for any number of poorly premised reasons, small business would seem like a natural launching point for the more enterprising among us.

So then, why aren't more women succeeding as entrepreneurs?

A working group I lead has explored the role of women in Latin America's small, medium-sized and large businesses, and found that they are consistently underrepresented across the board in terms of their leadership roles.

But the reasons for this are not easy to pack into one answer. In some countries in Latin America, women seeking to start up their own businesses face deep-seated cultural obstacles, such as the stigma of a woman's perceived role being in the home and the prejudice that women cannot negotiate or play hardball.

In other more sophisticated countries of the region, women may face a disadvantage because the business environment is not ready to accept the way women do business.

The examples abound. Consider golf. For the business elite, golf has traditionally served as the go-to sport of leisure for men – a place to unwind. But for captains of industry and the ambitious alike, there is no clear distinction between business and pleasure. Mergers, acquisitions and takeovers are hammered out between the first and the ninth hole. These interactions are relational, but they are transactional in their ultimate goal. Meanwhile, when women play golf . . . well, they just play golf. The interaction stays at the relational level. If women are watching their kids on the playground, most likely they are chatting with other women who may have interesting professions, but they are not necessarily using those encounters to do business. Women tend to be more compartmental: business is business, and other


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activities such as leisure or sports are simply leisure or sports.

Women often lack alternative sources of funding beyond their immediate networks of family and friends, as banks finance less than 20 percent of their business needs. The irony of the situation is that women are more likely to found businesses that they are passionate about, as opposed to businesses that are shallow cash-grabs. Businesses born of true passion are more likely to grow and succeed. They are in fact the best investments, but face the most challenges when getting seed capital.

Still, women are dogged by misconceptions in business. There is a prevailing notion that women are more risk-averse by nature – a notion that I find patently absurd.

Being a dynamic leader in business is the one key factor that can lead to success. We have found that being a dynamic entrepreneur is directly correlated to how engaged and active one is, and it is also a relatively solid predictor of success. A dynamic entrepreneur tends to proactively solve problems to improve her chances of success, rather than blame the tough environment for her lack of success. We have also found that women who become dynamic entrepreneurs often come from families in which a parent, a sibling, or a partner is an entrepreneur as well. Against a background of economic crisis, there are today many couples starting their ventures together as a way out of unemployment.

It takes a regional approach that also takes into account cultural differences among countries to address these systemic shortcomings. In a survey done in Uruguay, women seemed to place themselves second to men when it came to business skills. This could be related to not being offered training courses tailored to their specific needs and profiles. The Multilateral Investment Fund (MIF), part of the Inter-American Development Bank, recently started a partnership with Endeavor and OMEU to meet these women's needs and help them reach the next level in their ventures.

Meanwhile, in a survey done in Argentina, conclusions were different. Many women saw the fact of being a woman as a plus for their entrepreneurial aspirations. The ones who were less dynamic saw their lack of success correlated to difficulties in the business environment, whereas the dynamic ones saw their problems as another obstacle to sort out on the road to success.

"Still, women are dogged by misconceptions in business. There is a prevailing notion that women are more risk-averse by nature – a notion that I find patently absurd."

Early this year, the MIF supported a regional accelerator, NXTP Labs, that is already having some success nurturing teams with women founders. In a recently approved project to consolidate angel networks in the region, the MIF will create incentives to support angel networks that include women in leadership roles, as investors or as targets for investment.

Our findings in the recent undertakings in both Uruguay and Argentina, along with other results that could help drive successful women entrepreneurs in the coming generations, will serve as the backdrop for WeXchange, Latin America's first pitch conference focused on strengthening the networks for this demographic. There, we will provide a platform for Latin America's most promising women entrepreneurs, key investors and international experts. Together, these minds and voices can change the reality and even out the playing field.

Small business is a ladder, an accelerator, a way for people to thrive and earn outside of the typical corporate constructs. The startup ecosphere is where innovation happens. How can this economic engine be effective if half of the population is excluded from fully participating in it?

About the Author

Susana Garcia-Robles is the Principal Investment Officer in charge of MIF Early Stage Equity Group, MIF/FOMIN (Multilateral Investment Fund). Since 1999, Ms. Garcia-Robles has created and guided the seed/venture capital investments of MIF/FOMIN in Latin America and the Caribbean as well as its entrepreneurship strategy.

Private Investors' Take on Mexico's Infrastructure Spending Plans

Mick Bowen

When Enrique Peña Nieto became the President of Mexico in December 2012, he promised to make infrastructure investment one of the cornerstones of his six-year term. He even outlined plans for three passenger rail PPPs during his inaugural address. In July, after the market had waited for seven months, the government unveiled its National Infrastructure and Transportation Investments Program 2013-18, calling for MXN1.3 trillion (US$97.9 billion) in public and private investment, including MXN386 billion (US$29.6 billion) for highways and MXN191 billion (US$14.6 million) for other transportation projects.

Details about the full extent of private investments are still incomplete, but Mexico's infrastructure market appears confident it can fulfill the government's investment plans from procurement through financial close and construction. "It's ambitious but it's also feasible," says Astra Castillo, head of infrastructure and project finance analysis for Fitch Ratings in Mexico. "It's very likely that there will be enough financing for the program," she says.

So far, the federal government has included the three passenger rail projects, involving as much as MXN95 billion (US$7.15 billion) in total investments, and six toll road concessions in the PPP pipeline, including the MXN6.3 billion (US$476 million) Tuxpan-Tampico toll road concession, a new 159km highway through the states of Veracruz and Tamaulipas.

'It's ambitious but it's also feasible. It's very likely that there will be enough financing for the program.'

–Astra Castillo, Fitch

Proposed toll road concessions			
Project	**Location**	**Length**	**Investment**
Tuxpan-Tampico highway	Veracruz and Tamaulipas	159km	MXN6.3 billion (US$476 million)
Tuxtla Gutiérrez-Villaflores highway	Chiapas	63km	MXN1.55 billion (US$117 million)
Cardel-Poza Rica highway	Veracruz	126km	MXN3.8 billion (US$287 million)
Atizapán-Atlacomulco highway	State of Mexico	80km	MXN7 billion (US$529 million)
Guanajuato-San Miguel de Allende highway	Guanajuato	70km	MXN2 billion (US$151 million)
21st Century Highway	Morelos	61.8km	MXN2.4 billion (US$181 million)

Last week, the Ministry of Communications and Transportation (SCT) accepted offers for the MXN2.4 billion (US$181 million) 21st Century Highway, a 61.8km concession in the state of Morelos, with the likely bidders including local developers ICA, Ideal and GMD, along with major international firms like FCC, OHL and Odebrecht.

"Obviously the government has to carry out the financial reforms that will be presented to Congress later this year to have enough resources to fund the public investments, but we are certain that there are many private investors from around the world and also here in Mexico who are eager to put their money in the projects included in the program," notes an investment banker in Mexico City.

A Financing Template

The Peña Nieto administration introduced a financial reform proposal in May that would encourage state-owned development banks to work closely with commercial banks to increase lending. According to the IMF, lending to the private sector in Mexico ranks among the lowest levels in Latin America at less than 20% of GDP, only ahead of Venezuela and Argentina.

However, federal development bank Banobras, which focuses on project finance, has promised to forge closer ties with commercial banks and institutional investors to help develop infrastructure projects over the next five years. The bank has already made MXN28 billion (US$2.15 billion) in funds available for the second half of 2013, including money for PPP projects like the Zapotillo aqueduct and the Monterrey light rail transit (LRT) system.

Late last month, when developer ICA secured financing for the 30-year Palmillas-Apaseo El Grande toll road concession, Banobras led a group of three banks that provided a 10-year, MXN5.68 billion (US$435 million) loan for the project. The financing structure, with Banorte and Santander as the commercial lenders, initially appears to follow the template that ICA helped establish with Goldman Sachs Infrastructure Partners II (GSIP II) for the FARAC I concession package.

ICA and GSIP II first took a seven-year loan for MXN37.1 billion (US$2.79 billion) for FARAC I in 2007. Two years later they raised more than MXN6 billion (US$460 million) to cover part of the debt by issuing structured equity securities called CKDs. Then they issued MXN8.13 billion (US$623 million) in 20-year bonds in September 2012 and MXN7.5 billion (US$575 million) in 15-year bonds in June 2013 to pay back part of the bank loan and extend the maturities on the debt tied to FARAC I. Also in June this year, ICA agreed to sell its 18.7% stake in the FARAC I toll road concessionaire for

Proposed passenger rail PPPs			
Project	**Length**	**Estimated investment**	**Technical advisors**
Mexico City-Querétaro line	200km	MXN35-40 billion (US$2.63-3.01 billion)	Prointec and Cal y Mayor
Mexico City-Toluca line	55km	MXN36-38 billion (US$2.71-2.86 billion)	Sener and Ustran
Yucatán Peninsula line	278km	MXN11-17 billion (US$828 million-1.28 billion)	Adhoc, Sintra and Cosci

MXN5.07 billion (US$388 million), leaving GSIP II with a 73% stake and the CKD holders with 27%.

"That's the easiest one to replicate," notes a project finance banker in New York, explaining how the bank loan was partially termed out on the bond markets before the developer eventually sold out. "I think people are going to continue to be smart about determining the best capital structure, depending on the stage of the project."

CKDs and Construction Risk

One uniquely Mexican wrinkle in the FARAC I financing story was the CKDs issue. CKDs, which are listed on the Mexican Stock Exchange (BMV), allow local pension funds and other institutional investors to invest in infrastructure projects, usually before construction is complete, and they could make all the difference when infrastructure concessionaires go looking for financing.

"I think financing will be available in both the bank and bond markets," says Fitch's Castillo. "But remember that we have the CKDs capital markets instruments. Most of the investors in those instruments are private equity funds or pension funds. It's very likely that there will be enough financing for the program."

Over the past two years, Fitch has rated bond issues for availability payment PPPs, including prisons and hospitals that were still in construction, explains A.J. Santos, Senior Director of Global Infrastructure and Project Finance at Fitch. "The appetite for those types of bonds has been very robust. If that is any indication of future deals, it would be positive because they were so well received, particularly with the P3 programs, which are really a step up in Mexico," Mr. Santos says.

Typically, the developers and banks have absorbed the construction risk for concessions and PPPs, but that could change eventually, given the warm response the prison bond issues have received. But other than social infrastructure projects like prisons and hospitals, Mexico's bond market could also become a source of financing for toll road concessions because investors know the asset class so well, Ms. Castillo says. "The market is comfortable with toll roads because of the long-term nature of the projects, which match perfectly with the long-term expectations of many investors, particularly pension funds that have a lot of liquidity."

`Mexico has flown under the radar for years as a success story. It continues to grow and it continues to be of interest to investors.'

James Kaiser, HSBC

According to the investment banker in Mexico City, the financing needs for the sheer number of projects over the next five years will lead pension plans and other institutional investors to take on more construction risk, including greenfield risk for toll roads. But, up until now, only a handful of projects are prepared for procurement. "The biggest risk we face as a country right now is that there are only a few projects ready to be launched. But we're all hoping that is not going to be a problem during this administration," he says.

However, according to the project finance banker in New York, the trick is to match supply and demand on a managed basis, while recognizing the increased investor appetite at home and abroad, and structure the deals to meet bankability requirements. "Procurement is not something that governments like to do quickly. They prefer to grow it, and we expect to see that," he says. "As [the government] meets various boundaries and constraints, it is going to manage the supply of projects and keep investors and manufacturers suitably motivated. It's just practical."

Bond financing for greenfield projects can be done but it will require risk adjustments so pension plans are comfortable with the investment, the banker says. "It may well not be the area that is going to be the easiest to do, but in terms of mobilizing the amount of capital needed, it will be something that people will look at closely."

Mexico's Regional Appeal

While Mexico's procurement authorities prepare the project pipeline, other Latin American countries, such as Colombia and Brazil, are also working on their own concessions programs, potentially giving rise to future competition for capital market financing. However, Mexico holds two distinct advantages when it comes to appealing to investors: a proven bond market and transparent PPP legislation.

"Those help significantly, when compared to other markets in Latin America," Fitch's Santos says. "When you're trying to figure out the competitive landscape, it's important and, when coupled with clear and transparent rules of engagement through a P3 law, it increases your stable profile in terms of investors looking at Mexico as opposed to Brazil perhaps."

According to James Kaiser, Managing Director of Project and Export Finance at HSBC, Mexico's appeal to investors is illustrated by the dealings of many foreign investors in the market. "Mexico has flown under the radar for years as a success story. It continues to grow and it continues to be of interest to investors," Mr. Kaiser says.

Yet, according to the investment banker in Mexico City, the Mexican market does not have to fight for the attention of foreign bond buyers because the local pension plans have the resources to finance much of the infrastructure spending program on its own. "There are plenty of opportunities to raise equity and raise money in the bond market," he says, explaining that many CKDs have only invested about 20% of their funds. "The Afores, which are the pension plan administrators, are a good source of funding."

Mexico's PPP law, which previous President Felipe Calderón signed in January 2012, also provides a stable environment in the Mexican market, at least for projects procured by the federal government. Now the Peña Nieto administration and the Mexican infrastructure market will benefit from the legal framework already being in place, notes the investment banker in Mexico City. "There are investors at every stage of the projects that are just waiting for the bidding process to be launched."

MERGERMARKET

About the Author

Mergermarket, part of The Mergermarket Group, is an unparalleled independent M&A intelligence tool used by the world's foremost financial institutions to originate deals. It provides proprietary intelligence on potential deal flow, potential mandates and valuations via the world's largest group of M&A journalists and analysts who have direct access to the most senior decision-makers and corporates.

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Perception and Reality in Nigeria

James Knight

At a recent event in London to attract investors to Nigeria's tech industry, you would not believe the hype. Panelists made the point again and again that the widespread negative stereotypes regarding the country abound to such a point that they no longer recognize the country that they read about in the foreign press.

This kind of perception risk is a powerful disincentive to doing business. I am convinced, however, that a small number of investors are quite happy with the status quo, because the longer the competition stays away, the juicier the spoils. One head of a boutique banking firm said recently that he was more interested in Nigeria than South Africa exactly because of the lucrative in-country advisory opportunities for corporate and government clients that have been left by the absence of the big investment banks.

Africa's Century

Over the last decade, six of the world's 10 fastest-growing countries were African. Powering the expansion of the African middle class will be the key driver for the next 50 years. Some 313 million people currently spend US$2.20 a day, a 100% rise in less than 20 years. By 2060 an estimated 1.1 billion (42% of the predicted population) will be middle-class consumers looking for goods and services to cater to their needs.

Nigeria is already the continent's most populous country with almost 200 million people. Its GDP increased five-fold between 2000 and 2011, built on a commodities boom. It is also Africa in microcosm, full of the shocking contrasts that affect the continent. On Lagos's Victoria Island you can visit the local Porsche dealership, do the weekly shopping at online retailer Jumia (paying in cash on delivery of course, not via the internet!), and then download the latest tracks by local artists to your mobile phone through the music platform Spinlet. On the mainland, meanwhile, Lagosians still live in slums built on rubbish mountains.

For the wealth to flow out of wealthy enclaves and down to Nigeria's poorest, the country's oil industry is not the answer. The U.S. shale revolution is decreasing dependency on West African crude, and current foreign exchange earnings are remitted opaquely by the NNPC. The Delta area remains volatile, bunkering takes place on an industrial scale with collusion from politicians and the armed forces, and the Petroleum Industry Bill (PIB) languishes in Congress.

Finance, Power, Politics

The future of Nigeria rests on its finance, agriculture and power industries. The banking sector has seen two rounds of consolidation in the last decade. The second, in 2009, was ably managed by the Central Bank to minimize effects of the global financial crisis. However, recent problems at the top of Ecobank underscore the ongoing challenge of good corporate governance. The agriculture industry is the largest single economic sector, but it mostly operates on a subsistence scale, and has seen sensible reforms to try and create not simply self-sufficiency, but a surplus of grains and cereals for export. The power industry has been bedeviled by a lack of investment for the past 50 years, but the recent US$2.5 billion handover of 15 facilities to the private sector shows the ambition and appetite to improve on woeful generating capacity of 3,200MW. This industry is the backbone the country's development will grow around.

Effective government and weak institutions often lag the private sector. However, the political outlook is now more multipolar than at any time since Nigeria's return to civilian rule in 1999. A credible opposition to the ruling party has emerged, along with a rump of breakaway governors who are trying to create their own political movement. While much of this is political maneuvering, it has the potential to create a party system in Nigeria that will improve accountability and the quality of debate, as for the first time the electorate has the luxury of choice at the ballot box. There is a chance that power could change hands at elections in 2015, as it has done peacefully in Ghana, Senegal and Sierra Leone in the past decade. That, in itself, is progress.

About the Author

James Knight is a consultant with ten years' experience of working in and with emerging market countries. He is Director of Pionero Partners, a U.K.-based risk and strategic advisory consultancy serving international clients. Prior to his current role he advised a Hong Kong-based fund on various LatAm projects, and previously worked at Barclays Bank plc. He has also handled targeted communications projects for the World Bank and the United Nations. He began his career as a journalist, freelancing for Reuters, The Economist, The Sunday Times, and Africa Confidential covering business, investment and conflict. He holds a degree from Cambridge University.

When Blocs Collide

Jose L. Machinea

Latin America's two largest economic groupings – the Pacific Alliance and the Southern Common Market (Mercosur) – are pursuing further integration into the global economy in very different ways. Whether they succeed will depend not only on their individual strategies, but on whether these strategies complement each other. Only if they do can the region become a significant global player.

The Pacific Alliance – comprising Chile, Colombia, Mexico and Peru – represents nearly 40% of Latin America's GDP, having grown at an average annual rate of 2.9% since 2000. Mercosur's five economies – Argentina, Brazil, Paraguay, Uruguay and Venezuela – account for roughly 50% of the region's GDP, and grew by an average of roughly 3.4% per year during the same period, although growth has slowed since 2010.

But these economies' full potential has yet to be unleashed. While Mercosur has been relatively successful in achieving commercial integration, with intra-bloc trade accounting for 15% of member countries' total trade (and shares larger than 25% for Argentina, Paraguay and Uruguay), it has failed to deepen the integration of markets for goods and services.

Moreover, although trade within the Pacific Alliance stands at only 4%, member countries' leaders were not particularly ambitious at their summit in May. While they agreed to eliminate in the short run all tariffs for 90% of traded goods, the group has yet to make progress toward creating common rules on "accumulation of origin" (whereby member countries treat the commodities that they import from each other as their own).

It is not surprising that the Pacific Alliance, launched in 2012, is lagging behind the two-decade-old Mercosur when it comes to commercial and other forms of integration. But this does not justify its failure to produce more concrete measures, especially given that its member countries are Latin America's most receptive to trade liberalization. Indeed, Pacific Alliance members have the most trade agreements and are among the region's most competitive economies.

Mercosur members, by contrast, remain wary of excessive trade liberalization and, with the exception of Brazil (and to a lesser extent Uruguay), are significantly less competitive. As a result, over the last few years the grouping has increasingly become a source of frustration, failing to advance integration and, in some areas, even regressing.

In fact, despite some political and economic achievements, Mercosur has largely failed to advance the "open regionalism" – economic interdependence and further integration into the world economy through preferential liberalization and deregulation agreements – that the United Nations Economic Commission for Latin America and the Caribbean proposed two decades ago. Mercosur members have established almost no trade agreements with other countries, and the agreement that they have been negotiating for several years with the European Union remains out of reach, apparently because of opposition from Argentina.

But Mercosur, too, is essential to Latin America's global economic integration, owing largely to its core country, Brazil, whose international connections and influence are unmatched in the region. If the Pacific Alliance's creation reflects waning support for Brazil as Latin America's leading voice in the international community, as seems likely, progress toward regional integration, as well as efforts to negotiate greater economic integration with Asia-Pacific countries (one of the Alliance's core objectives), could be more difficult.

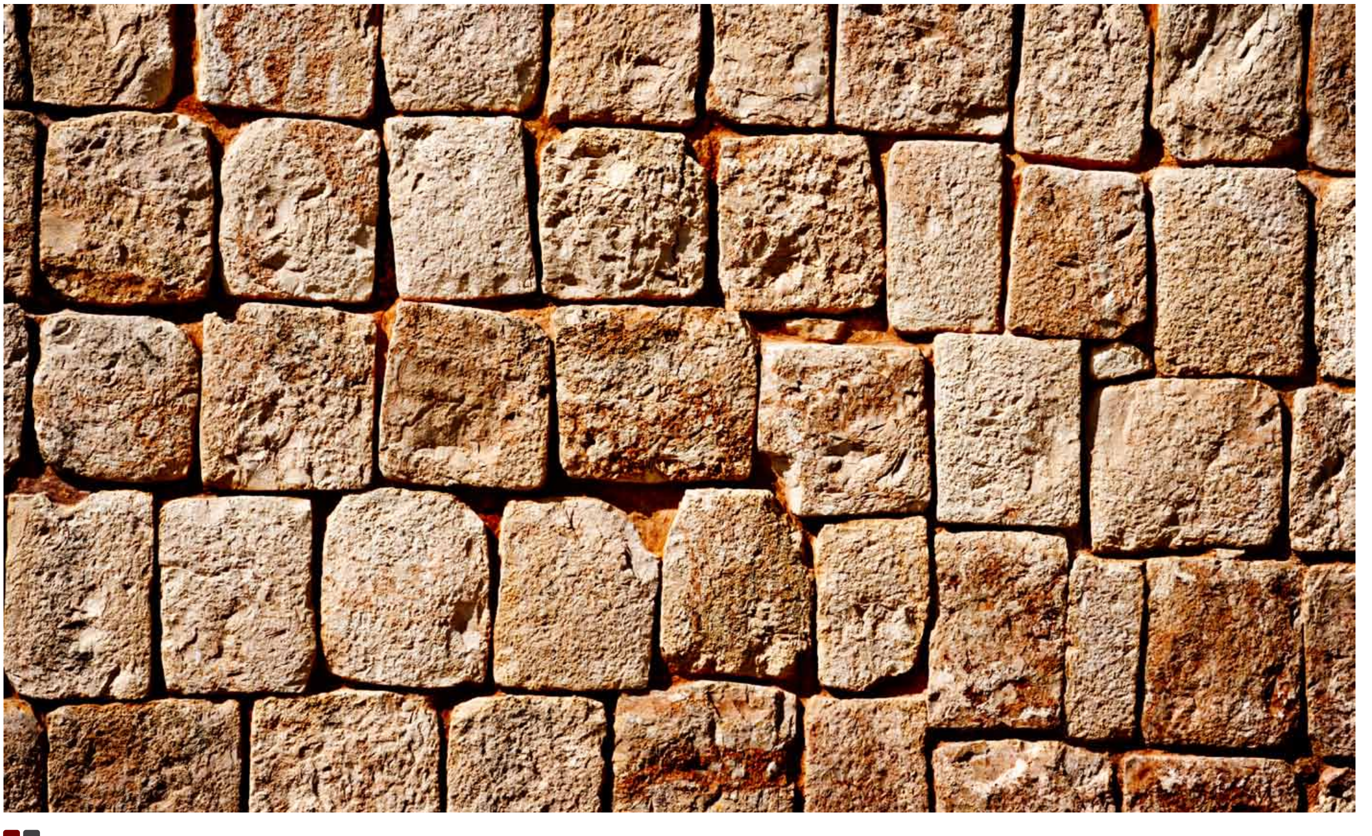
Against this background, competition between the two groupings would be damaging to all. If Mercosur and the Pacific Alliance fail to devise complementary integration strategies, other countries may well decide that it is worth cooperating only with the Alliance, leaving Mercosur to fade into irrelevance. But without Mercosur's economic muscle, the Pacific Alliance countries would be unable to power Latin America's rise to global prominence.

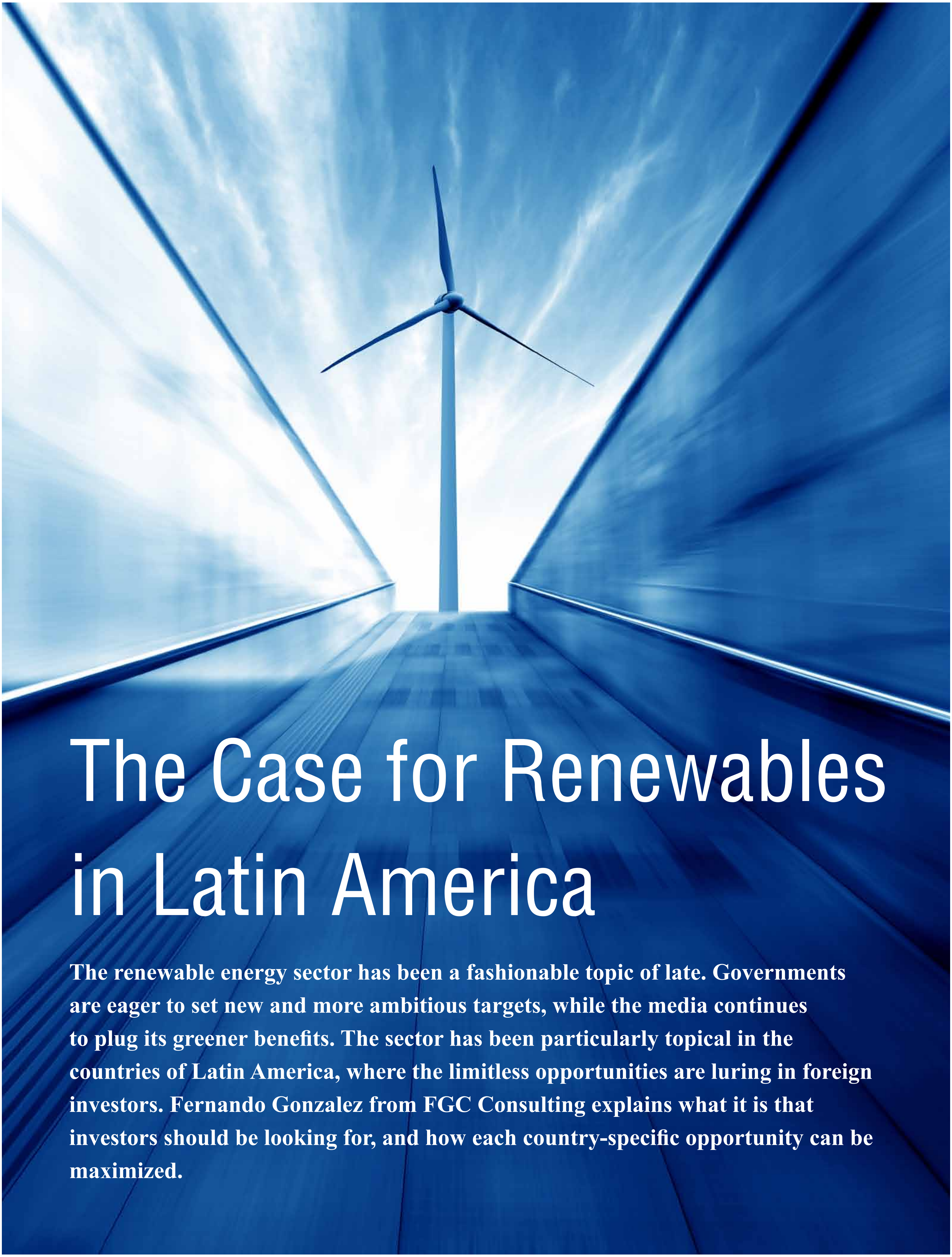
Even with a constructive approach, achieving deeper, higher-quality economic integration with Asia's emerging economies will be difficult. Latin America's exports to what is now the world's fastest-growing region are concentrated among primary goods. For example, 70% of Latin America's exports to China in 2010 were commodities, and 25% were goods manufactured from these materials, often with little added value.

This highlights a significant problem for Latin America. Asian countries, like the developed economies, have a tariff-escalation system: the higher the value added to primary goods, the higher the protection. So, if Latin American countries wanted to export higher-value-added goods, they would face significantly higher tariffs, undermining their competitiveness in Asian markets.

Given this, comprehensive free-trade agreements are essential. But while trade deals could provide opportunities for increased participation in global value chains, their impact would be limited without policies aimed at improving competitiveness and diversifying the production structure. Increased regional cooperation would accelerate this process.

Together, Latin America's economic groupings can provide an important platform from which to improve domestic economic stability, increase competitiveness, bolster regional integration, and gain a greater role in the global economy. Indeed, with bold, comprehensive and harmonious strategies, Mercosur and the Pacific Alliance could finally secure Latin America's status as one of the world's major economic players.





The Case for Renewables in Latin America

The renewable energy sector has been a fashionable topic of late. Governments are eager to set new and more ambitious targets, while the media continues to plug its greener benefits. The sector has been particularly topical in the countries of Latin America, where the limitless opportunities are luring in foreign investors. Fernando Gonzalez from FGC Consulting explains what it is that investors should be looking for, and how each country-specific opportunity can be maximized.

Latin America has the highest participation of renewable energy projects in the world, although it is important for investors to understand that each country has its own regulatory policies and culture. When looking at Chile, for example, the country has two main separate energy systems: the central system and the northern system. While the former has a combination of thermal and hydro assets, the latter is almost entirely thermal. And while the country has established a minimum requirement of energy coming from non-conventional renewable sources, the goal is to double that by 2024. That is opening opportunities to invest in a market that has a very good history of reliable regulation and great liquidity. This has resulted in a number of renewable projects (mainly solar) in the northern system.

Meanwhile, Brazil, which is, from my point of view, the leading country of renewable energy development, is very reliant on hydro power. Brazil began its auctions for renewable energy a few years ago and has been very successful with small hydro (PCHs) and wind projects. The market is currently very competitive, so prices are trending low, but the country has a good program, and Brazil has been very consistent in trying to develop its market by fostering energy initiatives.

Looking at how foreign operators can work in Latin America, I always suggest finding strong local partners. In most of these markets there is a good combination of well established companies that are looking to participate in renewable energy projects, and a well established entrepreneurship culture.

Market Players and Challenges

Renewable energy projects are generally smaller in size than traditional projects, and it is unlikely that we will see 600, 700 or 1000 megawatt projects in the renewables space. Traditionally for conventional energy you have the bigger international players, mainly American and European companies, that are involved in the larger projects, but for smaller projects (both conventional and renewable) there are tremendous opportunities in the region, and that is where I am generally focused. Latin America is growing much faster than the advanced economies (GDP growth in Latin America and the Caribbean for the period 2007-12 was about 8.7%, while advanced economies grew 2.2%), and that has resulted in high very high levels of local liquidity in most of these markets. This capital is now available (and eager) to develop these renewable energy projects.

I feel that it is important for developers working on smaller projects in Latin America to manage their expectations accordingly. One of the biggest risks can be overestimating project revenues or underestimating the cost and timing of projects. Investors need to be properly advised about what to expect when putting their money to work in this space. Investors need to outline what their risk appetite is, what returns they want, and how long they want the investment for. After that, it is important to research the different countries, to find the right opportunity to match their risk profile. They should also look at currency issues. Historically, some countries in Latin America have had very volatile currencies, so the investor needs to take a deeper look at whether they are willing to take some currency risks, or if they want to stay in a dollar market. Some countries, for reasons mainly related to the fuels and natural resources, have prices more aligned with the U.S. dollar, some others, like Brazil, for example, are clearly very local currency focused.

Why Look to Latin America for Renewables?

Latin America is growing, and that, naturally, results in the need to install new capacity to satisfy the demand. Some significant crises of recent years have played themselves out but that does not mean that all of the political and macroeconomic issues have been resolved. However, the economies are much more open and integrated, so there is a little less macroeconomic drama; and of course macroeconomic growth drives demand, and energy demands growth. Demand is growing faster than the Latin American countries' installed capacity, so there is an immediate need to invest in energy infrastructure, and the renewable energy sector is something that everyone is interested in. And technological innovation and competition in the last few years have made renewable energy more competitive with conventional energy and, therefore, less reliant on subsidies or special regulations. There is still room to improve but the trend has been really encouraging.

For investors asking themselves why they should choose Latin America for renewables, it is the combination of the regulatory environment's growth expectations as well as the evolution of the region's technology and resources (natural, economic and human). There are plentiful of hydro resources in the region, as well as vast amounts of wind and solar potential. In a world where nobody knows what oil prices are going to be, renewable energy projects, where prices can be established and fixed in long-term contracts, bring predictability to local economies. And as the world population and energy demand increases, renewable technology is going to be even more competitive.

One of the biggest misconceptions that I saw among investors looking at opportunities in the region is that they think local resources and markets are not that well developed. I find this groundless. There are very different ways to approach renewable energy issues (regulation may vary, from energy banks to offset intermittency of supply to fast-track processes for renewables, to feed-in tariffs), but one thing is almost sure, based on my experience: the human capital is really good.

Finally, investors need to be vary careful in managing their expectations on timing to get the project operational. Renewable energy projects, while having a positive impact on the environment, still have to go through regulatory and environmental approvals, regardless of how beneficial and needed they are. The fact is, despite the high demand for power, investors cannot take shortcuts and can get away with failing to take care of the environment.

About the Author

Fernando Gonzalez is the Managing Director and founder of FGC Consulting LLC. His expertise was developed through more than 18 years of work in a Big Four Accounting Firm, and Fortune 500 and Private Equity backed start-up companies.

Mr. Gonzalez served as Executive Vice-President and Chief Financial Officer for ContourGlobal, a power development company based in the US, with operations in over 13 countries in the Americas, Europe and Africa.

Prior to ContourGlobal, at The AES Corporation, a Fortune 500 global power company with operations in 29 countries, he was Regional CFO for Europe, CIS and Africa and Director of the Restructuring Office and Office of the Integrated Utilities. His work has spanned over 7 years in Buenos Aires, Argentina; Arlington, VA, US as well as in London, UK.

Before joining AES, Mr. Gonzalez worked for 6 years in Arthur Andersen's office in Buenos Aires, Argentina, in the Audit and Advisory area. His main clients included power, insurance and waste management companies.

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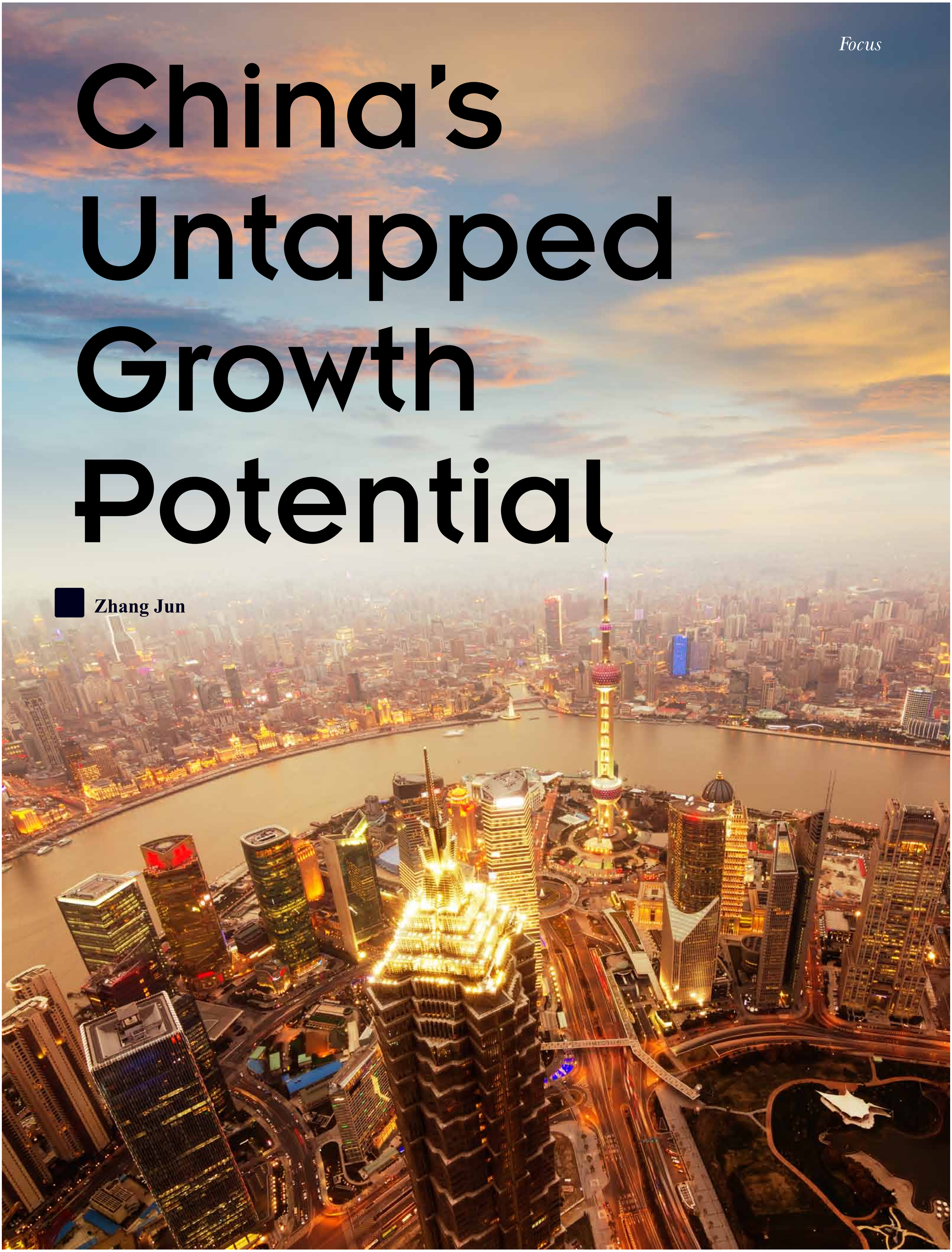
China's Untapped Growth Potential

Zhang Jun



China's economic slowdown, from a nearly 10% annual output gain in 2007 to below 8% today, has fueled widespread speculation about the economy's growth potential. While it is impossible to predict China's future growth trajectory, understanding the economy's underlying trends is the best way to develop a meaningful estimate.

Whereas short-term demand largely dictates an economy's real growth rate, its potential growth rate is determined on the supply side. Some economists – citing indicators like investment ratios, industrial value-added, and employment – compare China to Japan in the early 1970s. After more than two decades of sustained rapid growth, Japan's economy slackened considerably in 1971, leading to four decades of annual growth rates averaging less than 4%.

This correlation is reinforced by the convergence hypothesis – the benchmark theory for estimating an economy's potential growth rate – which states that a rapidly growing developing economy's real growth rate will slow when it reaches a certain share of the per capita capital stock and income of an advanced economy. According to the economists Barry Eichengreen, Donghyun Park and Kwanho Shin, that share is about 60% of America's per capita income (at 2005 international prices).

At first glance, the experiences of Asia's most advanced economies – Japan and the four "Asian Tigers" (Hong Kong, Singapore, South Korea and Taiwan) – seem to be consistent with this theory. In 1971-1973, Japan's per capita GDP fell to roughly 65% of that of the U.S. in purchasing-power-parity terms, while the Asian Tigers experienced economic downturns of varying degrees when they reached roughly the same income level relative to Japan.

But Eichengreen, Park and Shin also found that once this income level is reached, annual growth rates tend to fall by no more than two percentage points. This means that GDP growth should have slowed gradually in Japan after 1971, instead of plummeting by more than 50%. Likewise, given the remaining income gap with the U.S., the Asian Tigers should have grown faster than they have in the last two decades. But they each suffered a substantial slowdown (albeit less sharp than Japan's).

Indeed, considering that China's per capita income amounts to only about 10-20% of that of the U.S., with massive regional differentials within China, its growth potential, as dictated by the convergence hypothesis, is far from tapped.

These inconsistencies can be explained by external shocks – a point emphasized by Hideo Kobayashi in his book "Post-War Japanese Economy and Southeast Asia." During Japan's economic boom, its total factor productivity (TFP, or the efficiency with which inputs are used) contributed about 40% to GDP growth. When growth plummeted, TFP fell even faster – a dramatic change that was clearly linked to the 1971 yen appreciation and the 1973 oil crisis.

From a microeconomic perspective, a sudden exchange-rate shock and sharp increase in oil prices impedes firms' ability to adjust their technology and production methods to meet new cost conditions, eventually undermining TFP growth. Such a cost shock has a more prolonged effect than a negative demand shock. Without negative external shocks, exorbitant TFP growth would have declined gradually, as the returns from institutional adjustment, reallocation of resources, and technological catch-up naturally diminished, in accordance with the convergence hypothesis.

External shocks also explain China's GDP slowdown since 2007. The renminbi's gradual yet sustained appreciation against the U.S. dollar is the cost shock's main driver, but the demand shock that followed the 2008 global financial crisis aggravated the situation. It is likely that TFP has declined substantially as China's economy has slowed in response to these shocks.

Unlike Keynesians, who focus on demand shocks, followers of the Austrian economist Joseph Schumpeter view cost shocks as important potential catalysts for structural reform and industrial upgrading – both of which are needed to avoid falling into a low-growth rut in the long term. In the short term, a cost shock devastates some economic activities, forcing companies either to shut down or move on to another line of business. But what Schumpeter called "creative destruction" can facilitate the eventual emergence and expansion of new, more efficient firms.

The problem is that many country-specific factors, such as political concerns and pressure from vested interests, can impede this process. In this sense, China's government is facing an important test. If it fails to take advantage of the opportunity provided by the cost shock and economic slowdown to implement the necessary structural reforms, China's potential growth rate, as dictated by TFP, will never rebound fully.

Given that improving overall productivity is the best way to defend against cost shocks, the new round of structural reform should be aimed at creating conditions for economic transformation and upgrading. The key is to establish a level playing field guided by market rules, reduce government intervention in the economy, and stop protecting inefficient businesses. Such efforts would go a long way toward increasing China's potential growth rate.

Indeed, considering that China's per capita income amounts to only about 10-20% of that of the U.S., with massive regional differentials within China, its growth potential, as dictated by the convergence hypothesis, is far from tapped. But the degree to which it can fulfill this potential in the coming decades will depend largely on its TFP prospects.

In 2007, the economists Dwight Perkins and Thomas Rawski estimated that, in order for China's economy to maintain a 9% growth rate and a 25-35% investment ratio until 2025, it would need to maintain an annual TFP growth rate of 4.3-4.8%. Given that China's TFP growth has averaged 4% for more than 30 years, and is likely to slow in the coming decade, this scenario is improbable.

Maintaining 6% annual GDP growth with the same investment ratio would require annual TFP growth of only 2.2-2.7%. With China's productivity still well below that of developed countries, and allocational efficiency likely to improve in the next 10 years as labor and capital are redistributed across the country, 3% TFP growth is feasible. Aided by structural reforms, China's economy could expand even faster, achieving 7-8% annual growth over the next ten years. Either way, convergence will remain swift.

Financial Safety Nets for Asia

Lee Jong-Wha

Emerging economies are facing significant uncertainty and serious downside risks. One major source of instability is the looming reversal of the U.S. Federal Reserve's expansionary monetary policy – the prospect of which is generating volatility in global financial markets and threatening to disrupt emerging-economy growth.

The Fed has signaled that its federal funds rate will remain near 0%, at least as long as unemployment exceeds 6.5% and inflation expectations remain well anchored. But when and how the Fed will begin tightening monetary policy remains unclear. What is certain is that, in making its decision, the Fed will not consider its policy's spillover effects on the rest of the world, leaving affected countries' policymakers and central bankers to deal with the fallout.

Tighter U.S. monetary policy could intensify the global credit shortage, thereby increasing pressure on Asia's economic and financial systems. Overreaction and herding behavior by market participants could trigger a sudden reversal of capital inflows, with a severe dollar shortage – as occurred in 1997 and 2008 – straining Asian banks and corporations.

These risks explain why the Fed's mere suggestion of a potential move toward reducing its purchases of long-term assets (so-called quantitative easing) caused emerging-market currencies and asset prices to plummet this summer. They also underscore Asian economies' need for stronger financial safety nets.

The 2008 global financial crisis revealed fundamental flaws in the international monetary system, as the failure to ensure sufficient liquidity weighed heavily on emerging Asian economies. Since then, these countries have taken measures to safeguard the stability of their financial systems against volatile external shocks, strengthen financial supervision and regulation, and develop more effective macroeconomic frameworks, including better macro-prudential regulation and capital-control measures. But their heavy reliance on international trade and capital flows means that they remain vulnerable to severe financial spillovers from the U.S.

Moreover, since the 1997 Asian financial crisis, the region's emerging economies have increased their holdings of foreign-exchange reserves, and they now possess

more than half of the world's total. Seven of the world's top 10 reserve-holding economies are in Asia. But hoarding international reserves, mostly in the form of low-yielding short-term U.S. Treasury securities, is expensive and inefficient.

Some Asian economies, especially China, are also attempting to internationalize their currencies. Given China's expanding global influence, the renminbi's emergence as a new international currency is inevitable. For smaller economies, however, internationalization will be far more difficult.

In their quest to ensure sufficient liquidity, Asian economies have also actively pursued currency-swap arrangements. Since 2008, China has signed 23 bilateral swap agreements, including one with South Korea. Japan expanded bilateral swap facilities with its Asian neighbors during the global financial crisis. And the 10 ASEAN countries, together with China, Japan and South Korea, have constructed a US$240 billion regional reserve pool to provide short-term liquidity to members in an emergency.

Such swaps should help Asian countries to cope with currency turmoil in the wake of a Fed policy reversal. But they remain untested and, given their relatively small volumes, cannot reassure markets or provide adequate emergency support to crisis countries, especially in the event of large-scale systemic shocks.

The Fed, as the *de-facto* global lender of last resort, can improve significantly the effectiveness of Asia's financial safety nets by establishing currency-swap arrangements with emerging economies' central banks during the policy-reversal process.

In 2008, the Fed established currency-swap lines with the central banks of 10 developed economies, including the eurozone, the U.K., Japan, and Switzerland, and four emerging economies (Brazil, South Korea, Mexico and Singapore). These arrangements, most of which ended in 2010, responded to strains in short-term credit markets and improved liquidity conditions during the crisis. The South Korean central bank's US$30 billion swap, though limited, averted a run on the won.

Reestablishing the Fed's swap arrangements with emerging economies would minimize negative spillovers during the coming monetary-policy reversal. Even an announcement by the Fed stating its willingness to do so would go a long way toward reassuring markets that emerging economies can avert a liquidity crisis.

The swap lines would also serve American interests. After all, trouble in emerging economies would destabilize the entire global economy, threatening the fragile recoveries of advanced economies, including the U.S. And, given China's rise, it is clearly in America's interest to maintain a balance of economic power in Asia.

Critics might cite the moral-hazard risk generated by liquidity support. But a well-designed framework that offers swap lines only to well-qualified emerging economies – and only temporarily – would diminish this risk substantially.

In fact, some experts, such as the economist Edwin Truman, have proposed establishing an institutionalized global swap arrangementas as a more effective and robust crisis-prevention mechanism – an idea that G-20 countries should consider. But creating such a system would take time. In the meantime, the Fed should take the initiative by reestablishing swap lines with advanced and emerging economies alike.

The Real Heroes of the Global Economy

Dani Rodrik

Economic policymakers seeking successful models to emulate apparently have an abundance of choices nowadays. Led by China, scores of emerging and developing countries have registered record-high growth rates over recent decades, setting precedents for others to follow. While advanced economies have performed far worse on average, there are notable exceptions, such as Germany and Sweden. "Do as we do," these countries' leaders often say, "and you will prosper, too."

Look more closely, however, and you will discover that these countries' vaunted growth models cannot possibly be replicated everywhere, because they rely on large external surpluses to stimulate the tradable sector and the rest of the economy. Sweden's current-account surplus has averaged above a whopping 7% of GDP over the last decade; Germany's has averaged close to 6% during the same period.

China's large external surplus – above 10% of GDP in 2007 – has narrowed significantly in recent years, with the trade imbalance falling to about 2.5% of GDP. As the surplus came down, so did the economy's growth rate – indeed, almost point for point. To be sure, China's annual growth remains comparatively high, at above 7%. But growth at this level reflects an unprecedented – and unsustainable – rise in domestic investment to nearly 50% of GDP. When investment returns to normal levels, economic growth will slow further.

Obviously, not all countries can run trade surpluses at the same time. In fact, the successful economies' superlative growth performance has been enabled by other countries' choice *not* to emulate them.

But one would never know that from listening, for example, to Germany's finance minister, Wolfgang Schäuble, extolling his country's virtues. "In the late 1990s, [Germany] was the undisputed 'sick man' of Europe," Schäuble wrote recently. What turned the country around, he claims, was labor-market liberalization and restrained public spending. In fact, while Germany did undertake some reforms, so did others, and its labor market does not look substantially more flexible than what one finds in other European economies. A big difference, however, was the turnaround in Germany's external balance, with annual deficits in the 1990s swinging to a substantial surplus in recent years, thanks to its trade partners in the eurozone and, more recently, the rest of the world. As Martin Wolf of the *Financial Times*, among others, has pointed out, the German economy has been free-riding on global demand.

Other countries have grown rapidly in recent decades without relying on external surpluses. But most have suffered from the opposite syndrome – excessive reliance on capital inflows, which, by spurring domestic credit and consumption, generate temporary growth. But recipient economies are vulnerable to financial-market sentiment and sudden capital flight, as happened recently when investors anticipated monetary-policy tightening in the U.S.

Consider India, until recently another much-celebrated success story. India's growth during the past decade had much to do with loose macroeconomic policies and a deteriorating current account – which recorded a deficit of more than 5% of GDP in 2012, having been in surplus in the early 2000s. Turkey, another country whose star has faded, also relied on large annual current-account deficits, reaching 10% of GDP in 2011.

Elsewhere, small, formerly socialist economies – Armenia, Belarus, Moldova, Georgia, Lithuania and Kosovo – have grown very rapidly since the early 2000s. But look at their average current-account deficits from 2000 to 2013, which range from a low of 5.5% of GDP in Lithuania to a high of 13.4% in Kosovo, and it becomes evident that these are not countries to emulate.

The story is similar in Africa. The continent's fastest-growing economies are those that have been willing and able to allow yawning external gaps from 2000 to 2013: 26% of GDP, on average, in Liberia, 17% in Mozambique, 14% in Chad, 11% in Sierra Leone, and 7% in Ghana. Rwanda's current account has deteriorated steadily, with the deficit now exceeding 10% of GDP.

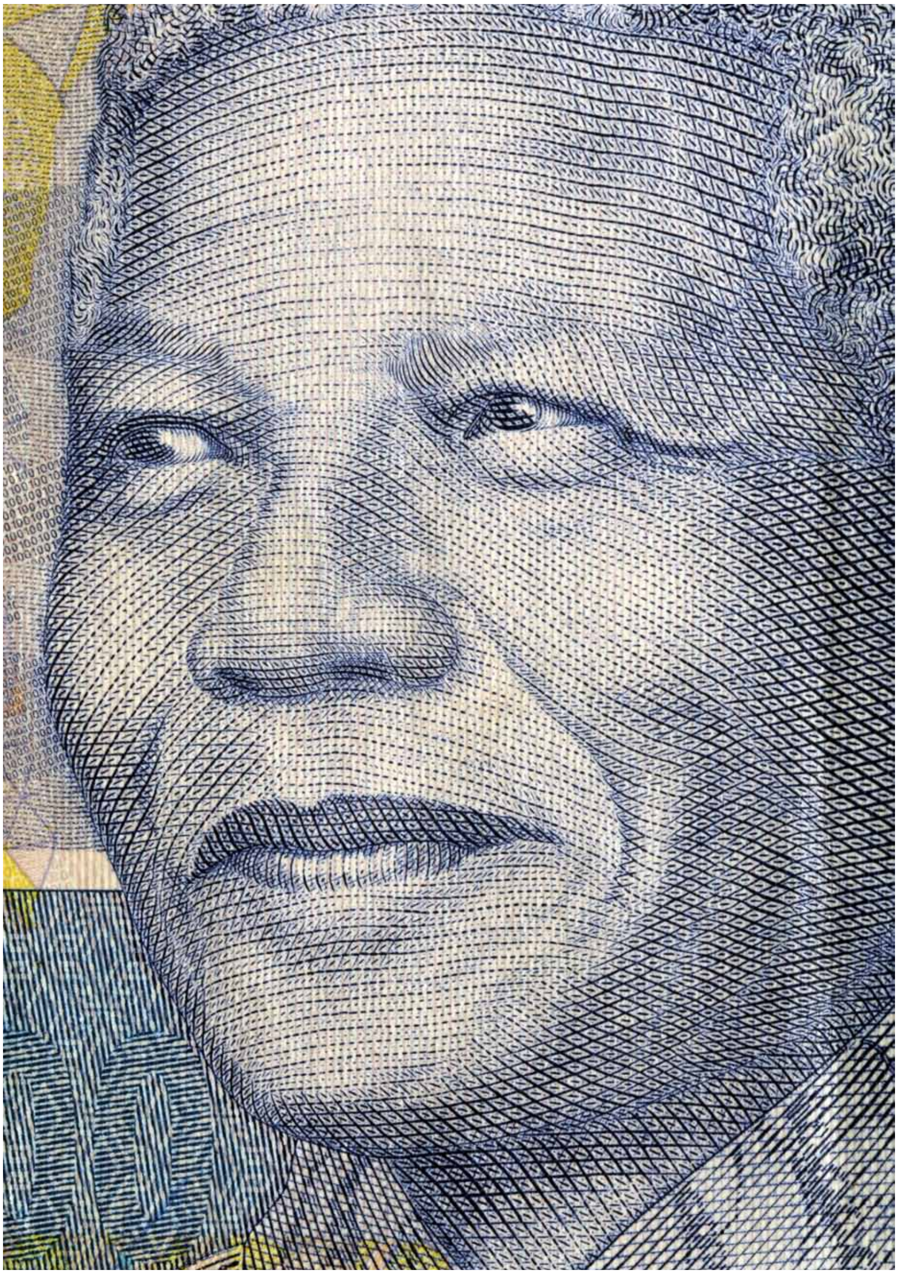
The world's current-account balances must ultimately sum up to zero. In an optimal world, the surpluses of countries pursuing export-led growth would be *willingly* matched by the deficits of those pursuing debt-led growth. In the real world, there is no mechanism to ensure such an equilibrium on a continuous basis; national economic policies can be (and often are) mutually incompatible.

When some countries want to run smaller deficits without a corresponding desire by others to reduce surpluses, the result is the exportation of unemployment and a bias toward deflation (as is the case now). When some want to reduce their surpluses without a corresponding desire by others to reduce deficits, the result is a "sudden stop" in capital flows and financial crisis. As external imbalances grow larger, each phase of this cycle becomes more painful.

The real heroes of the world economy – the role models that others should emulate – are countries that have done relatively well while running only small external imbalances. Countries like Austria, Canada, the Philippines, Lesotho and Uruguay cannot match the world's growth champions, because they do not over-borrow or sustain a mercantilist economic model. Theirs are unremarkable economies that do not garner many headlines. But without them, the global economy would be even less manageable than it already is.

South Africa Breaks Out

Joseph E. Stiglitz



International investment agreements are once again in the news. The United States is trying to impose a strong investment pact within the two big so-called "partnership" agreements, one bridging the Atlantic, the other the Pacific, that are now being negotiated. But there is growing opposition to such moves.

South Africa has decided to stop the automatic renewal of investment agreements that it signed in the early post-apartheid period, and has announced that some will be terminated. Ecuador and Venezuela have already terminated theirs. India says that it will sign an investment agreement with the U.S. only if the dispute-resolution mechanism is changed. For its part, Brazil has never had one at all.

There is good reason for the resistance. Even in the U.S., labor unions and environmental, health, development, and other nongovernmental organizations have objected to the agreements the U.S. is proposing.

The agreements would significantly inhibit the ability of developing countries' governments to protect their environment from mining and other companies; their citizens from the tobacco companies that knowingly purvey a product that causes death and disease; and their economies from the ruinous financial products that played such a large role in the 2008 global financial crisis. They restrict governments even from placing temporary controls on the kind of destabilizing short-term capital flows that have so often wrought havoc in financial markets and fueled crises in developing countries. Indeed, the agreements have been used to challenge government actions ranging from debt restructuring to affirmative action.

Advocates of such agreements claim that they are needed to protect property rights. But countries such as South Africa already have strong constitutional guarantees of property rights. There is no reason that foreign-owned property should be better protected than property owned by a country's own citizens.

Moreover, if constitutional guarantees are not enough to convince investors of South Africa's commitment to protecting property rights, foreigners can always avail themselves of expropriation insurance provided by the Multilateral Investment Guarantee Agency (a division of the World Bank) or numerous national organizations providing such insurance. (Americans, for example, can buy insurance from the Overseas Private Investment Corporation.)

But those supporting the investment agreements are not necessarily concerned about protecting property rights, anyway. The real goal is to restrict governments' ability to regulate and tax corporations – that is, to restrict their ability to impose responsibilities, not just uphold rights. Corporations are attempting to achieve by stealth – through secretly negotiated trade agreements – what they could not attain in an open political process.

Even the notion that this is about protecting foreign firms is a ruse: companies based in country A can set up a subsidiary in country B to sue country A's government. American courts, for example, have consistently ruled that corporations need not be compensated for the loss of profits from a change in regulations (a so-called regulatory taking); but, under the typical investment agreement, a foreign firm (or an American firm, operating through a foreign subsidiary) can demand compensation.

Worse, investment agreements enable companies to sue the government over perfectly sensible and just regulatory changes – when, say, a cigarette company's profits are lowered by a regulation restricting the use of tobacco. In South Africa, a firm could sue if it believes that its bottom line might by harmed by programs designed to address the legacy of official racism.

There is a long-standing presumption of "sovereign immunity," under which states can be sued only under limited circumstances. But investment agreements like those backed by the U.S. demand that developing countries waive this presumption and permit the adjudication of suits according to procedures that fall far short of those expected in modern democracies. Such procedures have proved to be arbitrary and capricious, with no systemic way to reconcile incompatible rulings issued by different panels. While proponents argue that investment treaties reduce uncertainty, the ambiguities and conflicting interpretations of these agreements' provisions have increased uncertainty.

Countries that have signed such investment agreements have paid a high price. Several have been subject to enormous suits – and enormous payouts. There have even been demands that countries honor contracts signed by previous non-democratic and corrupt governments, even when the International Monetary Fund and other multilateral organizations have recommended that the contract be abrogated.

Even when developing-country governments win the suits (which have proliferated greatly in the last 15 years), the litigation costs are huge. The (intended) effect is to chill governments' legitimate efforts to protect and advance citizens' interests by imposing regulations, taxation, and other responsibilities on corporations.

Moreover, for developing countries that were foolish enough to sign such agreements, the evidence is that the benefits, if any, have been scant. In South Africa's review, it found that it had not received significant investments from the countries with which it had signed agreements, but had received significant investments from those with which it had not.

It is no surprise that South Africa, after a careful review of investment treaties, has decided that, at the very least, they should be renegotiated. Doing so is not anti-investment; it is pro-development. And it is essential if South Africa's government is to pursue policies that best serve the country's economy and citizens.

Indeed, by clarifying through domestic legislation the protections offered to investors, South Africa is once again demonstrating – as it has repeatedly done since the adoption of its new Constitution in 1996 – its commitment to the rule of law. It is the investment agreements themselves that most seriously threaten democratic decision-making.

South Africa should be congratulated. Other countries, one hopes, will follow suit.

Dangote Cement and Its (so far) Successful Bet on African Real Estate

Federico Chirico

Dangote Cement is assuming a higher profile, if only for the fact that its CEO will co-chair the next World Economic Forum. Dangote is one of the most prominent cement producers Africa, is the most capitalized company on the Nigerian stock exchange and the fifth most capitalized on the continent. Its good performance in previous years has been confirmed by excellent figures for the first half of 2013, and the infrastructure outlook for the continent seem to indicate a bright future for a company that will shortly be listed on the London Stock Exchange.

Would you invest your money in a company whose business is strictly real estate construction? That is probably not the area where an investor would "seek the Alpha" considering past events and current market circumstances.

Africa, however, seems to present a completely different story. The fastest growing continent in terms of population and GDP is facing a persistent housing deficit and increased government focus on public infrastructure and urbanization, making it an interesting venue for real estate investment despite still-low levels of GDP per capita. The Nigerian government budget for 2013, for instance, allocated 32.5% of capital spending on infrastructure development – an increase of more than 8% since 2011, with further upside potential in the coming years. Other African countries are following on the same path.

With a market share of over 60%, Dangote is the largest producer of cement in Nigeria, the most populous country on the continent with 174 million people. Besides the financial solidity of its main shareholder (Aiko Dangote is the richest man in Africa) the company has demonstrated sound management by consolidating its national market share and expanding its operations all over Africa. Analysts expect Dangote to become the largest local cement producer and exporter by 2016, with a production capacity of 55 million metric tons. It is therefore no surprise to see Dangote severely outperforming the already positive performance of the Nigerian stock market for 2013, with a price per-

formance of about 150% compared with an index performance of around 130%.

These data are confirmed by the impressive interim financial figures presented by the company for the first part of 2013. Thanks to its cement plants' capacity expansion, gross revenue grew by 28.5% year on year, while the operating margin increased to 55.9% in June 2013, against 49.5% in the same period in 2012. These are excellent results that could lead to a more favorable financial exposure. Dangote's consistent track record and performance will allow the company to improve its risk profile, managing to secure cheaper funding from institutional lenders. The company's loan exposure overall increased, but short-term borrowing decreased by 28.7%, leaving space for long-term debt better matching its business needs.

Foreign exchange risk and lack of liquidity of the Nigerian stock market still make it difficult to invest in the company, but once the holding finalizes its listing on the London stock market, these risks will be eliminated, making the company an interesting bet.

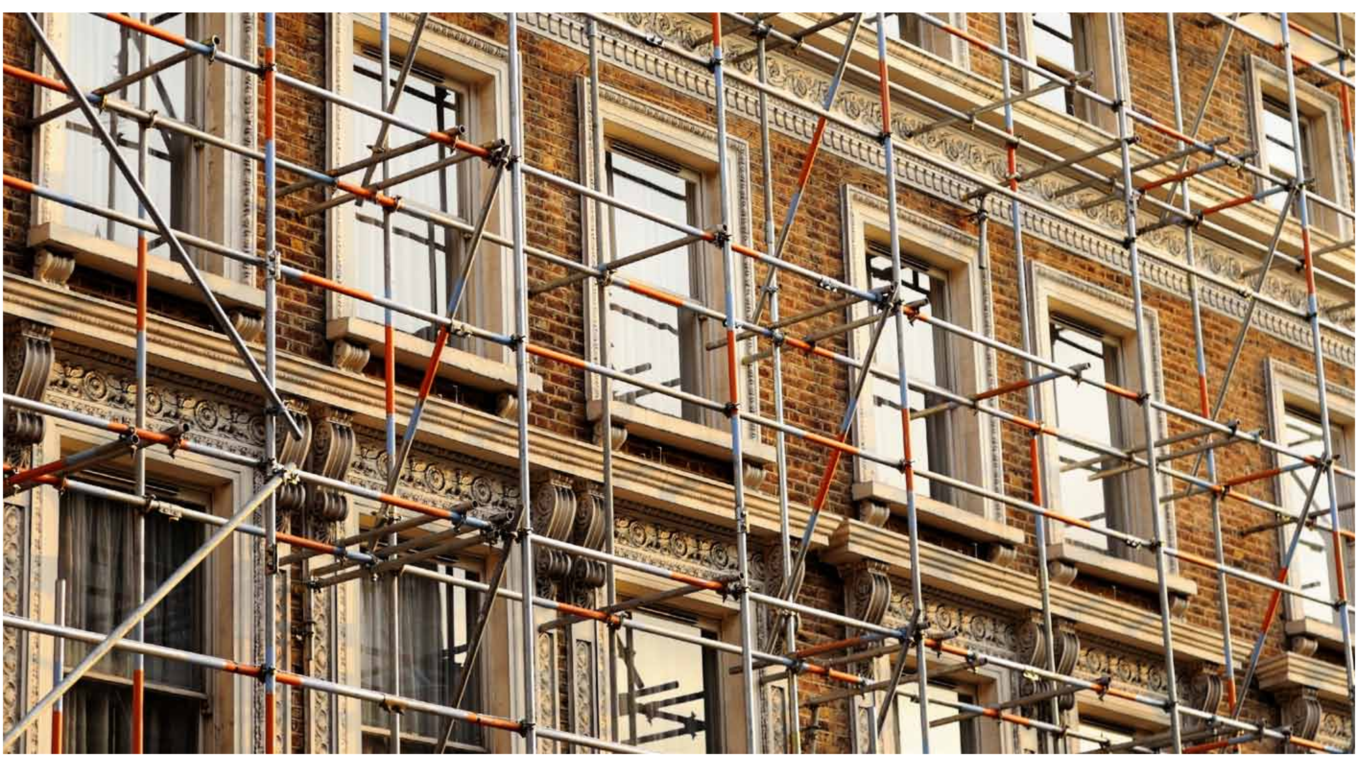
About the Author

Federico Chirico is the founder and editor of "The African Frontier," a blog dedicated to the discovery of African financial markets. He started his career in UBS Investment Bank in 2007, and he then moved to Ghana for a few years where we worked as business analyst for a Ghanaian based financial boutique called Canal Capital. Currently, Mr Chirico works for a large media and information company as financial markets executive, and is a CFA level 2 candidate.
www.theafricanfrontier.wordpress.com

The Re-emerging UK Real Estate Market

Why EM Investors Are Looking to the United Kingdom

Investors from emerging markets are turning increasingly to U.K. real estate as a reliable, long-term investment target. As the market grows crowded, however, they are taking a more granular approach to it, seeking low-leverage opportunities in supply-constrained sectors. The residential sector in particular is garnering investor attention, as demographic trends and government policies point to strong fundamentals in the short and long term. Of the many facets of the residential sector, the provision of consented land to the house-building industry, offers perhaps the best opportunity.



Port of Call

After the fallout of 2008-2009, U.K. real estate quickly became a target for emerging market investors, especially from Asia, and in recent years the market has solidified its standing as a top destination for global investors in general. According to the recent Global Investor Appetite Survey, published by Nabarro, a global real estate law firm based in the U.K., 73% of the 600 investors interviewed were likely to increase their allocations into U.K. real estate in the next two years.

Investment is coming from all parts of the globe, but Asian investors have taken the lead since the last financial crisis. A recent feature in the *Financial Times* highlighted the emergence of these investors, and the surprising role of Malaysia in particular.

Chris Westerman, Sales Director at Lucent Group, which advises the Lucent Strategic Land Fund (a Luxembourg-domiciled, open-ended SICAV SIF) has observed the prominent role of Malaysia.

"Malaysia has emerged as the second largest investor into U.K. real estate in recent months. The size of Malaysia's pension funds, relative to their domestic stock and bond markets, has encouraged them to look overseas and the U.K. has been a primary beneficiary."

They are being joined by Brazilian pension funds which are looking increasingly at alternative asset classes abroad in response to low domestic fixed-income rates. Offshore oriented Chinese insurance funds bolstered by government policy changes, abundant liquidity and local currency appreciation are also increasingly looking offshore.

"These investors are attracted to transparent 're-emerging' or developed markets such as the U.K.," says Mr. Westerman, whose fund is domiciled in Luxembourg but focused on U.K. land investments for residential development. "And in today's global market place, wherever an investor is based, a sound investment proposition, wherever it is in the world, is something that will be considered."

After the fallout of 2008-2009, U.K. real estate quickly became a target for emerging market investors, especially from Asia, and in recent years the market has solidified its standing as a top destination for global investors in general.

Demographics, Policy, Pricing

Global investors' taste for U.K. real estate can be attributed to such factors as the reliable legal system, strong education institutions, the convenient time zone, and low prices in the wake of 2008-2009, which is precisely when they began to enter the market more strongly. In addition, the U.K. real estate market boasts important fundamentals that distinguish it from other developed markets.

"The recovery in the U.K. residential sector has differed from that occurring in either the E.U. or the U.S.," says Mr. Westerman, "because of the unique political and demographic circumstances that are driving the market in England."

He points in particular to long-term demographic trends. The U.K.'s population is expected to grow from 61.4 million in 2008 to 71.6 million in 2033, an increase of nearly 17%. At the same time, household density is set to fall from 2.3 to 2.15 persons per household between 2013 and 2033.

To meet this projected household growth, figures from the U.K. government's Department of Communities and Local Government suggest that 5.8 million housing completions are needed in England in the 25-year period between 2008 and 2033. An increase of 61% over the current level of housing completions will be needed every year in that 25 year period in order to meet that additional demand. To meet this demand, several stimulus measures were introduced in the budget of April 2013, including the Help To Buy Mortgage Guarantee scheme, the Help To Buy Equity Loans scheme and the Build To Let scheme. The results are already apparent, with home mortgage approvals up 25% since January.

Asset prices are also up, with house prices rising 5.4% in the year to August 2013, and the consensus is that this trend is gaining momentum, particularly for newly built homes. According to the Construction Register, newly built homes in the U.K. are more popular than ever before, while a recent survey by Halifax on house prices shows that new builds are outperforming the rest of the U.K. housing market, with an average value 9% above the norm.

Chronic Under-Supply

But even as these policy measures stimulate demand, supply is nowhere close to meeting it. "There is no way anytime soon that the sector will be overburdened by an oversupply of housing" says Mr. Westerman, whilst also stressing that all political parties in the U.K. appreciate the gravity of the situation. "The housing shortage in the U.K. is so acute that there is absolute cross-party political support for the need to increase housing supply and this is unlikely to change before the end of the next Parliament in 2020."

An editorial in the Economist online, published on September 19, puts it bluntly: "With demand outstripping supply by such a large amount, the priority seems clear. Build more houses; build more flats."

In Search of Land

One of the major problems facing the sector is a shortage of consented land for the development of new homes.

Mr. Westerman says this shortage remains the single biggest constraint to increasing housing supply, a gap Lucent Group aimed to fill in establishing the Lucent Strategic Land Fund. The fund acquires land that has already been identified for development within a local plan, but prior to its having been granted planning consent, and then takes it through the design and planning process before selling "shovel-ready" land onto the housebuilder market.

"This targeted acquisition strategy," Mr. Westerman explains, "is aimed at mitigating planning risk while benefitting from the largest value uplift anywhere within the real estate value chain – typically 30% to 35% or more of the retail value of the entire development." He says this site assembly model has already been adopted in several other developed markets such as the United States, Canada, Australia and New Zealand.

Zero Debt Financing

Founded in 2010, in the wake of the global financial crisis, the Lucent Strategic Land Fund has attracted investors from the U.K., the Middle East, Latin America and Asia. Like all global investors post-crisis, these investors are wary of highly leveraged investments in residential housing sectors, and indeed, as another *Financial Times* feature noted recently, debt capital has been increasingly difficult to come by for investors in U.K. real estate. Institutional investors are particularly leverage-averse.

Consequently, global investors are attracted to firms like Lucent, which relies exclusively on its own fundraising capabilities via its Luxumbourg-domiciled and -regulated fund.

`The housing shortage in the U.K. is so acute that there is absolute cross-party political support for the need to increase housing supply and this is unlikely to change before the end of the next Parliament in 2020.'

"A large part of the root cause of the last financial crisis was the high level of gearing," Mr. Westerman explains. "It is bank debt during difficult times that is the killer for real estate funds. But with, Lucent there is no gearing or leveraging at asset acquisition level and this significantly reduces the risk profile associated with investing in this asset class."

Implementation

Mr. Westerman notes that the Lucent Strategic Land Fund reached an important milestone recently with the submission of four outline planning applications for its Lincolnshire Lakes project in August 2013. The proposals involve a major residential-led development with a total 3,500 new homes and a 50-acre commercial park. The project is supported with extensive infrastructure, including a new terminating junction to the M181 motorway and ample areas of open space, wetlands, parkland and sports pitches. A Planning Performance Agreement with North Lincolnshire Council has been signed, which agrees to a determination period for the planning applications concluding in June 2014.

Outperforming

Given the extreme constrained supply in the housing sector and the particularly acute need for developable land, Mr. Westerman predicts that there will be a steady supply of opportunities like the Lincolnshire project in the years ahead, and that funds like Lucent's LSLF will continue to capture ideal demographic and supply-and-demand fundamentals while avoiding the pitfalls of overleveraged positions.

"Our target returns are 12% p.a. net of fees," he says, "but given the increasing momentum driving the asset class, and the planning milestones that are expected to be achieved by the Fund's new and existing assets over the coming months, we are heading into a period where exceeding the target return is very likely. We are very confident going into 2014."

Scott Mathis of Algodon Partners

Bullish on Argentina

After an economic boom late last decade, during which it posted growth numbers to rival China's, Argentina's investment climate has worsened sharply in recent years. Soaring inflation, a mounting energy crisis, and a stubborn if not arrogant attitude on the part of President Cristina Fernandez de Kirchner, toward the global business and investment community has rendered Argentina a pariah.

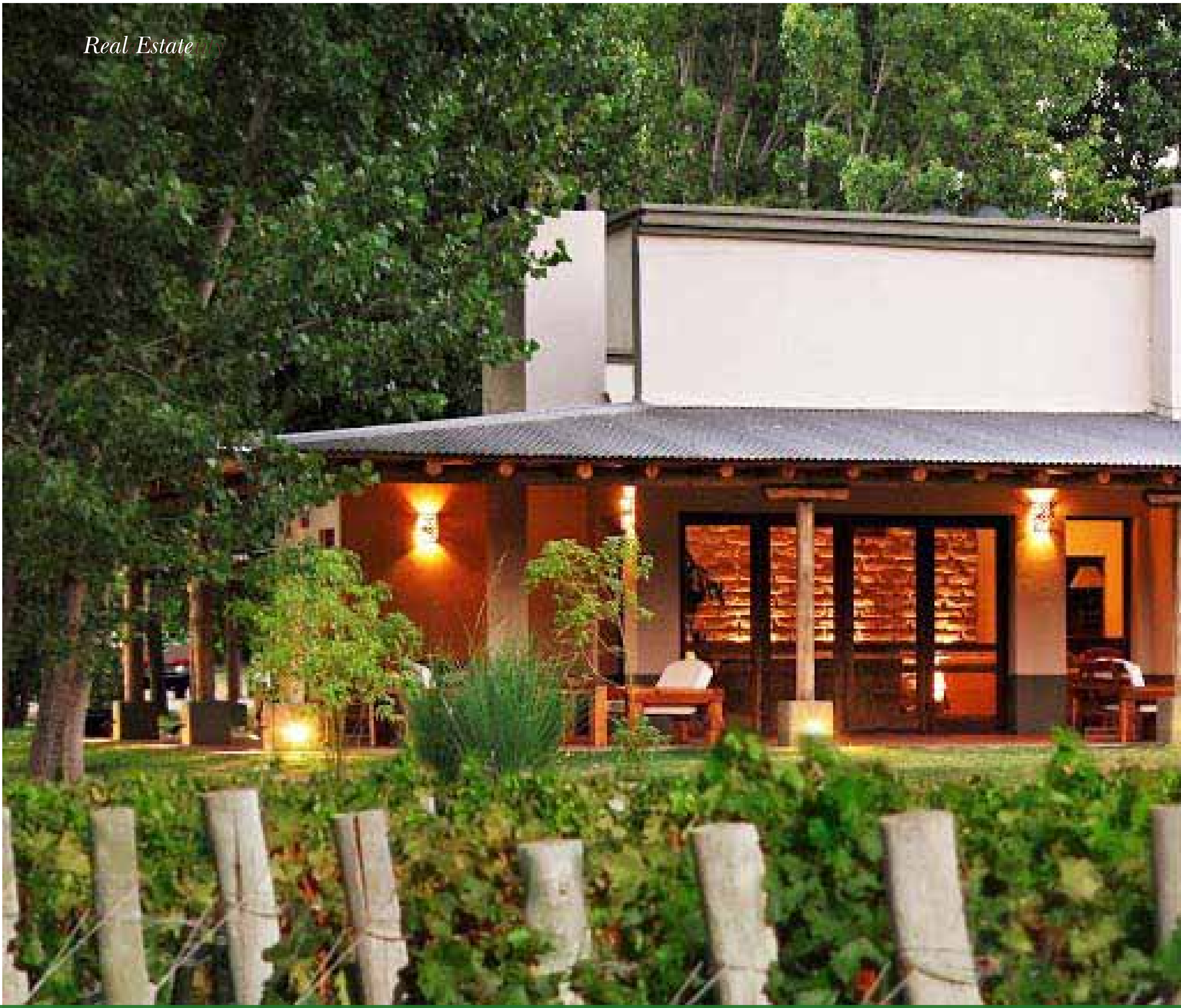
But there is a growing faction of investors who, having defiantly weathered the current crisis, believe the tide is turning. They see extremely low asset prices set to rise when Argentina's political and economic situation changes – a likely prospect, they say, particularly in the wake of the elections of October 27, when a weak showing by Kirchner's party signaled the possibility of a larger shift in the 2015 presidential election. By that time, too, the massive shale gas and oil reserves in northern Patagonia will have been tapped – by Chevron, among others – inaugurating what many believe will be a transformational energy boom.

"To take advantage of these opportunities," says Miguel Braun, Executive Director of Fundación Pensar, in a recent editorial in the *Buenos Aires Herald* summarizing the hopes and expectations of many global investors, "the next government of Argentina must reduce inflation, free its exchange rate, eliminate arbitrary government interventions in international trade and re-establish normal relations with the international financial community."

When these changes are realized, bullish investors in Argentina foresee a windfall for asset owners.

"People may think this sounds crazy, but Argentina is one of the best-calculated bets that one can make in world investment today," says Scott Mathis, founder and Chairman of Algodon Partners, a New York-based investment firm that owns real estate assets in Argentina in the hospitality and wine sectors. "Because there's virtually no leverage and no foreign investment, its asset prices are some of the cheapest in the world today."

Mr. Mathis sees a pent-up supply of businesses that, under more stable circumstances, would have been sold to companies such as Algodon, which is currently preparing to become a public reporting



company. He stresses that investors would be wise to enter now, before the tide turns. “I think asset values are going to turn in a massive, ferocious way, and you’ve got to be in here first, before the rest of the crowd. When the politics turn, the crowd will come rushing in.”

Eternal Recurrence

Mr. Mathis is accustomed to Argentina’s cycles. He entered the market for the first time in the middle of the last decade, attracted by the fallout of the country’s 2001 sovereign debt crisis. He was running several U.S.-focused investment firms at the time – including InvestBio, focused on biotech and DPEC Capital which is Algodon’s broker dealer – but sensed a malaise coming in U.S. asset prices.

Pre-2008, he wanted out. The question was where to go next. “I’m a contrarian by nature,” he says, “so I said, ‘Let’s go where it’s already blown up.’ My partners and I searched the globe and were attracted by the situation in Argentina, where the crisis had struck only a few years before.”

Merely being a contrarian wasn’t enough. It was important to do thorough due diligence and know the assets inside and out, he says – an approach he’d honed in the U.S. biotech and real estate markets.

He traveled down to Buenos Aires and discovered that the prices for prime assets were extremely low.

“It was what New York or London were like 35 years ago, with beautiful, old buildings way under market value. I saw the potential it could have over time.”

Algodon Mansion

Mr. Mathis returned to his colleagues in New York, but had difficulty convincing them that Argentina warranted their attention. He flew them down to Buenos Aires to see for themselves. In the end they decided to invest, purchasing a prime asset in the city's Recoleta neighborhood.

It soon became Algodon Mansion, a high-end boutique hotel. Over the last five years, the Mansion has become one of the top boutique hotels in South America, featured in *Condé Nast Traveler* and the *New York Times*, among other publications.

Mendoza

Mr. Mathis knew, however, that a single hotel property couldn't constitute an investment portfolio. So Algodon Partners began looking for more assets in the still-underpriced Argentine market, and found what they wanted near San Rafael in southern Mendoza, known as the Napa Valley of Latin America.

There, the firm purchased a 760-acre vineyard estate with a 9-hole golf course and 70-acre olive orchard, which formed the foundation of Algodon Wine Estates & Champions Club.

"I'd found multiple places in northern Mendoza that I was interested in buying," Mr. Mathis says, "but when I went to see this one in the south, I saw the beauty of the place, its maturity; and given the price comparison, I understood the value and negotiated to buy the property that week."

Algodon then bought adjacent properties. It currently owns 2,050 acres and is in negotiations to acquire an additional 2,100. The 9-hole golf course was expanded to 18 and opened in September.

The Best Ambassador

From the beginning, Mr. Mathis says, Algodon saw wine – and specifically Malbec wine – as the best way to enhance the value of Argentina's magnificent land.

"I've always thought that, over time, the land values in Argentina would perform incredibly well again, and I thought the one thing we could do to help activate that land price movement would be to create the best wine in South America. That alone would have enough carry-over power to increase the prices of anything that touches our estate."

To produce its brand of wine, Algodon Partners brought in venerable vintners, including Anthony Foster, Master of Wine, Mauro Nosenzo, and Marcelo Pelleriti, the first winemaker from Argentina to receive a 100-point score from Robert Parker. In addition, at Algodon Wine Estates, customers can purchase turnkey vineyards of their own. Algodon produces the wine from these vineyards, while the vineyard owners garner revenue.

Aside from being a great ambassador for the Algodon brand, top-shelf wines also protected Algodon from fluctuations in the wine market and Argentina's overall business climate, Mr. Mathis says.

"The wine business can actually be a huge opportunity for us, because if there's any fallout from the current situation, it's going to hit those companies that are working on paper-thin margins, not us."

Mr. Mathis sees a global trend of consuming Argentine wine, noting that Malbec has long surpassed being a mere "flavor of the month" and is now a staple of sophisticated wine cellars.

"In the last 20 years, there's been a lot of investment into the Argentina wine industry, which has helped create that credibility around the world. And the beautiful thing about Argentine wine is that, unlike other forms of investment, it has no borders. There are millions of investors out there who might have a problem with investing in Argentina but have zero problem drinking Argentine wine."

Poised for Growth

Algodon Partners purchased and developed their assets in Buenos Aires and Mendoza in the middle of the last decade, just in time to enjoy the commodities-fueled upsurge of the Argentine economy. They've stood their ground amid the current downturn, serving a still-teeming tourism industry and avoiding conflict with the government by remaining transparent, paying taxes, and helping bring money into the country.

But the firm's patient attitude also reflects a more mature philosophy. "As I've aged, I've come to realize that 'slow and steady wins the race,'" Mr. Mathis says. Now, that philosophy may yield dividends as the finish line draws near for the current status quo.

As in 2006, it's the low prices – and general pessimism – that attracts Mr. Mathis and Algodon Partners to Argentina.

"The reality is this: Some think it's safe to invest in New York real estate when it's at US$3,000 to US$6,000 per square foot, just because it's New York. But maybe it's a safer bet in Argentina where there's no leverage and property prices are 10% what they are in New York."

He quotes Sir John Templeton: "Invest at the point of maximum pessimism."

As the tide turns, Algodon will continue to buy properties in Argentina, and it is preparing to become a publicly traded company in the near future, giving global investors exposure to underpriced, high-potential assets.

Recent Trends in Bilateral Investment Treaties

Argentina has recently reached an agreement with some of the creditors that had favorable arbitration awards against it. Under administrative decision 830/2013 of October 8, 2013, the government reassigned the 2013 budget in order to include the agreement reached with certain companies.

The agreement is worth US$677 million, and it involves a 25% haircut off the original awards payable in Argentine bonds. The four creditor companies involved are to reinvest 10% of that money in the Argentine bonds issued for the tax amnesty (bonds for investment in infrastructure projects in Argentina with a 4% annual yield).

The arbitration awards were obtained in the International Centre for Settlement of Investment Disputes (ICSID). The good news is that Argentina, which was a somewhat reluctant debtor, agreed to negotiate.

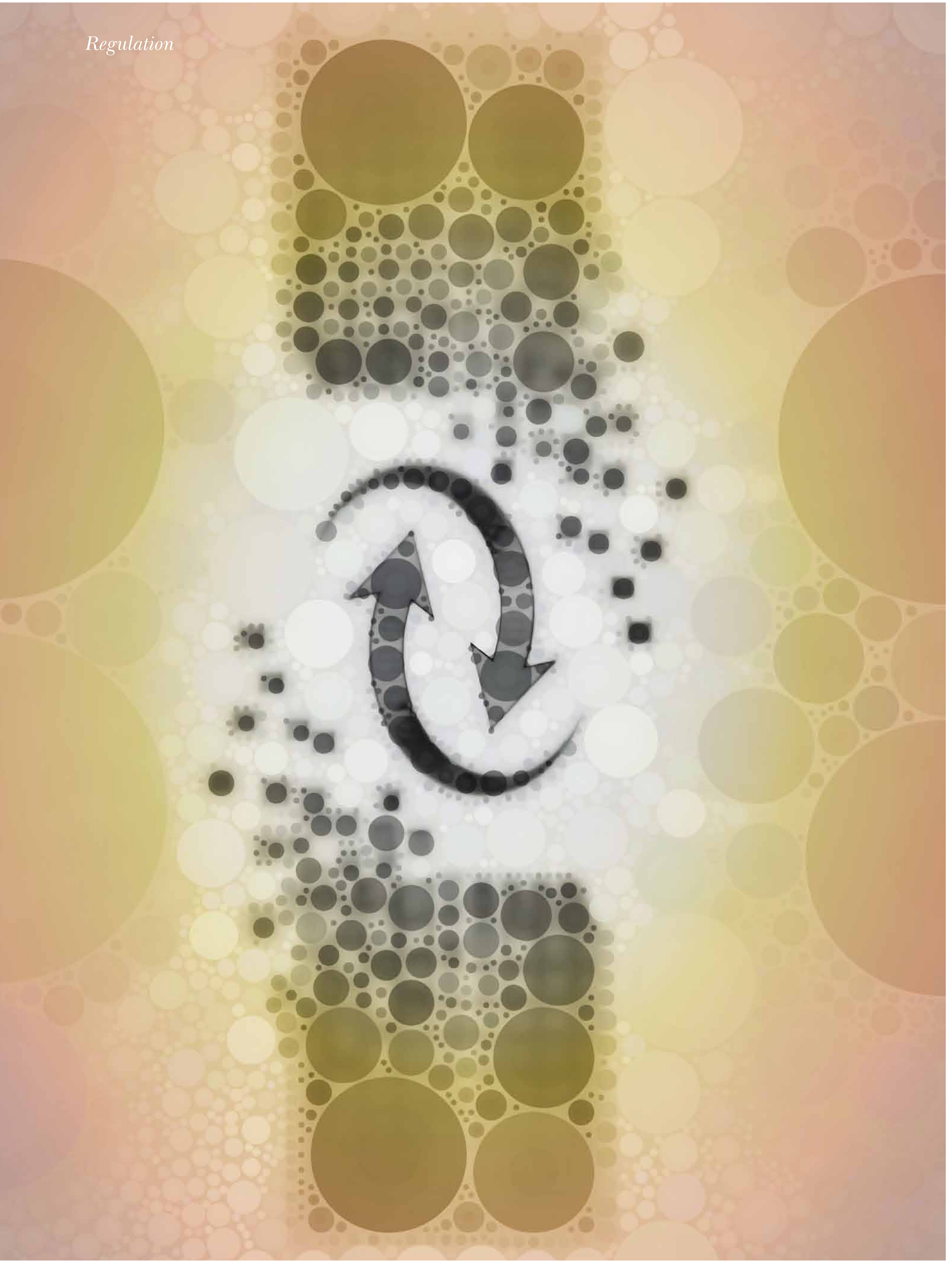
The four companies with which the government closed these deals had complaints that originated in the Argentine crisis of 2001. These companies are Azurix (a water and sewer service provider in the province of Buenos Aires, whose contract was terminated in 2002), Blue Ridge (which ran the CMS Gas Transmission Company, also terminated in 2002), Vivendi (which operated Aguas del Aconquija in Tucuman) and Continental Casualty Company (CNA shareholder Labour Risk Insurance had Argentine Treasury Bonds in pesos convertible to the dollar).

After 12 years of litigation, these companies finally settled their claims. This is a good indication of how the ICSID is beneficial for investment in general, because if these treaties are only "declarative" and not operational then they have no use. This development has reportedly released a loan from the World Bank to Argentina. However, it's not all good news. Argentina still has approximately US$20 billion in debt disputes pending at the ICSID. The most notable case is the expropriation of the controlling shareholding in YPF, the local oil & gas company, for which compensation has not yet been paid.

We believe now is a good opportunity to review the current trends and developments in investment disputes and investment treaties.

Bilateral Investment Treaties – Opportunities and Risks

Bilateral investment treaties (BITs) became very popular in the 90s. Argentina executed 55 BITs (all of them in the period 1990-2000) and because of this Argentina was subject – for investment disputes – to the jurisdiction of the ICSID. Many other Latin American countries executed BITs during the 90s: Bolivia 16, Ecuador 18, Venezuela 22, Chile 48, Perú 28 and México 15.



These BITs are agreements between states that aim to promote investment between the signatory countries, protecting investors in one of the states when investing capital into a signatory country. This is a treaty between sovereign states with the purpose of protecting individuals and corporations when doing business in countries with an additional element of uncertainty or risk. These undertakings have the benefits of the treaty and can claim the protection of the BITs.

The common traits of the BITs are based on four issues: admission of the investment, treatment of the investor, expropriation and dispute resolution. This last is perhaps the most controversial issue, because it involves a dispute between a state and a private undertaking, and they are treated equally for these purposes.

The principal raison d'etre of the BITs is very clear: the protection of the investment of a national of one state into another state. This is intended to enhance foreign investment and allow for the possibility of resolving an investment dispute through an independent third party (arbitrator). These are tools that were absent in previous international legislation or international common uses.

There are certain fundamental elements under the BITs that constitute the rational application of the above mentioned purpose of protecting investment in another state. These traits are the following:

The rights of the investor to enter and establish a business in a member state. This means the right to establish a presence on a level playing field with local players and the right not to be arbitrarily interfered during the lapse of the investment.

The obligation of the recipient state to treat the foreign investor the same as other foreign investors. This is an application of the Most Favored Nation principle.

The right to a free transfer of currency derived of profits, services, loans, compensation, etc.

Limits to expropriation. Expropriation will only be valid when it is for a public cause, non-discriminatory, and duly compensated in a freely convertible and transferrable hard currency.

The Argentine experience has yielded some important criticisms of international arbitration and suggestions for reform of these mechanisms.

The resolution of disputes between investor and the recipient state through international arbitration. Normally the arbitration is under the rules and auspices of ICSID (when negotiation is impossible).

After more than a decade of their existence and application, we can conclude that these instruments have advantages and disadvantages. While they provided for a seemingly secure environment for investment, in practice it took more than a decade to receive some kind of compensation, and market conditions, not investment treaties, drive investment in one direction or the other. For example, Brazil has never had a BIT in force, but Brazil has received the vast majority of foreign direct investment in the past decade in Latin America.

The Argentine Files

Argentina imposed in 1991 a fixed one-to-one convertibility between the peso and the dollar, so one peso was freely convertible to one dollar. That system worked well in the 90s but in 2001, after 10 years of convertibility, the country's economy collapsed.

Argentina defaulted on its foreign debt, which exceeded US$130 billion and included bonds under eight different jurisdictions. During the crisis, the Argentine Congress passed Law 25,561, the Public Emergency and Foreign Exchange System Reform Law. This ended the convertibility regime and imposed a restructuring of contracts, both public and private, in foreign currency under Argentine law. It also provided that prices and fees for public utilities would be set in pesos and not adjusted by U.S. inflation or the U.S. dollar.

Upon termination of convertibility the exchange rate was approximately 3 pesos to the dollar. This emergency legislation caused many foreign companies that had invested in Argentina to raise claims with Argentina before the ICSID. At one point Argentina accumulated nearly 50 cases with compensation claims for more than US$50 billion (without taking into account the defaulted public debt).

Faced with all these claims the Argentine government established an Assistance Unit for the Defense in Arbitration ("AUDA") in order to defend itself. Since the origin of complaints was basically the same, the arguments in defense of Argentina were often similar. The main argument was that after the 2001 crisis the emergency measures adopted were forced and unavoidable. The changes also equally affected domestic and foreign investors, and so just as many foreign companies' profits were diminished dramatically, many Argentine companies also went bankrupt. The crisis was so severe that it was a unique situation in the history of Argentina. The country's lawyers also invoked Article 11 of the BIT between Argentina and the U.S., which provides "this Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests." This article was included as a way to limit the protection of investors in situations of particular importance, as it provides the possibility to preclude the application of the BIT when the recipient government's rules intend to protect national security and public order. It is a kind of force majeure. Some ICSID tribunals have recognized the emergency situation Argentina faced in the aftermath of the crisis. They have also supported the defense argument by noting that the population as a whole was seriously affected by the crisis, so that the situation required immediate and urgent action by the Argentine authorities.

The Argentine experience has yielded some important criticisms of international arbitration and suggestions for reform of these mechanisms.

Conclusions

There are still many cases pending in the ICSID against Argentina and other Latin American countries. The bulk of the Argentine cases stem from the 2001 crisis, but there is one recent case originated in the expropriation of the local oil and gas company YPF.

In spite of all the criticism, and the fact that countries with no actual BIT in force (such as Brazil) have received substantial FDI in the past decade, the truth is that foreign companies, when deciding an investment in a certain country, first look at the market conditions (the growth opportunities as such), and then the double taxation treaties (DDTs) and BITs. These two conditions (DDTs and BITs) do not per se determine an investment, but in countries with higher political risk the existence of BITs can be significant.

The ICSID system has proven successful to resolve investment disputes in many cases with favorable awards to the recipient countries, but at the same time has been criticized because in fact it is almost impossible to enforce arbitration awards against a country receiving FDI.

The fact that Argentina has agreed to negotiate some cases is a good sign, but it is also a door that has been opened, and there are still many cases pending resolution.

South Korea Leads the Way for Renewable Energy

Natalia Pypec, Senior Analyst at EOS Intelligence

South Korea has embarked on an ambitious mission to become one of the largest wind energy producers globally. With an estimated renewable energy investment outlay of US$35 billion by 2015, the Asian giant is determined to reduce its huge energy import bill and, in doing so, become one of the leading adopters of clean energy.

Asia's fourth-largest economy currently generates approximately one-third of its electricity from nuclear power as part of its long-term aims to displace imported oil and gas. Renewable energy is hoped to make up an 11% portion of total energy production in South Korea. As of 2012, South Korea was the ninth-largest energy consumer in the world, and given the lack of its own reserves the country is placed among the largest energy importers (for crude oil, coal, liquefied natural gas) globally.

According to EOS Intelligence, a global research and constancy firm, South Korea imports 95-97% of fossil fuels used for domestic power generation, calling for urgent government action to develop alternative energy sources and improve the country's energy independence, while increasing its energy efficiency and reducing its energy import bill (estimated at about US$121 billion in 2010). Steps have already been taken by the South Korean government to strengthen its commitment to increasing the resources in overall energy production as part of a major push to diversify its energy sources.

Government Efforts

Over the past five years the South Korean government has been strengthening its commitment to the renewables cause. In 2008, President Lee Myung-bak announced the government's decision to increase investment in renewable-generated energy, and as a result the total investment in renewable energy is estimated to be approximately KRW40 trillion (US$34.2 billion) to 2015. Fifty six percent of this will be provided by Korea's largest industrial groups, 18% by the government, and about 26% by other private investors.

In 2010 South Korea's government set out a plan for the country's wind capacity development, outlining three scenarios starting with 2010 capacity level of 380MW. Capacity development was marginally behind schedule as of 2010, with planned 380MW versus the actual 373.3MW; similarly, the 2011 and 2012 targets were lower than planned, although it is believed that long-term targets are still achievable.

The country's energy ambitions have been based on private investors as well as national and local governments' plans and capacity development projects, which are already under development. As onshore locations for wind power development are limited, the country is increasingly focusing on offshore locations, and that sector alone is expected to receive US$8.2 billion by 2019, primarily in South Korean waters with their favorable volcanic seabed.

Renewable Energy Credits

In another bid to get the ball rolling for South Korea's renewables mission, the country replaced its old feed-in tariff for a renewable energy incentive plan, the Renewable Portfolio Standard (RPS), in 2012 – a set of targets and standards that promote the adoption of clean energy, reduce carbon emissions, and drive growth of the green energy industry.

Before introducing RPS in 2012, South Korea's feed-in tariff mechanism was used to guaranteed fixed rates for renewable-generated energy, as well as putting a cap on renewable-energy generation capacity, which resulted in heavy cost burdens for energy producers. The RPS introduced tradable Renewable Energy Credits/Certificates (RECs), creating revenues from renewable energy being determined by the market. Under the RPS, revenue from renewable-generated energy is derived from the wholesale electricity price plus sale of RECs, with one REC valued at about KRW40 (US$0.035).

The new tariff systems operate once the energy producer is awarded RECs and has registered with the New and Renewable Energy RPS Management System. The RECs are issued on a monthly basis

and are calculated per unit of renewable-generated energy; each unit of such energy generates one REC, and the renewable-generated power receives a price above the market rate based on the price of the REC multiplied by the weighted value of the renewable energy source. This depends on its type, with offshore wind, tidal and fuel cells receiving the highest multiplier. However, if the generator fails to meet the pre-set RPS ratio in its energy production volumes, penalties apply in the amount of 150% of the weighted average market price of each unit of green energy produced below the mandatory volume.

However, despite an ambitious goal to grow the market over the long term, it is expected that South Korea's renewable energy industry is likely to shrink during 2013 due to another year of decline in the combined sales of local renewable energy companies; the market shrank by about 7.8% in 2012. In comparison, the global renewable energy market witnessed a 38% growth during 2011-2012.

The decline of the Korean market is believed to be driven by insufficient government support to develop the country's renewable energy space.

Rising Demand

South Korea's need for developing new energy sources is apparent given the country's rapid economic growth, including the expansion of energy-intensive industries. Primary energy consumption increased by about 440% between 1980 and 2007. However, this energy consumption growth is expected to slow down over the coming years, and there are considerable shifts expected in the composition of the energy consumption by source. South Korea is aiming to increase its share of renewable energy in its overall domestic energy mix

The decline of the Korean market is believed to be driven by insufficient government support to develop the country's renewable energy space.

by over three times, with a minimum of 11% of its total energy needs to be met by renewable sources by 2030.

With the RPS and RECs system in place, as well as government support across regulatory, fiscal and public financing policies, the South Korean government plans to achieve a targeted share of 10% of renewable resources to be used in power production by 2022. A large part of this planned renewable energy generation is planned to be wind and tidal generation, which together are expected to contribute two-thirds of renewable-generated power. While these two resources are expected to be dominant among renewable sources used for energy generation, government support (in the form of research and capabilities advancements) is expected to extend its focus to also include solar and waste power.

In the case of solar power, the energy generation production proves to be more cost effective. For solar-only energy, versus wind-only energy, costs account for an estimated 10% and 66% of overall value of energy generated, respectively. However, despite lobbying for solar and waste-based energy generation, it is still expected that the majority of new capacity will be added in wind power in the long term.

A Promising Start

With an energy bill in excess of US$125 billion, it is not surprising that South Korea has taken a step toward transitioning from fossil fuels to renewable sources for domestic energy production; the fact that around US$35 billion has been allocated for investment in renewable energy by 2015 clearly indicates the country's will to reduce its reliance on imports and, in time, to become clean-energy dependent.

To support renewable energy growth, a range of policies and incentives have been developed: a feed-in-tariff was replaced with a Renewable Portfolio Standard system, which pushes to increase the use of renewable sources in power production by expanding the mandatory share of renewable-generated energy in overall energy production. The government also aims to achieve a targeted share of 10% of renewable resources to be used in power production by 2022; a large part of this planned renewable energy generation will be wind and tidal generation.

Favorable geographic locations, with mountainous terrains and long coastlines, provide South Korea with the ideal environment to develop wind farms to harvest energy; it is estimated that over 45% of renewable energy in 2022 will be generated by wind power, with an ambitious goal to develop 23GW of wind generation installed capacity by 2030.

If the Korean government's proactive wind power policies go hand in hand with investment by local companies and efficient R&D projects, the wind power industry will create synergy with Korea's world-class technologies related to shipbuilding, and heavy industry. "This will catapult Korea into the ranks of the world's wind powerhouses in the near future," the Chairman of the Korea Wind Energy Industry Association (KWEIA) said.

About the Author

EOS Intelligence (www.eos-intelligence.com) is a professional services firm that delivers business research and analysis solutions targeted at corporate, consulting and investment organizations. The firm works with companies in the U.S. and Europe to support their emerging market-focused growth and optimization strategies.

How Turkey Has Transformed Itself into a Mergers & Acquisition Hub

Ceki Bilmen

M & A in Turkey by the Numbers

The number of mergers and acquisitions (M&As) in Turkey has experienced a growth similar to that of the Turkish economy. In 2012 they reached 259 with US$28 billion of volume, with foreign investors accounting for 51%. 73 M&As took place during the first quarter of 2013 with a volume of US$8 billion. This represents a 40% increase over the same period last year.

Those numbers are even more staggering given that the volume of M&A transactions in Turkey was only around US$1 billion a decade ago.

Reasons for Growth

There are several reasons for the current boom in the number of M&As in Turkey. The most important is the end of the delicate political situation based on shaky coalition governments a decade ago and the emergence of political stability, contributing to macroeconomic stability.

Moreover, Turkey has transformed itself into an economic hub in its region and managed to attract US$123.7 billion of FDI during the last decade. Its low level of public debt to GDP, it high level of economic growth, the drastic reduction in inflation, its centrally located geographical proximity to Europe, the Middle East and the Caucusus, and the size of its market with 75 million inhabitants all combine to create a powerhouse with significant economic clout.

In addition to the political and economic stability, the emergence of the younger generation of business owners who view M&As more favorably and their taking over of family firms have paved the way for significant increases in M&A activity.

The change, not only in the leadership structure of the firms but also in the structure of the financial services industry, provided the necessary boost to M&A activity. The establishment of investment banks has been accompanied by Turkish private equity firms and law firms that are specializing in M&A transactions, providing the necessary financial expertise with legal knowledge.

Prominent Sectors

Since the Turkish economy has been growing steadily for more than a decade now, the consumer economics industry has reached new heights in Turkey with millions of Turks having greater purchasing power.

The majority of the M&As in Turkey in the recent past have taken place in the consumer goods, healthcare, retail, telecommunications, financial services and energy sectors. This is natural for a country lacking natural energy resources and suffering from a deficit exacerbated by energy imports.

by Kuwaiti Burgan Bank for US$355 million. 24% of the shares in Anadolu Efeses, one of the leading firms operating in the alcoholic beverages sector, were acquired by the U.K.'s SAB Miller for US$1.9 billion. 38% of the TAV Airports Holding shares were acquired by Aeroports de Paris for US$874 million and the American company Amgen paid US$700 million to acquire 99% of Mustafa Nevzat İlaç in the pharmaceutical industry.

The M&As that took place last year in the private sector accounted for 40% of the overall M&As in Turkey, and the rest came from the public sector. The previous year private sector M&As mainly focused on the financial sector, alcoholic beverages, transportation and pharmaceuticals.

Last year 99.85% of shares in Denizbank were acquired by the Russian company Sberbank for US$3.851 billion, and 99.26% of Eurobank Tekfen shares were acquired

As the volumes demonstrate, the M&A activities in Turkey have reached new heights in the last 10 years.

Despite the risks associated with the deficit and the exchange rates, the Turkish economy has already proven its resilience during the turbulent economic times since the end of 2008, and this should serve as a powerful reminder for investors seeking to engage in to M&A activities in Turkey.

About the Author

Ceki Bilmen started his professional career as an investment consultant at Global Securities Inc. in 2007, where he gained valuable experience with financial instruments in the Turkish capital markets. Between 2008 and 2012 he served as the PR Officer of the Israeli Consulate in Istanbul, where he prepared position papers, attended round table talks, prepared articles for publication, and gained networking and negotiation skills. His expertise lies in political economy, international political affairs, diplomacy, European studies, Middle Eastern studies and Turkish politics. He has studied neo-liberal economics, the Middle East, American foreign policy, Israeli policy making, Turkish politics and democracy studies. Mr. Bilmen contributes to the *Shalom* newspaper as an op-ed writer and is currently focused on Turkish politics and political economy within the framework of his PhD studies.

Entering a New Market

Felix Villalba

It's accepted practice in the investment industry to land in a foreign country and make contact with local politicians. In Colombia, except for government deals, that strategy may not lead you where you want to get. Ask yourself why you would not do that in the U.S., and it is the same reason in Colombia. Politicians, even if well intended, have a tendency to introduce bureaucracy and may not necessarily understand your business goals. Doors can be opened via private industry consultants without the need for frustrating government meetings.

In a recent example, an acquaintance of our firm came to Colombia and independently set up a week of business meetings in several cities in Colombia. These meetings were set up with Proexport and other similar governmental institutions. He selected this route rather than hiring us or other private consultants or local investment bankers. He left without doing a deal and with the mistaken impression that he could not set up shop in Barranquilla because of a lack of human capital. That conclusion was understandable; in fact, I personally attended one of his meetings, and they were a fiasco. The presentations he attended were done by young kids who have never even been in business, let alone know how to effectively communicate with an executive. Several meetings were canceled at the last minute by bureaucrats who clearly did not care. This story would play out differently for an investor who tapped directly into a specific industry or hired private consultants or local investment bankers with a vested interest in succeeding. These folks can open up real doors or, better yet, show you how to set up shop without external help other than that directly necessary for your business operations.

That sort of experience is much too common, and one wonders how to change the model. An investment or company executive doing market research usually enjoys rubbing elbows with government ministers, mayors, governors, etc. It makes for good stories back home, but it does not necessarily make for good business in private industry. In fact, many smart business people in Colombia (and other countries) shy away from getting too close to politicians and bureaucrats. Taking that route may even preclude you from getting to know the best players in a market you wish to enter.

Raising Local Capital

Investors going into Colombia to do small and medium-sized company deals should not be too focused on raising local capital. The investment theory makes sense on the surface, but when analyzed it has more cons than pros. The theory goes something like this: if you have local investors, they validate that you are entering into a deal that has potential.

Capital markets are underdeveloped in emerging markets like Colombia. As a result, there is a large need for smart capital in emerging markets. This forces entrepreneurs to look for foreign capital. As an investor you are "selling" a commodity that is more valuable than in a developed market (hence the higher returns). Placing a large local capital requirement therefore runs counter to finding the best entrepreneurs. It is understood within the U.S. that an entrepreneur does not have capital, so why change the model outside the U.S.?

Traditionally, Colombia, an underdeveloped financial market, mainly has family entrepreneurs. If an entrepreneur's family does not have money to invest, it is unlikely his business idea will ever get funded because organized angel or institutional investors are non-existent. These smart people become professional managers,

and maybe someday when and if they have saved enough they can start a business.

Entrepreneurs offer experience, knowledge, vision, industry connections, and smart management but do not have to have the capital. By definition, an entrepreneur in Colombia that brings local capital brings family capital, and if that family has enough funds to invest significant amounts next to an institutional investor, then a U.S. investor should

wonder why the family is bringing you in. Perhaps the family sees murky waters ahead, and the U.S. investor is the perfect way to decrease their risk.

Another challenge is the transparent cultural differences. For example, a U.S. investor uses the concept of last money in, first money out. However, that is not easily understood or accepted by many Colombian investors, nor is the system set up to protect last in/first out or other complex capital structures or investor agreements. This concept may be legal, but it does not mean that it will work as easily as in the U.S. Certainly a common way around that is to set up arbitration and the legal documents under U.S. law, but that does not mean that the Colombian family will not sue you in-country if things get difficult. A foreign investor must keep in mind that local understanding of terms and conditions are per Colombian culture, and that is not necessarily the same as the investor's home country. You create a potential time bomb when you insist on large Colombian investor capital – if you even get to an agreement in the first place. Having Colombian investors will necessarily create a legal in-country issue about difficult business matters. If a deal needs refinancing or additional series of investment, you will likely have a contentious issue.

It is possible to have complete foreign control of a company in Colombia, especially if you have a local well-respected entrepreneur (i.e. professional management rather than a family business). Therefore, as an institutional or large investor you should be happy to control the deal and decrease family money in your deal, not the other way around. Remember that a smile may be interpreted as acceptance, but it may really signal sarcasm. Don't misunderstand cultural cues.

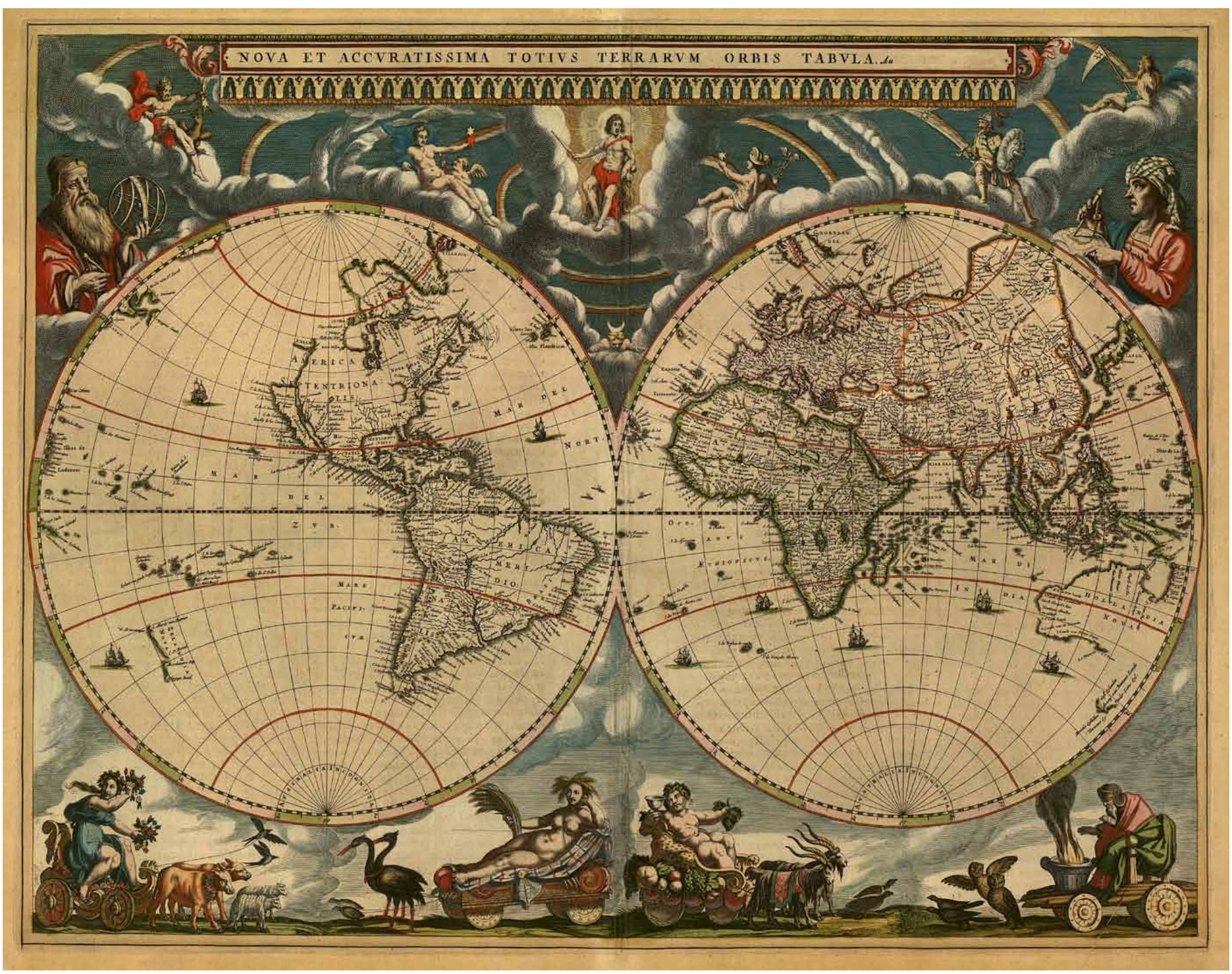
About the Author

Felix Villalba has over 15 years of experience on both the operating side and the investment side of business transactions. After his MBA, Mr. Villalba worked for captive financial services companies at Dell and Whirlpool, and later spent over five years as CFO with two venture backed technology companies. Dell's successful effort to start Dell Financial Services marked his official involvement in the venture industry in 1997. It was after that when he joined an Austin Ventures backed company that later led to his joining Pacesetter Capital Group. At Pacesetter he was Vice President and served as Portfolio Manager for several inherited deals, some of which required intervention strategies. In 2009, Mr. Villalba formed his own Private Equity management firm, Accordo LLC, and raised Accordo Fund 1 and 2, placing investments in residential and hospitality developments in Colombia.

Mr. Villalba is a graduate of the University of Notre Dame with three degrees, a Masters in Business Administration, a B.S. in Civil Engineering, and a B.A. in Economics. He successfully completed the Harvard Business School's Executive Management Development Program.

Frontier Markets
Old Acquaintances, New Opportunities

Tomás Guerrero



The economic deceleration process that the BRICS are experiencing is the result of the stagnation of advanced economies and the absence of internal reforms that would liberalize the capital markets of these countries. However, this deceleration has helped to highlight a set of countries growing nearly 10% year-on-year and whose past performance we are familiar with[1].

They constitute the so-called frontier markets. They are countries driven by the combination of abundant natural resources and low labor costs, and they are catching the attention and interest of large investors:

- The MSCI Frontier Market index rose 13.31% in the first five months of the year, the best beginning since this index was created five years ago. Meanwhile, MSCI Emerging Market index fell 4.4% for the same period [2].
- Equity funds specialized in investment and management of frontier market assets hit a new investment record in May: US$2.27 billion [3].
- Up to April 2013, funds classified as frontier funds have grown close to 20%, against 8% for funds classified as emergent [4].

There are some who believe that frontier markets only represent an option to diversify large portfolios due to the low correlation of the economies of these markets with the economies of advanced and developing countries [5]. However, there are some emerging voices that suggest making a better use of the excellent industrial and trade opportunities that these markets represent.

Under the name of frontier markets we find a set of heterogeneous countries that, up to a decade ago, were characterized by their instability, limited access and low liquidity. Nowadays, after having experienced a significant improvement in their fundamentals[6] and not without risks, these countries are starting to consolidate as a real alternative to developing economies in terms of direct foreign investment. Some of this year's most profitable markets can be found among these countries such as Vietnam, Nigeria or the UAE.

Three of the most relevant economic phenomena that are taking place in these markets are analysed below in order to evaluate the opportunities that these "old acquaintances" represent.

Demographic Dividend?

One of the things that make us feel optimistic about the frontier markets' economic future is the demographic factor. Frontier markets are experiencing an unprecedented demographic boom, and projections recently published by the United Nations Population Division describe a hopeful horizon for this set of countries in the next 90 years.

For the BRICS, demographic estimates project sustained demographic growth until 2050 [7].From that year on, a slow decline is expected, reaching in 2100 similar figures to those in place currently. However, this does not mean that they will not continue to be the most populated set of countries on the planet. China's one-child policy[8] will dramatically reduce its labor force, and only India, with more than 1.5 billion people, and South Africa, with more than 64 million, should have a positive demographic balance by 2100 with respect to current figures.

For developed economies, the outlook is even worse. Predictions for 2100 show a strong demographic drop in most of the advanced economies, except for the U.S., France and the U.K. These three countries are likely to experience population growth due to the arrival of immigrants from their former colonies – mainly frontier markets – and the high birth rate of various immigrant communities previously settled there. Moreover, progressive population aging will increase the dependency rate of these economies, decreasing the percentage of the productive population[9] and increasing the proportion of the population using resources without contributing to generate them. In Europe, this ratio is likely to reach a figure close to 76% by 2055, seriously damaging the sustainability of one of the hallmarks of the European project, the welfare state.

The United Nations predictions for the frontier markets totally differ from the predictions considered up to now, and they reflect the enormous potential of this heterogeneous set of countries. In 2100, the frontier markets' population will double current numbers, exceeding 2 billion people, and will overtake OECD countries' population by 500 million. This demographic boom will be led by the development of both Asian and African frontier markets. On one hand, as an example of Asian development, there is Pakistan, which by 2100 will become the seventh most populous country in the world with 236 million people. On the other hand, with a population of 1 billion people by 2100, Nigeria will not only surpass the population of the whole European continent but will also become the third most populous country after India and China. Some other countries such as Zambia, with 124 million in 2100, Bangladesh, with 182 million, or Kenya with 160 million, will also play decisive parts.

This demographic growth represents both an opportunity and a challenge for frontier markets. It is an opportunity because the high demographic growth rate can be seen as a dividend: the labor force[10] could have a higher growth rate than the population depending on that labor force, and the economic resources invested in the country's development would be released. Furthermore, increase in labor force and market consumers may seem attractive for multinationals based in developed and developing economies, and it may also help stimulate the arrival of companies, which would help diversify and modernize the productive network of these countries.

However, this phenomenon also represents an important challenge for frontier markets. The demographic boom offers the possibility of economic improvement but does not assure it. The rise of competition regarding resources and the demand for more and better social services and institutions may drift into new social conflicts or the reemergence of existing conflicts and, hence, an intensification in political instability, which may hamper economic development.

Will the governments of these countries be able to manage the tensions derived from demographic growth? Will they be able to make it profitable? It seems so, up to now.

Fleeing from the Curse: Frontier Markets Sovereign Wealth Funds

Frontier markets are countries with abundance of natural resources. Estimates indicate that, at present, these countries gather 41% of the world's oil reserves and 26% of the natural gas reserves as well as a high percentage of the world's metal reserves such as gold or copper. As a result, the exploitation of these resources – favored by the upward tendency of commodity prices – has become the economic driving force of these countries.

Countries with strong natural resources supplies theoretically have an advantage when it comes to fast economic growth. This could be due to their ability to use the obtained income to set up big pushes for modernization. But an excessive dependency on natural resources – which is currently yielding great results for frontier markets[11] – severely endangers the economic growth of these countries in the long term.

In order to reduce exposure to the commodities boom and to avoid all the problems derived from the so-called "abundance paradox," frontier markets have already begun to hoard sovereign wealth funds. The aim is to develop an intergenerational model that will allow future generations to enjoy the benefits that abundant raw materials are giving to the current generation.

The main five objectives that the governments of the frontier market countries are trying to pursue with these state investment tools – whose risk-tolerance is higher than that of the traditional central banks – are the following:

- To obtain long-term profits from current account surpluses arising from the exploitation of natural resources.
- To reduce inflationary pressure stemming from the budget surplus.
- To avoid the effects of the so-called "Dutch disease," the loss of competitiveness of other sectors in the economy (with respect to the extractive export industries) as a result of the appreciation of the national currency.
- To diversify and restructure the country's economy, investing in high-tech industry and knowledge-intensive services.
- To develop a model of intergenerational solidarity that spreads out over time the wealth that finite natural resources are bringing now.

On the basis of the analysis by Capapé & Guerrero (2013)[12] of the nature and definitions of sovereign wealth funds[[13]] – which would exclude funds controlled by the Central Bank (such as the Botswana Pula Fund), funds that restrict their investments to national markets (such as the Investment Corporation of Dubai), funds used as stabilization funds (such as the Ghana Stabilization Fund), and public companies with large investment portfolios (such as Sonangol) – frontier markets are home to 19 sovereign wealth funds that manage assets worth over 1 trillion dollars.[14]

Implementation of sovereign wealth funds does not guarantee a better management of the profits made out of the exploitation of natural resources. This improvement can only be achieved by the design of a good corporate government – isolating the activity of the fund from opportunistic decisions – and by providing the institution with first-class experts and practices. Success or failure of frontier markets funds will depend on the implementation of these recommendations and the ones gathered in Principios de Santiago [15]. It will also determine the possibility of a continuous economic growth of these countries in the long term.

Frontier Markets as Tech Hubs

Along with the setting up of sovereign wealth funds, frontier markets have already started to make a series of investments focused on motivating and promoting the development of innovation and technology sectors.

In this process, two frontier markets (one from Africa and another one from the Middle East) appear to have taken the lead [16].

Kenya: From iHub to Silicon Savannah

A little over two years ago, and thanks to funding by Hivos and Omidyar Network, we saw the rise in Nairobi of what would be the first tech hub in Kenya: iHub. Since then, iHub, which started out offering free internet access and specialist forums for entrepreneurs, has been expanding continuously, becoming a benchmark for tech hubs in Africa; it has more than 10,000 members, over 150 incubated companies, and the backing of multinationals such as Intel, Google and Samsung.

iHub turned out to be just the beginning. A series of publicly and privately funded projects were set up with the aim of deepening Kenya's commitment to upgrading its production sector. Due to this this public-private cooperation, several successful projects were released, such as the startup incubator NaiLab and the research and entrepreneurship institute @ilabAfrica (inaugurated in 2011) followed by the startup accelerator 88mph (in 2012) and the proposal to build a technology city that has been dubbed Africa's Silicon Valley: Silicon Savannah.

This tech-city project, planned to be carried out in four phases – the last of which is expected to be completed in 2030 – will be built on a 2,000-hectare site in the city of Konza (a settlement 160 km from Nairobi). In order to do so, almost US$14.5 billion will be mobilized (from which only 5% will be provided by the government led by President Mwai Kibaki). The Kenyan government hopes that this ambitious project will make the country a benchmark for the production and distribution of technological components in Africa, creating 200,000 jobs in the ICT sector and positioning Kenya as a an international tech hub.

Jordan: Making a Virtue Out of Necessity

Not only was the Arab Spring, which brought about the downfall of the vast majority of Maghreb's dictators, the result of the citizens' revolution, but it was also the triumph of a revolution that had begun years before that silently paved the way for the wave of protests to spread at breakneck speed: the technological revolution.

The outlook of economic growth and the consolidation of large markets with increasing middle class populations offer an ideal scenario for the establishment of European enterprises.

If it was basically private initiatives what had promoted and provided funding for the construction of the centers in Kenya, in Jordan it was the institutions of the Hashemite Kingdom that decided to transform their capital, Amman, into a benchmark tech hub for the Arab world and, therefore, into the main Pan-Arab competitor to Israel's tech hub, Silicon Wadi.

One might think that the technology epicentre of the Arab world would be a city like Doha, Riyadh or Abu Dhabi, as they are the catalysts of the progress in the Middle East and the main magnets for FDI. However, it was the decisions made by Jordan's King Abdullah II to re-launch the country's economy – characterized by its lack of natural resources and strong energy dependence – that positioned Jordan as the tech hub of the Arab countries.

As it seems, these decisions are succeeding: the latest International Telecommunication Union data indicate that Jordan currently hosts three-quarters of all Arabic content online. Moreover, the Queen Rania Center for Entrepreneurship (QRCE) – launched in 2004 – and the startup accelerator Oasis500 – launched in 2010 and located on a site that was built to be the headquarters of the Jordanian Army – indicate that Yahoo's acquisition of the Jordan-based startup Maktoob for US$80 million is not likely to be the last.

A Chance for Europe

There is enormous potential in frontier markets, which calls for a strategy to get more and better use out of the amazing business opportunities that these countries offer.

To that end, many of the European Union countries have a privileged starting line with respect to the rest of the developed and developing economies. There are trade connections that were established decades ago with many of the markets now known as frontier markets, and with some others that will soon become frontier markets too such as Angola or Cambodia. These connections imply that countries like France, Spain or the U.K. continue to be the natural gateway for some frontier markets' FDI to western economies in general and to European economies in particular.

Therefore, one of the main aims of these European countries is strengthening bonds with these "old acquaintances" in order to ease the arrival of new investments. The current European asset devaluation represents a great opportunity for large emerging companies from these countries – such as Dangote in Nigeria or Etisalat in UAE – to invest in leading companies, establish themselves on the old continent[17] and get access to the know-how of these companies. Meanwhile, it represents a great opportunity for European companies too. The outlook of economic growth and the consolidation of large markets with increasing middle class populations offer an ideal scenario for the establishment of European enterprises. They would compensate the consumption drop that many domestic markets are experiencing, which would make them obtain excellent returns in the short, the medium, and the long term.

The empowerment of these relationships will be an advantage for both sides: on one hand, frontier markets will continue to develop and improve their citizens' welfare and, on the other, European markets will benefit from economic growth and employment creation.

Frontier markets are the real alternative to emerging markets. Shall we take advantage of them?

About the Author

Tomás Guerrero is Researcher at ESADEgeo-Center of Global Economy and Geopolitics of ESADE Business School and SovereigNET Research Affiliate at Tufts University's Fletcher School. He specializes in frontier markets, sovereign wealth funds and entrepreneurship.

www.esadegeo.com

Condensed and translated from 'Frontier Markets: Old Acquaintances, New Opportunities' by Tomás Guerrero from The World Financial Review September/October 2013 issue.

www.worldfinancialreview.com

1. *Many of the countries known as frontier markets maintain a close economic, political and social relationship with the European countries on which they depended when they were colonies.*
2. *MSCI, 2013.*
3. *Citi, 2013.*
4. *Schroders, 2013.*
5. *Frontier markets present a lower correlation with advanced economies than developing markets: 0.48 vs. 0.74 (Bloomberg Database, 2013).*
6. *Nowadays, frontier markets are a synonym for equilibrated fiscal balance and of low debt, in both public and private sector with levels lower than 50% (approx.) of GDP and even lower for the OECD, respectively.*
7. *Near the figure of 3.5 billion people.*
8. *The one-child policy promoted by the Chinese government will be decisive in the demographic drop that China will begin to experience from around 2040.*
9. *International organizations defidne productive population as the part of the population that is between 15 and 64 (United Nations, 2013).*
10. *In 2050 Africa will have the highest percentage of labor force (>65%) overcoming Asia (<65%) and Europe (<55%) (Boston Consulting Group, 2013).*
11. *The countries with the highest level of development are frontier markets. This is inferred from several updates of the IMF's World Economic Outlook.*
12. *Capapé, J., & Guerrero, T. (2013). More layers than an onion: Looking for a definition of Sovereign Wealth Fund. The Fletcher School Network for Sovereign Wealth and Global Capital Working Paper, Tufts University, Boston, MA, (Summer Bulletin, August 2013).*
13. *The five criteria needed for a sovereign wealth fund to be considered as such are: owned exclusively by a sovereign government; comply with the characteristics of an investment fund, not to those of a state-owned company; invest nationally and internationally in risk assets; investment seeking commercial returns; not a pension fund with regular cash outflows.*
14. *2013 Sovereign Wealth Funds Report, Invest in Spain/ICEX, KPMG and ESADE Business School (September 2013).*
15. *Generally Accepted Principles and Practices (GAPP)—Santiago Principles*
16. *See Guerrero, T. (2013) Frontiers Markets: A World of Opportunities. ESADEgeo Position Paper N°30.*
17. *For Spain see Santiso, J. (2013). The Decade of the Multilatinas. Cambridge University Press.*

How Safe Is the Brazilian Capital Market?

Considerations about transparency in light of the recent problems with the 'X' group

Adler Martins

It is now widely known that the "X" group, composed of companies that are directly or indirectly owned by Mr. Eike Batista, is facing dire financial problems. The company OGX, one of the most important in the group, recently filed for debt restructuring (a preliminary procedure that may pave the way to bankruptcy under Brazilian law). Meanwhile, two other companies in the group, OSX and MMX, may be insolvent, according to media reports.

The rise, fall, and, possibly, rebirth of the X group is a story that will undoubtedly generate many books and academic evaluations. Here we will deal with a relatively narrow question that has stirred small and medium-sized investors: Have the relevant facts published by OGX violated Brazilian rules by being excessively optimistic?

Brazilian laws on publicly traded corporations subject the company's administrators (both directors and members of the board) to transparency duties. The Brazilian Stock & Exchange Commission (CVM) has further detailed this obligation through CVM Instruction n. 358 of 2002 (and further amendments).

According to the rules, "Relevant Facts required to be disclosed" are those that may have influence on the stock price, or on decisions of current and potential investors regarding the purchase, sale or negotiation of the stock, or any rights (such as options) related to them.

The rules list a detailed description of acts and decisions that are necessarily classified as relevant facts, including change of control, changes in economic prospects, etc. The rules are also very clear on procedures for the disclosure of the relevant information, establishing, for example, that it must be published before or after market hours, whenever possible. They also detail the extent of the duty to disclose information, especially regarding sensitive or confidential data.

The criticism directed toward the relevant facts published by OGX and other X group companies, however, points to a matter not addressed by the CVM Instruction. That is, what is the limit between an optimistic market forecast and simple irresponsible boasting? Should public companies be restricted to hard facts, or are they free to also present personal evaluations or to sugar coat business prospects, even if only a little?

The fact that this question has come up reflects the lack of maturity of the Brazilian stock market. There are relatively few precedents on which to. Also, the oil and gas sector has long been monopolized by the government, which has further restricted the development of industry norms by market players.

The question becomes even more important because an administrative or judicial decision indicating that the X group's managers have, through excessively optimistic reviews, induced the investors to error or somehow omitted bad news would certainly benefit small and medium-sized investors during the debt restructuring/bankruptcy procedures. Eventually, a ruling to this effect would even allow for the piercing of the corporate veil and for the personal liability of the company's directors and board members (including, in theory, Mr. Batista).

In order to aid the comprehension of this topic, we present below several relevant facts published by OGX between 2008 and 2013, as well as several notices to the market conveyed during the same period.

Regarding Excessive Language, Undue Optimism and Inadequacy

The relevant facts are abundant in number. X group has published, on average, more notices and relevant facts than other publicly traded companies.

The optimistic tone is clear. The company is always (or almost always) described as “the major private player in the oil and gas sector,” or similar expressions.

On several occasions (for example, on July 16, 2008), newspaper headlines about the company have been used as a notable facts.

Also, on at least three occasions during 2009 (one in October and two in December), relevant facts that had objective content (finding of new oil reserves) have been “complemented” by positive statements about the impact of the finding, issued by directors of the company.

More importantly, it is remarkable that the first relevant notice that contained worrisome bad news was published in the second quarter of 2013. If the only source of information were to be the relevant facts published by OGX, the bad news would have to be considered an absolute surprise. The quarterly review from the first period of 2013 is, if not distinctively positive, not in the least negative. It does not signal the catastrophic results disclosed in the second quarter of this year.

This inferred incoherence between the publication of several positive facts and the sudden disclosure of an almost irreversible financial problem is the basis for the claims of minority shareholders, who feel duped and misled by the company.

Regarding Strict Adherence to the Rules

As noted above, if the only source of information for investors were the relevant facts published by OGX, those investors would probably be entitled to claim reparations.

However, the relevant facts are not the only source of information. OGX has published accurate financial statements, as well as managerial and technical reports. Close analysis of those reports would undoubtedly indicate that the company was generating little cash, and that its investments were taking a long time to mature.

In addition, bear in mind that the analysis of one single relevant fact, or of several of them, individually considered, will not reveal a direct breach of CVM rules. In spite of the embellished language, the relevant facts do contain objective data, such as expected production, the company’s actual and forecast revenues, etc.

Conclusion

My conclusion is that OGX’s relevant facts and notices to the market are not, generally speaking, in breach of CVM rules. Considered individually, almost every OGX publication fulfills the objective requirements described in Brazilian law.

If OGX’s managers are found guilty of market manipulation or similar conduct, this will probably arise from recent accusations regarding the concealment of technical information, not from the way the company’s notices to the market have been drafted.

Brazilian rules regarding communication with investors should evolve organically, and will benefit from OGX case. But it is doubtful that more detailed and comprehensive rules would entirely prevent misunderstandings. Ultimately, the evolution of the custums and practices of the market will help to avoid a similar case in the future.

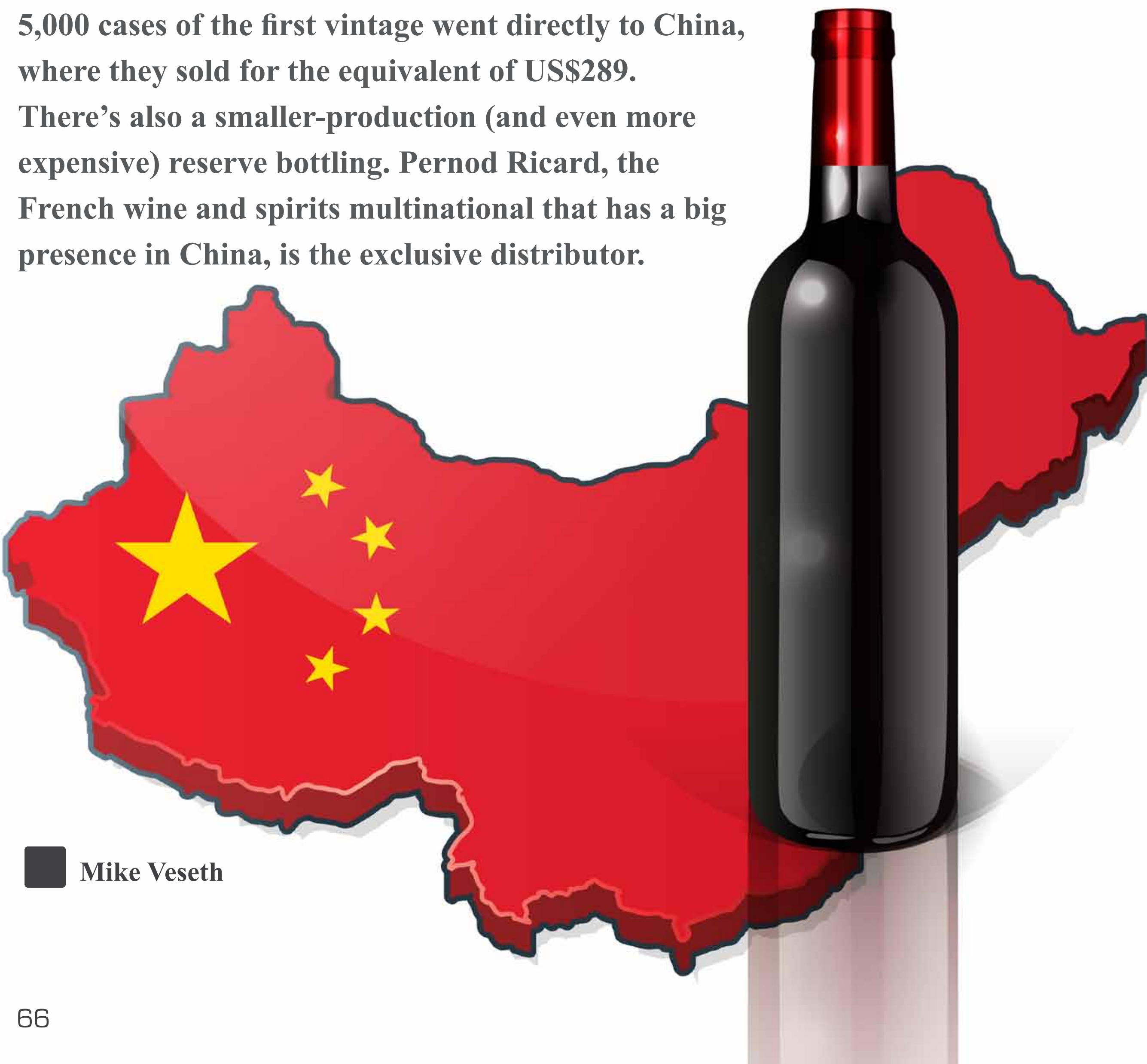
About the Author

Adler Martins is a Law graduate from the Federal University of Minas Gerais (UFMG). He holds an MBA from Fundação Getúlio Vargas and is pursuing a Masters (LLM) at Pontifical Catholic University of Minas Gerais and a post-graduate course in Financial Planning at São Paulo City University. Mr. Martins speaks English, Spanish, Portuguese, German and some Chinese (Mandarin). He has working experience in Argentina, Mexico, India, England, China and Dubai, aside from extensive experience in Brazil.

Mr. Martins is the co-founder of UFMG’s group on the study of International Trade Law (GEDICI) and has represented UFMG at the Vis Arbitration Moot, in Austria. He is also a pioneer in legal research of contracts among Brazil, Russia, India and China.

Big in China

The head of the winery has one unquestioned distinction. He is the tallest winemaker in the world. He stands seven feet six inches (2.29 meters) tall. The winery website describes him as a "global humanitarian and recently retired NBA star," and in November 2009 his company released Yao Ming® 2009 Napa Valley Cabernet Sauvignon. Most of the 5,000 cases of the first vintage went directly to China, where they sold for the equivalent of US$289. There's also a smaller-production (and even more expensive) reserve bottling. Pernod Ricard, the French wine and spirits multinational that has a big presence in China, is the exclusive distributor.



Mike Veseth

Yao Ming is already a Chinese sports legend. He has played basketball for the Shanghai Sharks (a Chinese professional team that he now owns), the Houston Rockets (he was named to the all-NBA team five times), and of course the Chinese national basketball team. How did he get interested in wine? He learned from his fellow National Basketball Association team members, he says. He'd pay attention when they ordered wine at dinner and ask lots of questions. His unlikely mentor in this seems to have been a Congolese player named Dikembe Mutombo, who stands a mere seven foot two.

When Yao retired from the Rockets, he asked his business agent, BDA Sports International, for help starting a winery in Napa Valley. Yao, like most sports stars today, has many business and charitable interests (he's Apple's face in China, for example) and is therefore the central figure in a complex management structure. Tom Hinde, a well-connected winemaker, joined the team. Classic Bordeaux-variety grapes were purchased from various sources (no estate vineyard or winery yet), new French oak barrels were filled, and an attractive label was designed that features "a hand-drawn illustration of Napa Valley with the ancient Chinese character for 'Yao,' elegantly representing both cultures Yao Ming has made his home," according to the winery web site. The very first bottle of Yao's wine was revealed at a 2011 charity auction in Shanghai, where it raised more than US$31,000 for the Special Olympics.

The wines are apparently very good. The 2009 cabernet received a silver medal in the Decanter world wine competition, and Wine Enthusiast's California editor Steve Heimoff gave the cabernet a score of 95 and the reserve a 97. It's not surprising that the wines score so well; celebrity wine projects, when they are well designed, can bring out the best. I'll bet everyone was happy to join Yao's team – it's just good business, as well as good wine. Good for Yao, hopefully, good for Pernod Ricard, good for his vineyard and wine-making partners. It's even been good for the Special Olympics, which got money and helpful publicity, too. It's also been good for Napa Valley and the California wine industry. In fact, I suspect that the biggest beneficiaries of Yao's new wine venture are the dozens of top-drawer producers of Napa Valley cabernet. Yao's new wine will do wonders to publicize the region's brand and to validate the quality and importance of their wines. They already have a foot in the door of the Chinese market, but Yao's big size-18 sneakers will open it so much wider than they ever could by themselves. Yao is big in China, and I think everyone hopes to ride on his coattails into this growing market.

About the Author

Pakistan, which ranks eighth in the world for its share of shale oil resources, and among the highest for which it is technically recoverable, could be the country most impacted by the shale oil boom.

Pakistan Faces Shale Oil Challenge

According to research by Codexa Capital, a specialized investment banking firm, there can be a large gap between technically recoverable and economically recoverable resources. As Pakistan's shale potential is geologically complex, and the cost of extraction may be high, foreign investment required to exploit resources is elusive. However, for an energy-starved country that now imports between 85% and 90% of its oil demand, the new outlook is highly constructive. "The issue in Pakistan is, frankly, the financial demands of extraction," says Douglas Clark Johnson, CEO/Chief Investment Officer at Codexa.

He adds that the ability to attract foreign investments and to allocate the financial resources that are required to develop the shale oil reserves is a tough challenge in the current global environment. Pakistan's perceived risk premium is very high, and investors may be deterred, instead exploring shale oil opportunities elsewhere that may prove less costly to develop.

"If you look within the Middle East, Jordan is working very hard right now to develop some of its shale oil capacity. As a percentage of the world's shale oil reserves, Pakistan has a similar share as Canada, but obviously the situation in Canada is relatively easy to exploit. Canada further has the U.S. market at its doorstep to support the development effort," Mr. Johnson says. However, a vast range of untapped opportunities exist in Pakistan. One of the current attractions is the lack of local competition on the supply side; the country imports approximately 85% to 90% of its oil requirements, making its market a captive one.

"We often forget about the percolating investing potential of Pakistan because political issues dominate the headlines. It's a massive economy. And it's an economy that needs energy resources to accelerate growth, with limited at-hand options in the context of a national energy policy. You have a vastly improved political situation in Pakistan than you did, say, five years ago," Mr. Johnson says.

"We saw this year perhaps the first smooth power transition in Pakistani political history with Prime Minister Sharif winning the election. He's just come off of a relatively successful trip to Washington. While you have a more accommodating geopolitical backdrop, there is still a myth among the poorly informed that Pakistan is an evil twin to India."

Mr. Johnson adds that in the minds of many, Pakistan is a no-fly zone for foreign investment. However, one of the largest foreign investors in Pakistan is actually the United Arab Emirates, due to the many Pakistani expatriates in the UAE who are allocating capital back to their home economy.

"I often like to say that if expatriate Pakistanis didn't believe in the underlying potential, then they certainly wouldn't be the largest foreign investor into their economy," Mr. Johnson says.

The U.K. and the U.S. are also two of Pakistan's biggest investors at any given time. "The government has long recognized the oil-import challenge and it's among the reasons why the Pakistani government is so friendly to China, for instance," Mr. Johnson adds. "Chinese investment in Pakistan has been extremely high over the past cycle, at a time when traditional Western sources have dried up. There's no quick solution to Pakistan's oil-import requirement; it is an issue that is constantly at the forefront of economic policy."

Shale Potential

The economic cost of extraction in Pakistan is relatively high, Mr. Johnson says, due to the reserves being in geologically hostile areas. The setting in Baluchistan – one of the key Pakistani provinces – has been tapping foreign investors for the initial stages in the hope that these voices can easily influence other names who may be looking at Pakistan for the first time.

"You're moving into the framework of government concessions, but that should not be a deterrent. Islamabad is relatively astute about these things. They certainly understand that they need foreign capital. I would suggest that the Pakistani government is more receptive to foreign investment than most people would believe."

In comparison to similar extractive frontier markets, such as Mongolia and Indonesia, Mr. Johnson believes that Pakistan is the most attractive. One of the reasons for this, he says, is that in Mongolia and Indonesia the national policies toward foreign investors have been volatile over the past cycle, influencing the pace of international commitments. Meanwhile, the trajectory of policies in Pakistan has been generally positive.

As a way for investors to sound out the shale potential in Pakistan, Mr. Johnson explains that there are a number of private equity funds available to exploit the Pakistani opportunities. In the context of liquid securities, he explains that the Karachi stock exchange is transparent and accessible, while the investment community routinely publishes high-quality research. "The financial intermediaries are among the most sophisticated in the developing world."

Codexa Capital is a specialized investment banking firm spanning Islamic and conventional finance. It concentrates on cross-border transactions, typically involving one or more emerging markets. Codeza provides project finance, product-structuring, and capital-introduction services that encompass marketing and sales strategy, roadshow development, and research-based communications support.

South Korea Strengthens Its Asian Presence

South Korea is set to grow at the highest rate since 2010. Reportedly, the positive developments in Asia's fourth-largest economy are largely due to the improvements in Seoul and the middle and southwest areas of the country. Meanwhile, the South Korean stock market, which has been under considerable pressure throughout the year, is also showing signs of recovery, helped by easing tensions with North Korea.

However figures are still low. The daily average trading volume for the main Korea Composite Stock Price Index (KOSPI) market in 2013 was approximately US$3.8 billion, according to data from the Korea Exchange – down from a year earlier in 2012, which had fallen by 30% from the same period in 2011.

The North-South Korea relations are not significantly affecting the South Korean stock market and economy, according to Hyong T. Cho, Managing Member of the General Partner ANTHROP-J KOREA. The current issue is the sharp devaluation of the Japanese yen, and for the next several months the weak yen is expected to present a competitive challenge for Korean exporters. And it is this devaluation that has had the worst impact on the Korean stock market, a factor that will affect large corporations and exporters over the next quarter, Mr. Cho says. However, he firmly believes that Korea's economy has always found ways to respond to its challenges.

"The KOSPI in U.S. dollar terms was down about 14.5% year-to-date as of June 30 and down 2.7% year-to-date as of September 30," Mr. Cho adds. "ANTHROP-J KOREA LARGE CAP was up approximately 4.8% year-to-date. The Korean equity market is currently cheaper compared to other emerging markets, which can be attributed to several geopolitical and economic factors."

Mr. Cho believes that the external and internal balances of South Korea are among

the best in the world, with technology advancements, creative products, aggressive marketing, and a strong work ethic, which are all drivers of South Korea's success. The R&D-to-GDP ratio of South Korea, he adds, is one of the highest in the world. "The behavior of North Korea shown last spring is not inconsistent with its past behavior, but the hostility of the rhetoric has been amplified to a new level. Motivations behind the new, young leader Kim Jong-un's threats may be to consolidate power domestically and demand larger economic concessions from abroad for their failing economy."

However, Mr. Cho says that the North Korean regime is nearing the end of its life cycle, and that although the current political atmosphere will not lead to war, he anticipates the possibility of an abrupt event taking place within the next several years, resulting in a regime transition. While many express pessimism regarding a reunified Korean peninsula, this anticipated change in political leadership could in fact be a harbinger of great new economic opportunities. Despite its current economic and political challenges, the Korean currency is also expected to appreciate over the longer term. The fundamentals of the Korean economy are sound, something that Fitch has reiterated by increasing South Korea's credit rating to AA-, one level higher than Japan and China.

Turning to China, the country with which the South Korean market shows the highest correlation, Mr. Cho says that it has huge potential as a developing country. However, for the past four to five years its equity market has been struggling. Foreign investors in China, he adds, are faced with two big problems: global transparency, due to the country's questionable accounting methods, and the government's economic dominance. Therefore, despite the huge growth potential for China, Mr. Cho believes that these two factors have a chilling effect on foreign investors.

"If the Chinese government wants to pull their stock market down, they can do so abruptly over a few weeks with no warning. It's very difficult to predict what the government will do in China."

Korean Trade Ties

Korea's trade with China outweighs that with the U.S., something that has been seen as a point of weakness over the past few years. As the market is dependent on Chinese growth, the focus now turns on how this affects the Korean stock market, due to how tightly the stocks of many Korean companies are correlated with the Chinese market.

"The U.S. is the next largest buyer, so the U.S. economy is correlated as well. And then the global economy itself. This is because Korea is an export-driven country. So when global demand is down, it's related. And then in terms of currency, we believe the Korean currency is undervalued. The Korean won has been especially undervalued this year."

Therefore, despite the Korean currency devaluation being steeper than expected, Mr. Cho says that he remains extremely optimistic about the appreciation of the Korean currency in the near term. Korea, he adds, has a very good fundamental economy, and the government debt-to-GDP ratio (35%) is one of the lowest among all of the emerging market countries. Both the internal and external balances of the country's trade and financial positions remain excellent and are ranked among the best in all of the developing countries.

Turning to Korea's trade offerings, South Korea in particular has become globally competitive in its technological advancements and creative products. The country has also become independent in terms of its currency, and has been ranked as one of the leading countries in innovation and creation of intellectual property.

"You know that there are many economies that emerge and then collapse. However, Korea has passed emerging status and is now one of the strongest economies in the world. And they are very innovative in technology, and that'll be the future, the dominating driver for the Korean consumer market. On the other side, China has huge potential for emerging growth. Korean companies have a large domestic market presence in China. Korean brands are among the most popular brands there. So rather than investing in Chinese companies, it is far better to invest in Korean equity, for example, like large cap Korean companies. And in doing so you can participate in the future opportunity of China's economic growth."

Mr. Cho emphasizes the reward in capitalizing on Korea's stable and moderate risk-adjusted return offerings. Investing in Korea, he says, is not only less of a risk than any of the other emerging market countries, but the investor can still expect moderate risk-adjusted return on growth. Compared to the other emerging markets, such as India and Indonesia, Korea's sound economic fundamentals and strong corporate growth outlook have recently caused foreign investors to reallocate funds to Korea.

"Korea's equity evaluations are still relatively cheap," Mr. Cho says. "My long-term view of the economy, market and currency remains bullish. With the outlook for an improving global economy, conditions under which the Korean economy prospers, any upcoming correction would prove to be an ideal point for existing investors to increase long-term positions, and new investors to enter the market."

Between India and China

A Wealth of Opportunity

The countries between India and China (BICsm) – namely Sri Lanka, Bangladesh, Cambodia, Laos and Pakistan – have the potential to become lucrative markets for investors. And Mo Riad, the Chief Executive Officer & Chief Investment Officer at Elephant Capital Advisors, an independent investment boutique providing global investors access to the rapidly developing Frontier BIC economies of South Asia, is keen to tap into these opportunities.

Elephant Capital Advisors generates returns for its shareholders by investing in growth companies in the BIC region. So far, investments have been made across a range of sectors, including hospitality, automotive, mobile payment services, building materials, education, sports media, children's entertainment and clinical research. One investment has already been fully exited.

Mr. Riad says that the super power houses of India and China led him to question the growth and investment opportunities in the nine countries that sit in between the two; the frontier markets of Sri Lanka, Bangladesh, Cambodia, Laos and Pakistan. "This is an interesting product because you have the demographics, namely a young workforce and large population bases that work for the region, and two large economies on either end geographically of that region that feed into it as well as globally," Mr. Riad says.

"This makes for an interesting investment thesis. One, is because it's a frontier emerging region, and two because it has demographics and geography on its side. It should be a fairly rapid growth path if the demographics and the two anchor countries maintain their progress over the next 10 to 20 years, those little countries by and large have to grow pretty significantly."

Perceived Risk Versus Actual

Mr. Riad is keen to obliterate the risky investment tag that Westerners have placed on the "between India and China countries." Pakistan, he says, serves as an example of how deceiving these high risk labels can be.

A factor that still inhibits this region from being considered as a serious contender in the emerging market stage is its exclusion from the global trading business.

"There is no country in that area as volatile from a violence standpoint and conflict standpoint as Pakistan. But when you look at the earnings growth of the KSE, just take the top 50 companies in the Karachi Stock Exchange and look at their earnings growth, and then look at the growth of the Karachi Stock Exchange itself, and the index growth. There's a paradox."

Despite internal conflicts in these regions, and in Pakistan in particular, Mr. Riad explains that for the larger established corporations, some of which may have up to 20,000 employees growing at 20-30% a year for 10 years, it is business as normal.

"The business community continues to do what they need to do, to live and support their families. They adjust whether its logistics, trade patterns, the roads where they take the busses or the trucks. They adjust for it and they continue to go on. So the only way to really disprove the high risk theory is, if it was real, then you really wouldn't be able to conduct business in an efficient manner over a long period of time, and you wouldn't be able to grow. When you look at the business aspect on a bottom's up basis from the indexes, you look at the companies, and the earnings, and the growth, not over a one to three years, but over a 10-year period, it says, this is the real; the perceived risk is what we all read in the papers and see in the papers. But the business side of it is just chugging along."

However, persuading potential investors of this, is always tricky, and changing perceptions is a challenge. Mr. Riad says that the majority of the potential investors he meets will believe that making a profit in some of these politically unstable Asian countries is impossible.

"If there is a conflict in Pakistan next year, we will just exit the market until we feel comfortable, then we re-enter the market. I don't foresee it but there could be. Then you simply move your money into Bangladesh or you go to Sri Lanka or you go to Vietnam, wherever else you see the relative value. So I think we have a way to defend against that. We don't dismiss it like it cannot happen but again the perception is a lot larger than the reality and the fact is because of that they're mostly contained conflicts, not big blown out conflicts to destroy the country like Syria."

"Yes, the roads are bad," He adds. "The people are bad. There are bad things happening. That doesn't mean that business doesn't go on. I just revert back to the earnings and the stock price growth and corporate growth, Finance can be very complicated. And especially in the United States, it is very complicated. But, in those kinds of countries for investing, it really comes down to the proof is in their continued existence."

Investment Flows

However, this is something that is hoped will change, and Mr. Riad confirms that investment sentiment is building in these nine "between China and India" countries, especially from European fund managers. "I've seen lot of trades going off and I get contacted by other companies by the brokers of who's buying it. I'm hearing names of European asset managers, for example, that I hadn't heard from before, and a U.S. asset manager I hadn't heard before. Or frankly, a couple of Chinese funds that are buying state funds. So we've seen a lot of new interest in it," he says.

A factor that still inhibits this region from being considered as a serious contender in the emerging market stage is its exclusion from the global trading business. Mr. Riad believes that it is imperative that this region join the WTO (World Trade Organization) to be a part of the global environment, although the biggest challenge, he says, will be entering into a dialogue to make plans and execute the idea.

"If you are not investor-friendly and you don't bring in the capital, you cannot do the infrastructure, you cannot ship the goods out. You have to develop the marketplace, you have to get capital, and that requires foreign investment because there's no inherent huge internal capital market. All these countries are trying their best to put their best foot forward as far as investor protection," Mr. Riad says. "They are all at different stages. Some are great, some are not, but I can honestly say that all want to be part of the global economy, and they're all progressing toward that. Even if they're clawing along like Laos and Cambodia, there's no doubt in my mind that in 10 years they will be no different than you are seeing in Thailand or Malaysia or Indonesia. I think that I would be their model."

Vietnam

Emerging as a Market Contender

For investors looking to diversify their emerging market exposure, Vietnam has been a main contender among the Southeast Asian markets. The country's economic growth is expected to continue as the government's recent monetary policy actions and proposed financial sector restructuring come into play.

However, the country's financial sector faces its fair share of challenges. Banks are suffering from 15-20% NPL rates as a legacy of the bubble economy, government corruption is a major complaint, and there were serious difficulties with inflation and foreign exchange depreciation over the recent years.

Since 2010, Vietnam has been experiencing an economic lull, largely down to the government's imposed austerity measures, and fiscal and monetary discipline, as a result of its "bubble economy."

"Vietnam has only been growing by 5% recently which is not enough to furnish employment in the long-term to its young population. But then, this is the process of

adjusting to the implosion of and workout from the bubble economy. The bubble economy takes about two years to come and go, and the cleanup is usually about four to five years. That's what the Asian crisis is all about in the period of 1997 to 2003," says Bill Stoops, Chief Investment Officer at Dragon Capital, a Vietnam-based investment group.

Why Invest in Vietnam?

On the upside, Vietnam is believed to be emerging from the government's "clean-up" process, and is ready to move to better levels of growth. According to Mr. Stoops, the country is expected to grow by 6-6.5% from late 2014, putting it on a par with the other emerging or frontier economies.

"From 1986 to 2006 Vietnam was really on a run and the Communist Party was doing great things in terms of turning Vietnam into a more market-oriented economy. But things got out of control when the bubble economy happened and the government did not have optimal economic management. It lost some credibility with the population. Nonetheless, despite all those things I think the economy will do well. The government has laid something of a base now, with fiscal and monetary policy, for the economy to first be stabilized and then bounce back."

"When they were doing the austerity thing, they had interest rates of about 25%, but now we're slowly making our way back to about 10%. I think right now we're at 14% whereas.10% is about the level where Vietnamese loan growth starts to fire. We're doing 10% loan growth, which is very sub-par, just like a GDP growth of 5% is sub-par."

"As rates come down, loan growth can go back up to about 20%," Mr. Stoops adds. "You get the interest rate to 10%, loan growth to 20% and Vietnam is kind of back. Now, we'll be supplemented by the government undertaking a big infrastructure investment, based on recently raising money in order to restart the public investment cycle in 2014. So, there's a lot of growth engines that are starting to revive.

"When we look at the export mix now, I think it's about 35% commodity, 65% manufacturing. The manufacturers are getting better all the time. Right now, on the back of Korean foreign direct investment, they are exporting about 13 billion cellphones.

Vietnam is a socially conservative country which reveres education, has high savings, is inclined towards loan order, is racially homogenous, has no religious fanaticism, and has a national work ethic."

Despite slower economical growth, a macro policy is emerging from Vietnam, the economy is stabilizing and gradually it is expected to grow. This has already been sufficient to make the country number two in Asian stock-market performance since 2011. In addition, Vietnam has shown signs of bouncing back from its political troubles in August of 2012, when politically related arrests were made in the banking sector.

"I think the market went down overnight by about 30% but it bounced back. So we've seen signs of the market wanting to move on the back of an economy which is definitely stabilized, and it's now waiting to return to growth mode," Mr Stoops says.

The Vietnamese Outlook

With regards to the domestic economy, 70% of Vietnam's GDP is made up of consumption, which lies in stark contrast with China, which is currently at around 35%, Mr. Stoops says.

"This is a nation of about 95 million people who are consumption crazy. And you can see it in the statistics in GDP. And in the population growth rate, it is about 1.5% to 2%. And at the same time, they have this great export machine which comes from a combination of factors; SMEs are very important, but the big locomotive is foreign direct investment."

Mr. Stoops explains that much of Vietnam's export sector is owned by overseas investors. And due to the country's relative political stability, foreign direct investment has been pouring in of late, which is also due to the offer of cheaper labor, as well as investors diversifying away from, or altogether relocating, from China.

"That is definitely gathering momentum. So for years and years, FDI ticked over at around US$8 billion, and I think next year it is going to go up to US$9 billion."

Trade Sales

In 2006, the country's export sector was already big but still somewhat rudimentary, with manufactured goods accounting for half, and commodities the other half.

"When we look at the export mix now, I think it's about 35% commodity, 65% manufacturing. The manufacturers are getting better all the time. Right now, on the back of Korean foreign direct investment, they are exporting about 13 billion cellphones. Three or four years ago, that export did not exist, we're getting a lot more electronics on the manufacturers side of exports."

"Exports are moving up the value chain, although it is still pretty low-end stuff, mostly based on wage arbitrage. However, there's definite progress there, and on the back this, Vietnam's exports are up about 20% this year, that's off the peak of about 40% in 2010. But this was in the middle of a global recession and they are way outpacing exports from their peers, such as Thailand and Indonesia," Mr. Stoops says.

However, Mr. Stoops points out that the country's commodity sector is very important. Vietnam is the world's number one or number-two rice exporter. Robusta coffee is also a major exporting product, and after of this is rubber, shrimp, and catfish, along with a lot of agri-commodities.

The Perceived Risk of Vietnam

"I think it's a very positive fact here, and then the gradual rationalization of the banks, and don't forget there is a big private sector among the banks in the banking system here, unlike China where everything is about the four big banks. In Vietnam there are about 35 banks and many of them are private and listed, and the private sector controls about half of the loans, deposits and assets," Mr. Stoops says. He adds that the banking system has shown vast improvements over the last few years, and that there is much better prudential regulation.

Looking ahead, the ongoing rationalization of Vietnam's macro policy remains successful, in terms of inflation is continuing to edge down, leaving the currency at a stable position, "an absolute key thing" when looking to attract foreign investors.

"You're not going to get much traction on privatization," Mr. Stoops explains. "But the SOEs have been thoroughly contained. It's all about macro policy continuing to rationalize so that the private sector can come more and more into its own. And I think that's happening."

Established in 1994 from an initial base of US$16 million and eight staff, in June 2013, Dragon Capital managed around US$1.2 billion with a headcount in excess of 90. It has offices in Ho Chi Minh City, Hanoi (registered with Vietnam's SSC), the United Kingdom (regulated by the FSA), Bangkok and Hong Kong (registered with SFC). The company is owned by present and former management and staff, with the World Bank's International Finance Corporation (IFC) and Proparco, the French government's development finance entity, also having shareholdings.

Private Equity Talent Management in Emerging Markets Survey

The Results Explained

The Emerging Markets Private Equity Association (EMPEA) has published the results of its Private Equity Talent Management in Emerging Markets Survey. The report provides an overview of the current recruitment dynamics within private equity firms across different emerging markets, the challenges that general partners (GPs) face in staffing their emerging market teams, and how practitioners anticipate the job market will evolve over the next five years. EMPEA's findings are based on data from 88 respondents, representing 70 private equity fund managers in 34 countries that operate across the emerging markets.

Looking firstly at talent repatriation, Mike Casey, Director at EMPEA, explains that global private equity firms are becoming more established and pushing further into emerging markets, and as a result a trend is emerging among overseas students, who, after receiving their education and experience in developed market institutions, return home to either work on emerging market private equity deal teams or launch their own funds.

While most respondents stressed the importance of familiarity within the local markets, the results showed that employers tend to source entry-level hires from schools based in developed markets. The most-cited school based in an emerging market (Universidade de São Paulo) ranks sixth behind HBS, Wharton, INSEAD, London Business School (LBS) and Stanford. Meanwhile, the recruitment of local graduates is concentrated in Brazil, sub-Saharan Africa and India.

Nadiya Satyamurthy, Senior Director at

EMPEA, says that there has been an increase in local education and emerging market MBA programs, particularly in some of the more developed emerging markets from a private equity perspective, such as Brazil and India. This trend is also emerging in some of the more frontier markets, such as sub-Saharan Africa and Southeast Asia, but at a slower pace, she says.

"That being said," Ms. Satyamurthy adds, "interest in these markets is high. In EMPEA's most recent Global Limited Partner Survey, the most attractive emerging markets for GP investment from a limited partner (LP) perspective were sub-Saharan Africa, Southeast Asia, and then Latin America ex-Brazil, and these are the markets LPs anticipate increasing new capital commitments. As the trend now is to be very local, education and training will pop up around that."

Talent Spotting

One of the most important factors for investors looking to allocate capital within the emerging markets, regardless of the sector, is the involvement of local knowledge and local partnerships. However, who will investors be opting for if they are given the option between hiring a local expert or an individual with the prestige of a Wharton degree? The answer might not be so straightforward. As Mr. Casey emphasizes, local knowledge and an advanced degree from a program in a developed market are not mutually exclusive.

"Some of the individuals interviewed for the survey highlighted that, yes, local knowledge is key, but they also viewed some of the premier business schools as one of the means by which they could vet candidates. There are some hard and soft skills that they know students should cultivate while in these programs; as a result, they check a lot of boxes and it's just an easier decision from a hiring manager's perspective."

Looking at the competitive elements of working within the emerging market landscape, the parity between the developed and emerging markets' need for talent is beginning to widen. According to Ms. Satyamurthy, the trend of wanting to work in the emerging markets is rising because of the growth opportunities that these economies can offer – a trend that seems to be continuing. Although the demand for talent is high in both developed and emerging markets, the latter offers significant room for new professionals with the right skill sets to step in.

Local knowledge is certainly a hot commodity, but the survey's results do not bode well for China. 67% of respondents said that China lacked candidates with adequate local knowledge; this is also the most commonly cited obstacle in Emerging Asia, Turkey and Russia/CIS. China's diminishing competition for talent could be based on numerous factors, such as the projected Chinese slowdown and the rapid growth of sub-Saharan Africa, Southeast Asia and Latin America in comparison.

However, Mr. Casey cautions that the survey's results are from a selected set of professionals only, and it may not reflect wider opinions at large. "Bear in mind that these are findings from the industry professionals we surveyed. That said, I really do think that there is some merit to the notion that, following the pre-IPO phenomenon, there is a lot of talent that could be entering the Chinese market. There's a bit of a separating of the wheat from the chaff going on in China's private equity industry right now, and as a result, there's likely to be more of a glut of talent in China than in a number of other markets."

Compensation Negotiations

In six out of the 10 markets, compensation negotiations are seen as the biggest obstacle to acquiring qualified talent. In particular, more than 70% of respondents operating in India and 60% of respondents operating in Brazil cite compensation negotiations as an obstacle to adequately staffing open positions. Compensation negotiations are also cited as the biggest obstacle to acquiring qualified talent in MENA, sub-Saharan Africa, CEE and Latin America. Several respondents trace upward pressure in compensation to competition from large global private equity firms building new local teams.

"We've definitely seen upward pressure on base salaries being offered to private equity professionals particularly at the senior level, and we're seeing this to the greatest extent in markets like India, China, and Brazil." Ms. Satyamurthy adds. "It's no longer a fly-in fly-out game – as the larger global funds try to build up their emerging markets presence, they know that they need to be local and they're often willing to pay very highly for local talent. A number of local fund managers are telling us that it's becoming very difficult to retain talent because they just can't match the salaries being offered by some of the larger, global firms."

The survey showed that India has the highest staff turnover within the emerging market countries with an annual rate of 21%. Turnover rates in emerging Asia, Brazil and MENA are also higher than the equal-weighted emerging market average of 13%, while the lowest turnover rates reported were in CEE and Turkey.

Ms. Satyamurthy attributes India's high turnover rate, in part, to the influx of capital that went into the country in prior years. "As more capital comes into a market, you're going to find people trying to capitalize on those inflows. This was the case three to four years ago in India, although we are seeing a bit of a slowdown at the moment. Previously, it was very common to see spin-outs emerge from existing homegrown firms to capture investor appetite. This is not necessarily a bad thing, because in order for an asset class to really mature, there is a need for people with the right skill sets to deepen the competitive landscape. However, team stability is one of the most important things to the LP community, so the constant shuffling of teams has also had a negative impact on the Indian private equity industry at a time when its macroeconomic picture became a bit cloudier."

The survey also concluded that operational expertise was the skill set that was in the shortest supply, relative to demand. Practitioners active in the BRICS report an adequate supply of finance-related skills among recent graduates of MBA programs and candidates with investment banking backgrounds. However, they also point to a dearth of qualified mid-level and senior candidates who marry knowledge of local markets with operational backgrounds and/or private equity deal-making experience.

"We know that emerging markets are important for a number of the large executive and talent search firms. If a new group of outsourced HR intermediaries were to emerge, I imagine they would be very specific to each market," Mr. Casey says.

"There's a valuable role to be played by these institutions, but to some extent it's limite," Ms. Satyamurthy adds. "Private equity is a very long-term asset class. It takes a long time to build up the operational expertise from sourcing deals to making an investment, to implementing the value enhancement all the way through exit. So to really have that operational expertise, you have to have gone through the entire fund cycle process. To some extent, it's just a matter of time before we see a massive build-up of operational expertise within these markets."

About the Author

The Emerging Markets Private Equity Association (EMPEA) is an independent, global membership association whose mission is to catalyze the development of private equity and venture capital industries in emerging markets. EMPEA's 320+ member firms share the belief that private equity can provide superior returns to investors, while creating significant value for companies, economies and communities in emerging markets. Its members, representing nearly 60 countries and more than US$1 trillion in assets under management, include the leading institutional investors and private equity and venture capital fund managers across developing and developed markets.

The Capital-Flow Conundrum

Eswar Prasad

In recent months, emerging economies have experienced capital-flow whiplash. Indications that the U.S. Federal Reserve might "taper" its quantitative easing (QE) drove investors to reduce their exposure to emerging markets, sharply weakening their currencies and causing their equity prices to tumble. Now that the taper has been postponed, capital is flowing back in some cases. But with little influence, much less control, over what comes next, emerging economies are still struggling to figure out how to protect themselves from the impact of a Fed policy reversal.

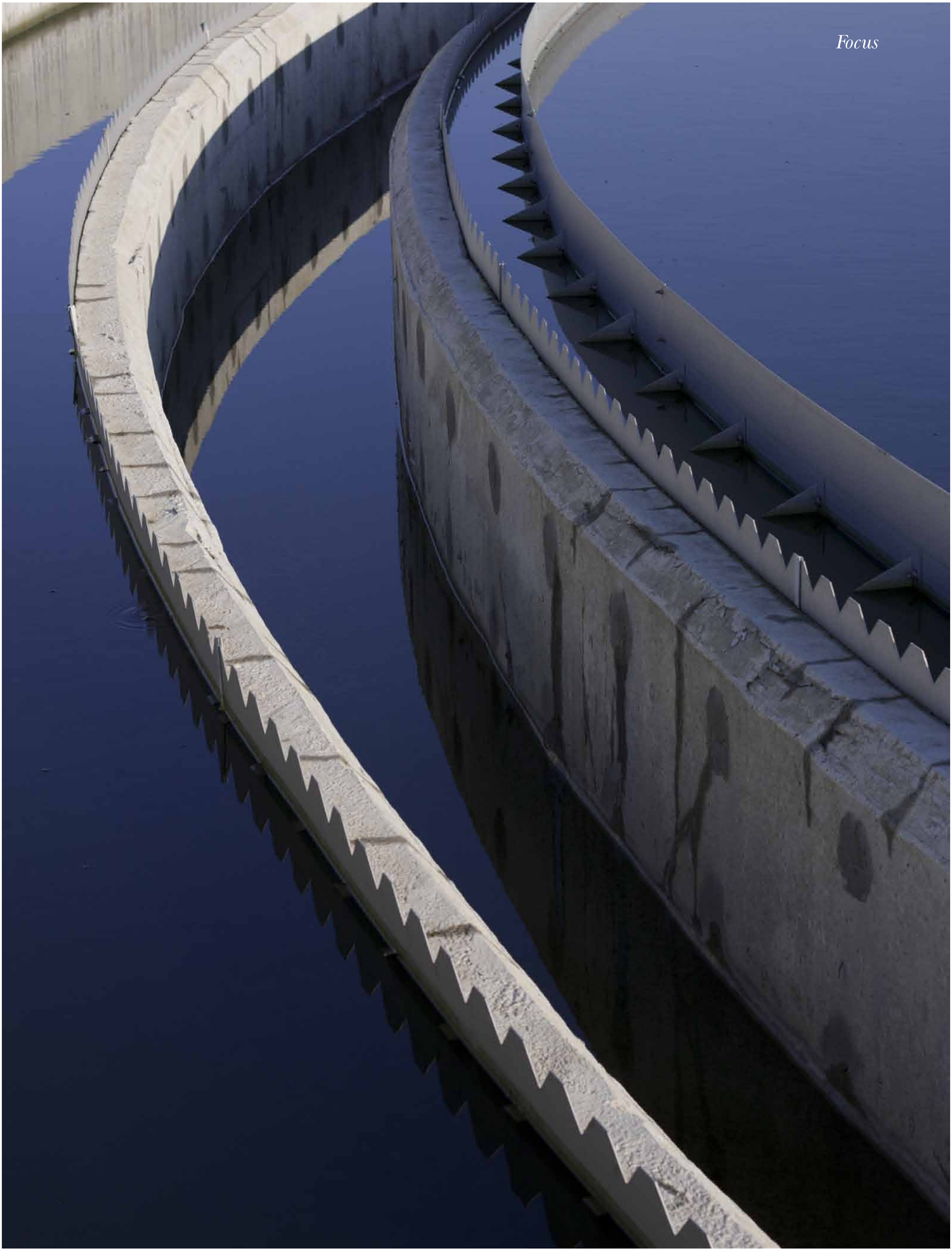
When the Fed initially hinted at its intention to taper QE, policymakers in some emerging economies cried foul, but were dismissed by advanced-economy officials as chronic complainers. After all, they initially rejected the very policies that they are now fighting to preserve.

But emerging-market policymakers' criticisms do not reflect an inconsistent stance; in both cases, the crux of their complaint has been volatility. They have already attempted to erect defenses against the potentially destabilizing effects of advanced-country monetary policy by accumulating foreign-exchange reserves and establishing capital controls. Now they are calling on their central banks to ensure stability by, for example, raising short-term lending rates.

But this approach fails to address the underlying issue – and misdiagnosing the problem could have far-reaching consequences, not only leading to ineffective solutions, but also possibly causing severe distortions for specific economies and the global financial system as a whole. In order to design effective remedies, it is useful to distinguish among three types of failures that impede financial-market functioning.

First, there are market failures, which occur when, for example, investors display herd behavior, information asymmetries exist, or the structure of incentives for investment managers encourages excessive risk-taking. Second, there are policy failures, which occur when undisciplined macroeconomic policies and inconsistent or ineffective financial regulatory policies heighten the risks associated with volatile capital flows.

The third – and currently most problematic – failure is one of national or international institutions. Domestic monetary policy has become the first and last line of defense against growth slowdowns and financial panics, enabling policymakers to avoid pursuing other important, but far more difficult measures. Using monetary policy to compensate for deficiencies in other policy ar-



eas constitutes an institutional breakdown: monetary policymakers are not necessarily getting it wrong, but they are constrained by the configuration of other policies.

The inadequacy of the current framework for global governance compounds the problem. The grim reality is that, with financial markets becoming increasingly interconnected, monetary-policy measures taken by any of the major economies have international spillover effects. An effective governance mechanism or reliable institution is needed to help emerging markets cope with these effects.

The lack of effective global economic governance has important implications for capital flows. Emerging-market policymakers believe that they lack recourse to safety nets that would cushion the impact of volatile flows. Their efforts to "self-insure," by, say, building up their foreign-exchange reserves, perpetuate global economic imbalances.

So how can policymakers address these failures? There has been some progress at the international level on regulatory reforms aimed at addressing market failures, though such efforts have been limited by strident resistance from financial institutions.

Solutions for policy failures are not difficult to discern. Flexible currencies, more transparent monetary frameworks, and sound long-term fiscal policies can serve as buffers against capital-flow volatility. Moreover, the functioning of emerging-economy financial markets should be improved, with policies aimed at institutional development and improved regulatory capacity. While the right policies cannot eliminate risk, they can ameliorate the cost-benefit tradeoff from capital flows.

Fixing institutional failures is the most important and the most difficult step. Successful reform requires, first and foremost, finding the right mix of domestic policies. In the advanced economies in particular, a sharper focus on long-term debt reduction, rather than short-term fiscal austerity, is needed, along with structural reforms to labor, product, or financial markets, depending on the country.

In many of the troubled emerging economies, however, monetary policy has shouldered the burden of controlling inflation, managing the local currency's value, and supporting growth. This balancing act is difficult to maintain, leaving these economies vulnerable when the external environment turns unfavorable.

In India, for example, increasing productivity and long-term growth require fiscal discipline and a raft of financial- and labor-market reforms. But the central bank is being asked to do all the heavy lifting. In other emerging markets, too, the main challenge is to ensure that all macroeconomic and structural policies advance common goals.

At the same time, the governance structure of multilateral institutions like the International Monetary Fund must be reformed, in order to bolster their legitimacy in emerging markets. Otherwise, these institutions will remain ineffective in confronting collective problems related to macroeconomic-policy spillovers, and in providing insurance against crises.

Policymakers in advanced and emerging countries alike should focus on the underlying failures that destabilize their economies and impede growth, rather than trying to treat the symptoms by manipulating monetary policy or capital controls. Unless they are supported by strong institutional structures at all levels, such measures will prove futile in managing capital flows.

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