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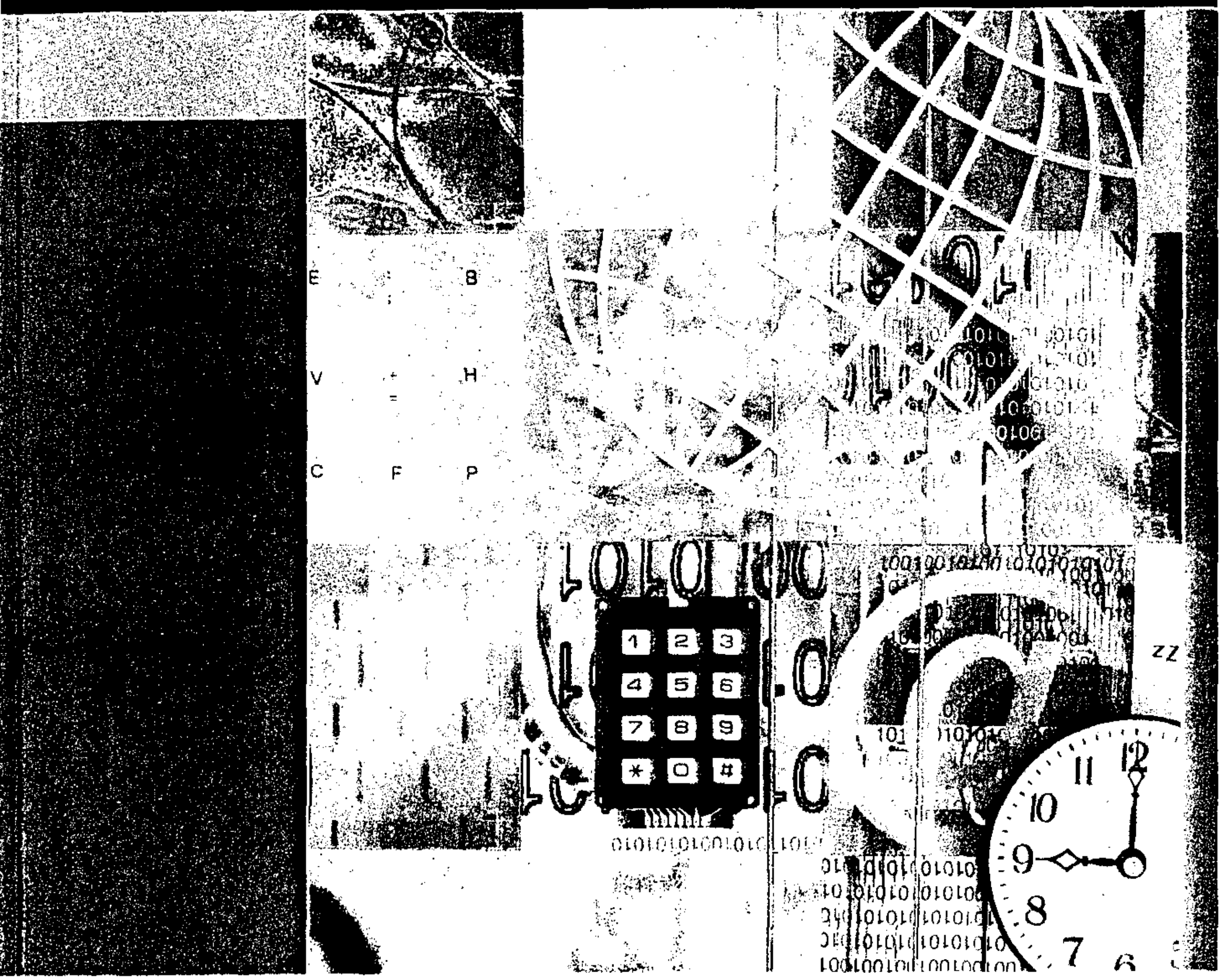
An Examination of Emerging Financial Markets

Identifying Potential New Roles for UNIDO



UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

economy environment employment

An Examination of Emerging Financial Markets

Identifying Potential New Roles for UNIDO

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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna, 2004

Definitions and Acronyms

Definitions

Developing Countries: Countries with developing economies, as identified by UNIDO and the World Bank.

Emerging Markets: Initially coined by the IFC, the term emerging markets tends to mean different things to different people. In this report, however, the term emerging market pertains to stock markets (also sometimes referred to as equity markets) that are increasing in: size, sectoral diversity, trading activity, and level of sophistication. In general, ratings companies classify a stock market as "emerging" if it meets at least one of two main criteria: (i) it is located in a low or middle-income economy, as defined by World Bank, and (ii) its market capitalization is low, relative to the GDP of the underlying economy.

Financial Market: A market for the exchange of capital and credit, including money markets and the capital markets.

Capital Market: A market where debt or equity securities are traded.

Equity: Ownership interest in a corporation, usually in the form of common stock or preferred stock. A company's equity is commonly calculated as its total assets minus total liabilities, also referred to as shareholder's equity.

Private Equity: Private equity companies and funds tend to provide investment capital to enterprises not quoted on a stock market (also known as unlisted companies), in return for an equity stake. Private equity can be used by a company to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen its balance sheet.

Venture Capital: The term venture capital (or simply VC) also tends to mean different things to different people, sometimes used interchangeably with the term private equity. In the US, VC is usually regarded as equity co-invested with an entrepreneur to fund the early stages or expansion of a relatively new company. Due to the high risk of such investments, a VC investor will typically expect to derive a higher than average rate of return on such an investment.

Acronyms

BA – Business Angels

BP – Business Plan

DCF – Discounted Cash Flow

FDI – Foreign Direct Investment

GDP – Gross Domestic Product

HIPC – Heavily Indebted Poor Countries

IFC – International Finance Corporation

IPO – Initial Public Offering

IMF – International Monetary Fund

ITPO – Investment and Technology Promotion Office

M&A – Merger and Acquisition

MBI – Management Buy In

MBO – Management Buy Out

MNE – Multinational Enterprise

PE – Private Equity

ROI – Return on Investment

SAP – Structural Adjustment Program

SME – Small or Medium-Sized Enterprise

UNIDO – United Nations Industrial Development Organization

VC – Venture Capital

Preface

Numerous studies show that the most potent instrument for fighting poverty is economic development. But economic development requires adequate access to capital and finance. This fundamental truth applies to any investment and technical development program, at any level.

Financial markets in developing countries often tend to be relatively weak, inadequately structured, and benefit considerably from counterparts that have significant levels of knowledge and experience.

Many enterprises in developing countries are effectively separated from both local and international capital markets. It is therefore difficult for these enterprises to access the equity markets or make use of debt market instruments.

It is extremely important, in order to promote industrial and technological development, strengthen the financial systems of developing countries, in terms of: institutions, instruments and relationships. The ability to better understand and utilise efficiently the potential of financial markets as a source of long-term funding can be an important advantage in increasing productivity growth in developing countries.

The approaches underline the possible intermediating role that UNIDO could play to assist and foster not only the financial communities in developing countries, but also enable the further use of capital market instruments for enhancing capital flows to developing countries[1].

The report give some suggestions on a potential role for UNIDO as "advisor" in the financial markets, and detailing the different roles UNIDO could play with different actors in the financial community (fig.1). The topics covered in the report are dealt with "horizontally", without a focus on a specific industries or geographical areas.

The report is structured in three main parts:

1. A business model for UNIDO

The first part of this report introduces the proposed model, and the advisory role that could be assigned to UNIDO.

Fields > Actors

2. A model for raising capital: the interrelation of financial instruments

The second part of the report analyses the model from the perspective of the various financial fields (investment funds, debt markets, private equity, IPO and stock market, M&A and FDI), in order to frame and describe the different actors and their roles in the specific fields.

Actors > Fields

3. Relations between UNIDO and Financial Community

The third part of the report focuses attention on the different groups of actors, and analyses the actors' initiatives in different financials fields.

[1] Through out this report, the terms capital and financial instruments are used interchangeably.

Executive Summary

Emerging capital and financial markets around the world are heterogeneous and display different characteristics. By definition most firms on their growth trajectories do not have access to capital markets. Nevertheless, this draft report expresses a view of UNIDO's potential to play a role in intermediation within the capital and financial markets to assist developing countries. The view is necessarily balanced towards the organisation internal perspective rather than towards an external analysis of either emerging market in general or their capital markets in particular. The scope of this report therefore is limited to consideration of possible areas of intermediation in capital markets where UNIDO could play a role – and what kind of role it might be.

First, from the outset it is important for the reader to note that reference to a model of capital and financial markets does not imply statistical technicalities – it is merely an illustration of the basic nature of such markets. Secondly, the pictorial position of UNDIO within the illustrative model does not imply that UNIDO's role would be, or could be, universal. Thirdly, the draft report is intended to be read with an educative perspective – to the extent that it brings to the attention of the organisation various aspects and dimensions of the workings of capital and financial markets and the different applications of financial intermediating instruments. And fourthly, a valid measure of the organization's ability to play a well-articulated and finely calibrated role will rest on the results of performing some tests that are proposed in the Annex A to the draft report.

The report is seen as a "first step" in a particular direction. It depicts the following with respect to emerging markets in developing countries.

I. UNIDO as advisor

In harnessing its deep knowledge of industrial and technical challenges faced by developing countries, UNIDO could facilitate in the interaction between different actors in the capital and financial communities (comprising private financial institutions, companies, multilateral institutions and donors, and governments).

By utilising an already established network of contacts and structures, in combination with some existing technical tools, UNIDO could be a significant player in emerging markets and their development. As a **financial industry business advisor**, providing an extensive range of services (such as strategy definition, business modelling, business planning, valuation, developing country emerging market expertise, and other transaction services), UNIDO could facilitate in the raising and development of investment funds, private equity and venture capital funds, issuing of bonds, and intermediating in merger and acquisitions deals, and other transaction in developing countries.

II. UNIDO and the inter-relationships of financial instruments

The **Private Equity and Venture Capital** industry in emerging markets are considered relevant in order to give more opportunities to enterprises to access capital markets. Growth in private equity activity can also support the development of investment funds and stock markets. Private equity and venture capital funds tend to focus on enterprises operating in high growth sectors, and on enterprises with relatively robust fundamentals.

UNIDO could assist in the growth of specifically dedicated funds, by advising well-defined associations, companies and entrepreneurs to develop higher standards of corporate transparency and governance in emerging markets, partly through education and training. Thereby increasing their chances of acceptability to access capital markets.

UNIDO could help developing countries to attract **investment funds** that are disposed to long-term investment with well-defined strategies for specific enterprise groups in emerging markets, due to the fact that building a diversified international portfolio is important for funds not just to maximise returns but also to reduce risks. Concerning the **debt market,** first, it needs to be taken into account that developing countries have diversities. Secondly, it is necessary to assess, country by country, the policies and regulations pertinent to the capital structure. In this field, UNIDO might support governments, local institutions, financial institutions and companies to foster a wider use of debt financing using financial instruments. UNIDO could act as an independent advisor, to assist governments to develop bond markets in support of enterprises to exploit the advantages of corporate bond markets.

In order to support the growth of capital markets in developing countries, UNIDO could encourage and assist countries to seek a sovereign **credit rating** by an international credit rating agency. At the enterprise level, UNIDO could support local rating agencies to adopt and apply international methodologies necessary to ensure enhanced credibility of their local rating judgement and performance. Also specific projects to develop the domestic rating industry, and thereby bring small and medium enterprises closer to the capital markets, could be implemented.

III. UNIDO relations with the financial community

Observing the financial industry in emerging markets from the point of view of different classes of actors (such as Financial Institutions, Public Institutions, and the Private Sector), there is an evident need for international advisors that are able to bring the parties closer and thereby close the existing gaps[2].

Thanks to its international agency and industrial positioning, UNIDO could encourage international financial institutions to start up projects in developing countries, and also support local financial institutions to establish partnerships and strategic agreements aimed at supporting enterprise credit access.

[2] These gaps include: technological gaps, gaps in business thinking and practice, as well as gaps in different business cultures, and insufficient knowledge of financial intermediation.

UNIDO, as an advisor to Governments, could offer assistance to design policies and strategies, and also act to harmonize and standardize regulatory frameworks relating to financial institutions' activity.

UNIDO could work more closely with developing country governments and industry in identifying and formulating projects to be submitted to multilateral institutions and to national, regional, bilateral and multilateral investment funds.

UNIDO could engage more closely with selected enterprises in developing countries to overcome technical and industrial problems related to local capital markets in relation to advise to enterprises to define their entry strategy and relations in emerging markets. Favourable coordination of multilateral institutions, and bilateral and multilateral funds, is essential if governments want to effectively improve the management of their development processes. Coordination will also be important for sharing knowledge of best practices in donor organisations and working methods.

UNIDO could support selected local companies to acquire visibility and to help to meet financial market requirements. A wide business and cultural gap removes enterprises in developing countries from the attention of financial institutions in industrialised countries. Therefore, one of the greatest challenges in financial sector development in emerging markets is education and training. It is important to expend more time, effort and resources on financial education, targeting small and medium enterprises in developing countries.

The Annexes provide a way forward in creating additional services that UNIDO could provide.

This draft report does not rule out the need for further work more balanced in the direction of diagnostics of selected emerging markets and their capital and financial market characteristics. It is hoped that it is part of an evolving process that will, given adeguate levels of support and funding, lead to an expansion of the serivces that UNIDO can confidently offer to its member states on an appropriate basis. In this respect, the inputs of the UNIDO expert in reviewing this draft have been considered.

1. A business model for UNIDO

UNIDO could play a key role in the identified circular business model as a *Financial and Industry Business Advisor,* supporting industry development and consolidating technology in developing countries by emphasising its strategic and international positioning.

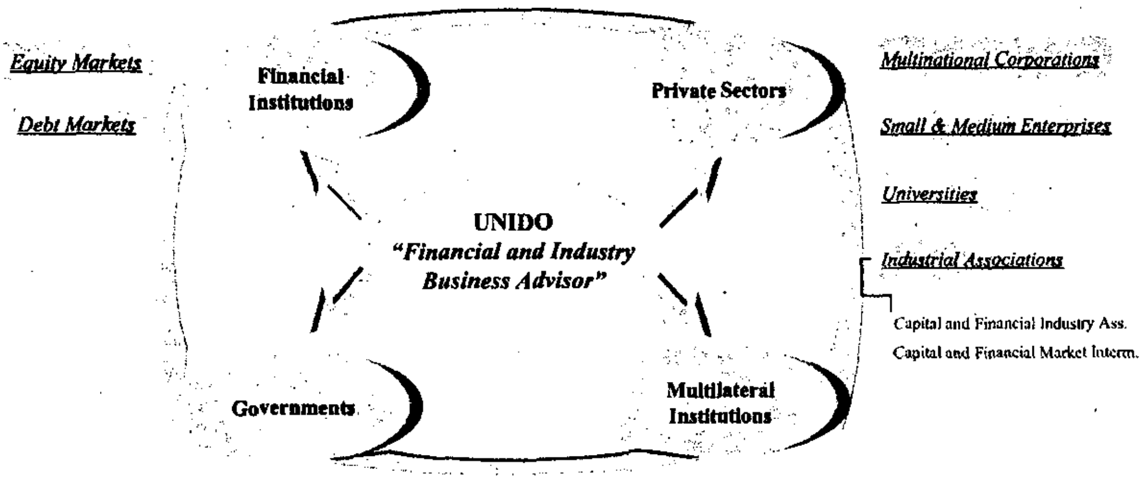


Fig. 1 A business model for UNIDO

The diagram serve to illustrate the full extent of potential UNIDO interventions, from which an exercise of selection can flow, to identify the potentiality most fruitful areas of pursuit.

1.1 UNIDO as Advisor[3]

UNIDO aims to bring itself closer to the financial community, enterprises and governments in developing countries and economies in transition.

In order to attain the goals inherent in such an aim, UNIDO could play the role of a financial and industry business advisor to the different categories of institutional actors in the emerging markets:

- Financial Institutions operating both in the equity markets and in the debt markets (such as Banks, Investment Banks, Emerging Markets Funds, Private Equity Funds, Venture Capital, Incubators, etc.
- Small and Medium Enterprises (SMEs), Multinational Corporations, Universities, Industrial Associations, etc.

[3] Henceforth the Advisor.

> Multilateral Financial Institutions (such as the World Bank Group), the United Nations System, the European Community Cooperation Systems, Institutional Fund, etc.

> Governments, both of developing countries and donors countries.

UNIDO could provide a platform for the various actors in the financial community to enhance their level of cooperation, establish dialogue, develop partnerships and initiate projects, so as to develop capital markets and enlarge its huge potentialities.

Industrial experience, technological 'know-how' and a strong international network gives UNIDO strength also to act in the financial sector. Multidisciplinary experience and comprehensive market, industry and technical expertise enable UNIDO to solve different and complex problems.

Whatever operation UNIDO is involved in, and whatever counterpart the advisor is collaborating with, the strategic intent shall be to create growth, increase competitiveness and efficiency and raise value through the application of financial instruments.

What kind of financial intermediation services UNIDO and its global network could offer?

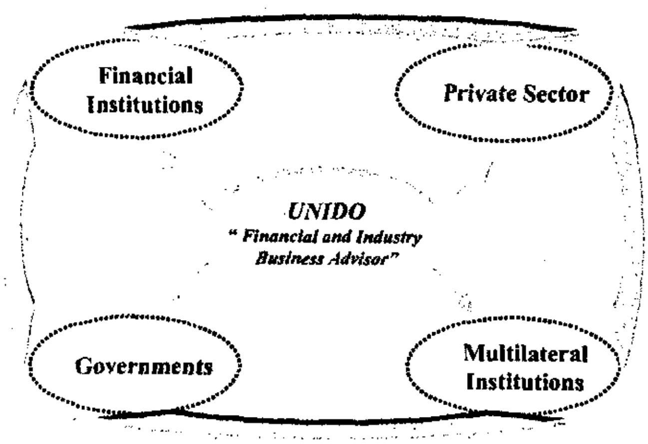


Fig. 1.1 – A business model for UNDO, the advisor

A financial advisor provides an extensive range of lead advisory, strategy definition, business model and business plan, valuation and transaction services to companies, private equity/venture capital firms, MBO/MBI teams, entrepreneurs, institutions and governments.

A corporate finance advisory can advise on a range of corporate finance transactions, including mergers, acquisitions, takeovers, disposals, project and structured finance, and capital raisings (whether in the form of debt, private equity or by way of Initial Public Offering). An advisor can also act as coordinator of all the partners involved in a project, such as technology consultants, tax and legal, audit, due diligence, accounting services, management process and public relations.

As trade barriers fall and new markets begin to open, the business landscape is increasingly viewed from an international perspective. Financial institutions and industrial players must expand globally and enter emerging foreign markets to pursue new business opportunities.

Growth in emerging markets can be rewarding, but it means adopting a high-risk strategy. The need for local knowledge and an in-depth understanding of new markets requires the right professional advice, thereby reducing the level of uncertainty and risk. It is in this area of local knowledge that UNIDO's implementation of technical assistance services, concerning investment and technology, has value.

As the financial centres and economies of the world globalise and capital becomes more dynamic and mobile, **valuation is gaining importance in emerging markets** – for privatisation, joint ventures, mergers and acquisitions, restructuring, and just for the basic task of running new business to create value. The issue of valuation is much more difficult in developing country environments because buyers and sellers face greater risks and obstacles than they do in developed markets, partly because of the combination of extreme information asymmetries, governments and market failures.

Many emerging markets are characterised by extra risks, including (but not confined to): high levels of inflation, macro-economic instability, capital controls, political risk, war or civil unrest, regulatory change, poorly defined or enforced contract and investor rights, lax accounting controls, and corruption.

The issue of valuation

The core of the financial and industry business advisor activity could be providing accurate and independent valuations. The aim of a valuation is to allow third parties to establish the worth of an entity, asset or liability, so they can price risk, and make informed business and investment decisions.

The valuations would have the scope to determine a fair equity value of a group of UNIDO-related companies or projects, based upon rational and demonstrable methodologies, taking into consideration companies' characteristics. The valuation has to be carried out referring to the budget and the business plan of the company and its management strategy.

It should be stated that the concept of equity value expresses a valuation that is:

- *General*, meaning that it ignores any associated impact of supply and demand, as well as the characteristics of the parties interested in the transaction;

- *Rational*, meaning that the value is constructed using a logical format;
- *Demonstrable and objective*, meaning that the assumptions underlying the projection of future results are determined with a suitable degree of rationality and objectivity;
- *Stable*, meaning that future results are projected by ignoring volatile factors arising from unique, extraordinary events or transactions with abnormal values.

A business valuation must use criteria and methods that are able to express, as far as possible, rationality, demonstrability, objectivity and stability. Academic theory and international practice have come up with numerous methods for valuing businesses which demonstrate, in their different ways, these characteristics.

The valuation methods commonly used include:

- Discounted Cash Flow Method (DCF). DCF is a financial method based on the business's future results, which in this case are interpreted in terms of cash flows available to the investor.
- Comparable Analysis Method (or 'Multiples'). The multiples method assumes that the business is valued at a similar level – as measured by various methods – to comparable companies listed on the local or international stock markets.
- EVA (Economic Value Added), focused on the company's balance sheet and cash flows; and Z-scoring credit test.

<u>The issue of the business plan for firms</u>

The business plan is the basic starting point for any assessment and evaluation of a company. The business plan is based on assumptions made and discussed with the management. It is a document detailing the past, present, and future prospects of the company, often designed to attract investments.

The usually structure of a business plan will contain a profile of the company's past and present activities, management and ownership, products and services, market analysis, with a view projected into the future.

The financials elements of a business plan usually comprise a profit and loss (or income) statement, a balance sheet, and a cash flow statement. A variance and sensitivity analysis is sometimes carried out, elaborating the worse case, base case and best case scenarios of the business plan.

A good business plan is crucial for two fundamental reasons: first, as a management tool; and secondly as a means of obtaining financing. While the plan is an essential element in securing financing, it should also be an operating guide to the business, with the goals, objectives, milestones and strategies clearly defined, well-written and articulated for the benefit of potential investors.

A high quality business plan is an important first step in convincing investors that a company's management team has the competence and clarity of vision to build a successful enterprise. The plan also provides measurable operating and financial objectives for both management and potential investors to measure the company's progress.

A discounted cash flow valuation is pertinent to the business plan, as the company's value is affected by the assumptions made on revenues and costs of the business plan. The estimated profitability of the company, and the financial assumptions that effect the working capital estimates, are the starting point for a valuation.

An advisor can support a company in the definition and elaboration of the business plan, from which the assumptions can be made and subsequently quantified in revenues and costs.

2. A model for raising capital: the interrelation of financial instruments

The model can be expanded by introducing the various financial flows and asset classes (such as investment funds, debt markets, private equity, IPO and stock markets, FDI and cross-border M&A), in order to frame the different actors roles in the respective fields.

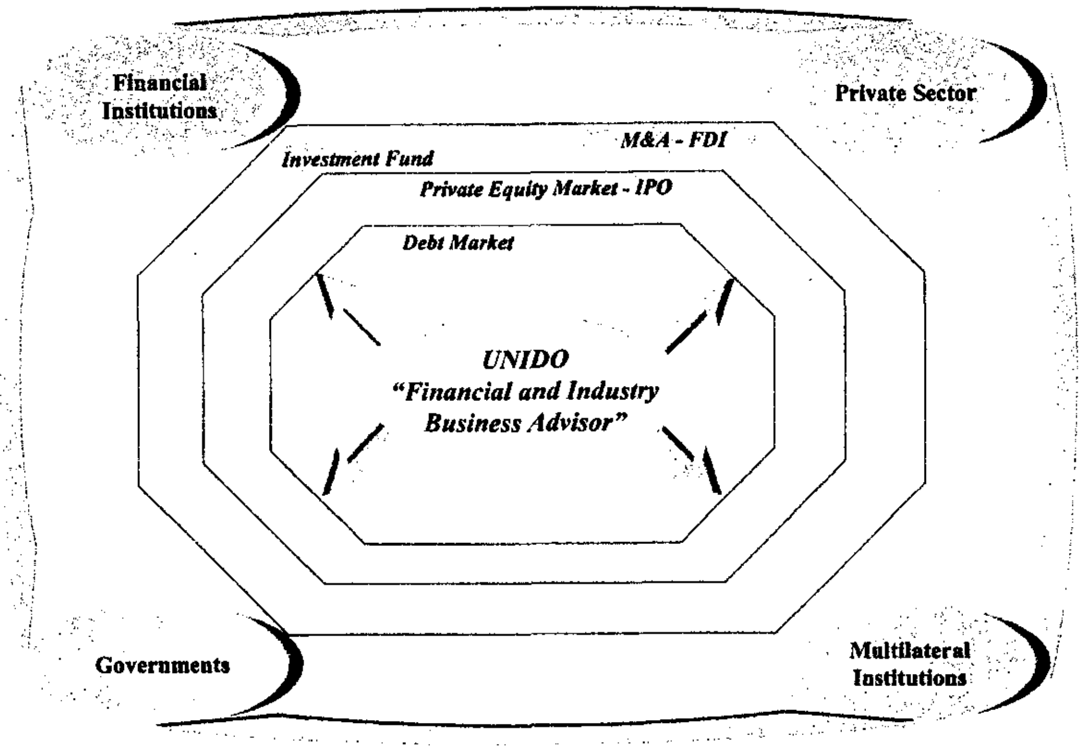


Fig. 2 – A model for the interrelations of financial instruments

Financial instruments and sources of finance for enterprises

The two broad categories of capital from which a company may choose to finance its operations are debt (short, medium and long term) and equity (share capital, retained earnings and private placement). The main categories of equity funds are portfolio funds (medium risk), private equity funds (high risk) and venture capital (very high risk).

The issuance of loan securities is one of the methods by which a company may raise finance; the others being the issue of shares and bank credit. Other instruments used by companies and government alike are debt securities (bonds).

The principal categories of equity finance for both private and public companies are ordinary share capital, undistributed reserves and retained earnings. The holders of either ordinary or preference shares in a company are its shareholders. The principal rights normally attached to shares comprise the rights to a dividend (if declared), and differentiated rights to vote at general meetings of the company.

A company's formal admission to the capital market or stock exchange is commonly known as a "flotation". A flotation allows a company to extend its present sources of finance to a larger pool of individual investors, including large financial institutions such as investment trusts, pension funds and insurance companies.

Importantly for emerging markets, a company considering 'going public' may also consider the 'placing' of shares with a limited number of institutions (commonly known as a 'private placement'), or an issue of shares to one or a small number of outside shareholders. In such cases, the intermediating role of an advisor can be crucial.

Financial markets are hierarchically ordered: in terms of risk at the most basic level is the money and bank debt market, above which is the government market (first at the short end, then at the long end) and private equity market; finally there are corporate bond and equity markets and, at the top, the markets for asset-backed securities & derivatives and options (fig.3).

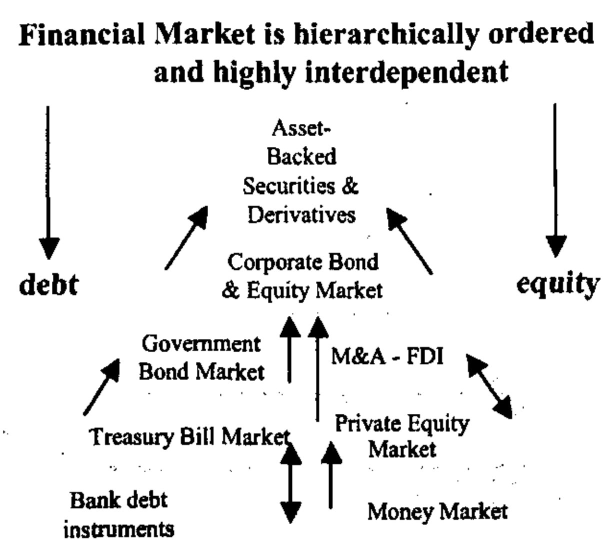


Fig. 3 – Financial Market pyramid

Government actions and policies to develop financial markets should be sequenced in a manner that observes and respects these hierarchies and interdependencies.

2.1 Private Equity industry: an advisor to get in Emerging Markets

Private equity funds invest directly in companies, usually taking an equity stake in what is an unlisted company. Unlike a loan, there is no requirement that the equity investment has to be repaid, and usually there are no requirements for dividend payments. However, there is also no limit to how much profit equity investors can derive from their investment in the company. As a consequence, private equity investors tend to be more interested in long-term success and capital appreciation of the firms in which they invest.

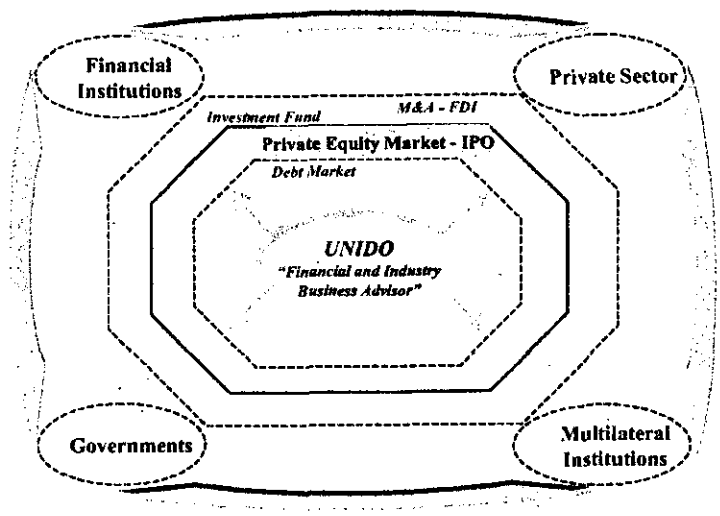


Fig. 4 – A model for the interrelations of financial instruments, Private Equity Market and IPO

With private equity investments, funds participate in the risks of success or failure of the business and, because they face such risks, they also expect to derive high returns. Consequently, they will only invest in projects or companies that present a satisfactory ratio between growth opportunities and risk.

There is a large variety of equity funds (see fig.5) operating in advanced and emerging markets, each characterized by the risk level of the investment class, the average scale of investment, and the anticipated internal rate of return.

The managers of venture capital and private equity funds not only provide investee companies with capital, they also usually provide various forms of guidance and support, in a bid to make their investment a profitable one.

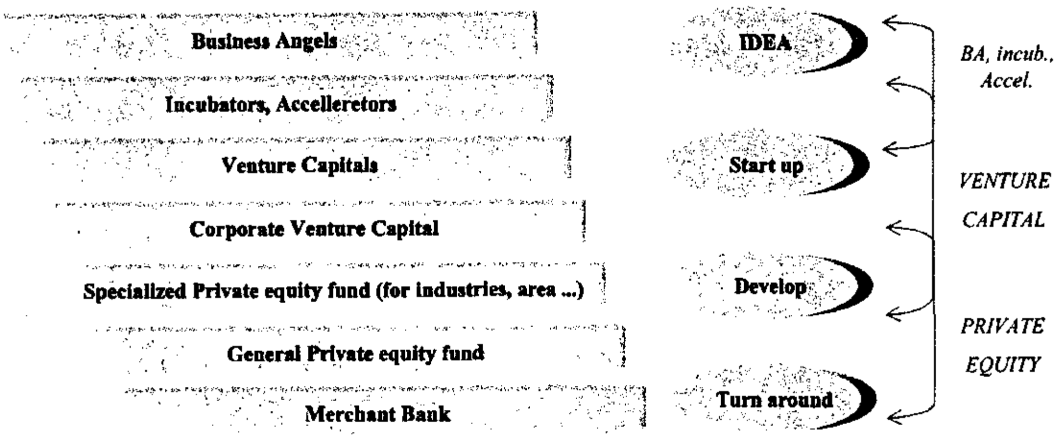


Fig. 5 – Different levels of investor types and variety

Funds usually require that companies in which they invest meet relatively high standards of financial reporting, including having their accounts audited by a reputable auditing company on an annual basis. Funds tend to also require that investee companies meet high standards of corporate governance, so that the rights of the non-founding shareholders, including the Fund, are less likely to be violated[4].

Private equity funds tend to believe that the quality of management is essential to the success of any company, and therefore aim to assist investee companies to continuously strengthen their management capabilities, both in terms of the strengths of their people as well as the effectiveness of their systems and processes. This kind of non-financial assistance can be quite considerable, and in the context of developing countries, very valuable to the investee company, allowing it to harness the kind of expert guidance and support that is not always available from domestic business development services.

The quality of management is often measured in terms of: openness to sharing information and cooperating with the Fund to continuously make improvements to management systems; the record of pro-actively identifying weaknesses and implementing measures to address those weaknesses; genuine interest in developing the skills of middle and senior managers and delegating responsibility to them; commitment to meeting the Fund's corporate governance and transparency requirements; and reputation.

[4] Again it is in these areas that the advisor can play a relevant intermediating role

The private equity investor will usually require an 'exit strategy' to disinvest from the company at a later stage, and hopefully realise a profitable return on the initial investment [5]. This means that there should be one or more plans in place that would allow the private equity investor to fully or partially sell its equity stake in the investee company, usually after an average holding period of approximately 5 to 8 years. A private equity investor may exit the investment in various ways, including:

- A listing of the investee company's shares on a stock exchange;
- Sell its shares in the investee company directly to a financial institution, such as an investment fund or insurance company's investment portfolio;
- Sell its shares in the investee company to the other shareholders (including possibly the founding shareholders from which it first acquired the equity);
- Sell its shares to a strategic partner or strategic investor (often another company in broadly the same area of business);
- The shares may be 'intermediated' through other instruments. [Reviewer: An example might be useful here.]

A private equity investor can support investee companies in many ways, including:

- A source of long term equity capital which can be used to expand the business;
- Improving their management systems based on knowledge of, and access to, information on international best practices in various areas of *management expertise;*
- International industry specific knowledge, including technology, based on the experience of similar companies in other countries, particularly issues relating to reasons for success and failure. This will help invested companies to refine their business model, management systems and corporate strategy;
- Solving specific problems in areas in which they are weak, such as helping out on some management related tasks from time to time – for example, helping to develop business plans, prepare presentations, approach potential partners;
- Supporting improvements in corporate governance and transparency.

[5] The exit strategy has profound implications for the advisor, in that only with requisite guidance and technical cooperation as well as management advice can the firm be presented as a serious prospect for formal admission to a stock market.

Areas where assistance is usually provided may include any of the following: business strategy and planning; organizational restructuring; human resource management; customer relationship management; sales and marketing development; supply chain management; quality control; partnership development; internal controls and financial analysis/management; technology, production planning and management; corporate governance systems and transparency; assistance with the process of preparing for a listing on a stock exchange.

Private Equity cause also economic development and creation of jobs through:

- Creating new businesses and encouraging entrepreneurship across related business sectors;
- Improving the performance and efficiency of enterprises;
- Supporting innovation and technology transfer;
- Promoting the development of closer links between large manufacturing firms and small enterprises thereby deepening business intermediation;
- Helping new business grow faster, thus creating more jobs.

Providing its international, politico-social, industrial and technical expertise, UNIDO could act as advisor on both sides of the process, but not in the same operation (fig.6) An agency, impartiality mandate will be define for each operation and will point out the scope of the advisor role.

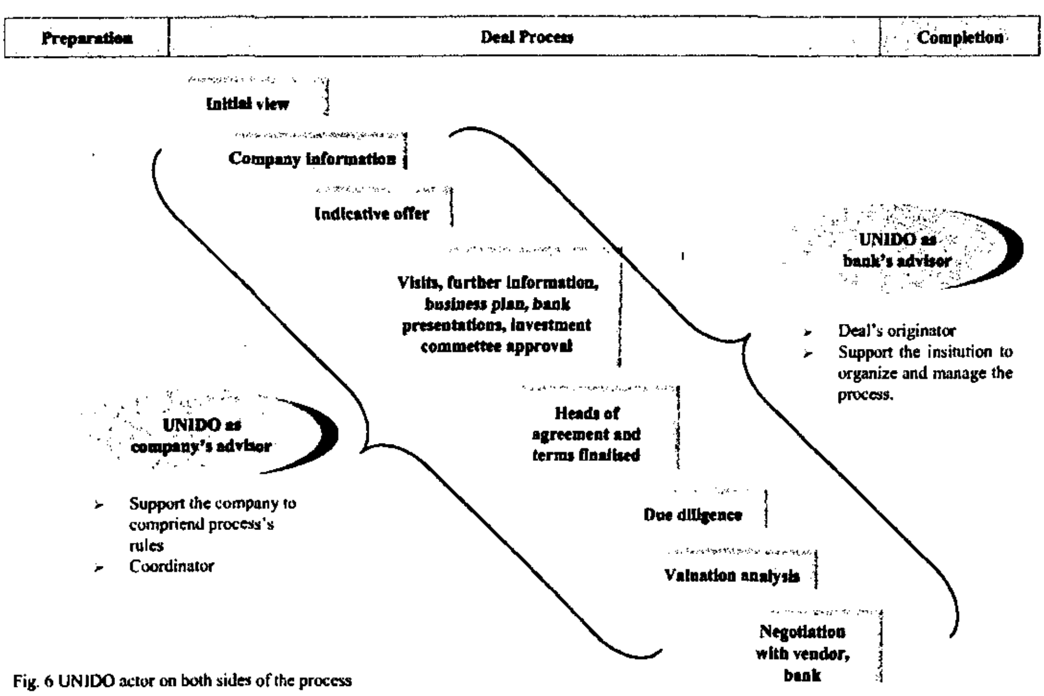


Fig. 6 UNIDO actor on both sides of the process

Private equity in emerging markets

Emerging markets have numerous weaknesses and obstacles that are constraining growth in the private equity sector. These include: the volatility and low liquidity of local stock markets, lack of information and information asymmetry, higher-risk macroeconomic environments, lack of skilled or capable management in investee companies, etc.

All these factors make it difficult to choose the right opportunities, not only in identifying and making investments, but also in managing these investments and ultimately defining an exit strategy.

Developing countries can also face constraints that stem from different business cultures. Entrepreneurs in some developing countries often do not properly comprehend the advantages and drawbacks of equity finance as a financing tool, and do not always know how to approach private equity companies.

While UNIDO is not a financial institution, its industrial expertise allows it to provide technical contributions in solving some of the obstacles facing private equity development in developing countries.

Therefore, UNIDO might consider acting as an advisor to private equity funds operating in emerging markets.

More specifically, UNIDO might operate in terms of:

- Identifying and screening potential companies or investments for fund managers;
- Appraising potential firms or investments;
- Negotiating potential investments;
- Implementing investments via financial instruments;
- Monitoring the fund's investments after they have been made;
- Providing assistance to companies in which the fund has invested;
- Eventually providing support to sell fund's investments.
- Cooperating with funds to facilitate technical assistance programs for the investee companies;
- Providing other support and assistance to funds, such as allowing fund managers to use UNIDO offices, relations and expertise around the world.

UNIDO could advise funds to invest in companies in which UNIDO has positive impacts regarding the environment, fair labour practices, positive social impacts, positive impacts on women and positive impacts relating to resettlement in post-conflict contexts.

UNIDO could also assist funds to seek financial partnership (domestic and/or international partners) activity that requires geographical and thematic concentration.

UNIDO might be also support the creation of private equity associations, delineated by geographic areas and industrial sectors. This support could be in terms of database building, news and information, specific industrial knowledge on emerging markets, professional training, etc.

Within the context of equity investment and other participatory forms of finance, UNIDO could collaborate with fund mangers, investors, entrepreneurs and related associations to develop a process that seeks to to:

- Identify and disseminate best investment practices;
- Provide training and networking opportunities for fund managers and investors in developing countries;
- Define and refine standards of practice and performance[6];
- Promote supportive legal and regulatory environments.

a. Private Equity Market: from the innovative idea to the IPO

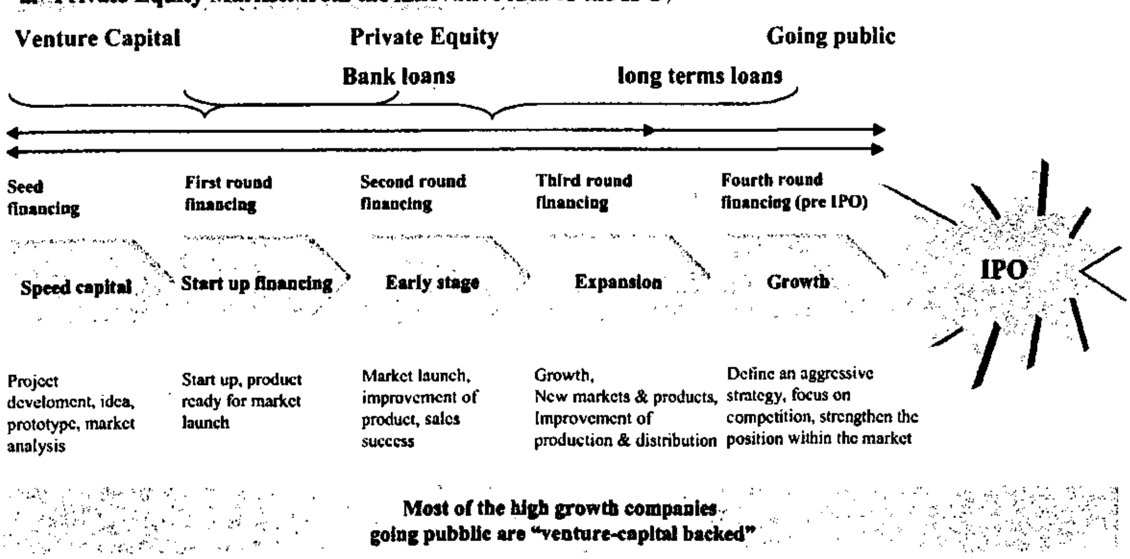


Fig. 7 Private Equity Market: from the innovative idea to the IPO

[6] In this regard, the QSM (Quality, Standardization and Metrology) methodologies of UNIDO would be key in enabling emerging market firms to meet the competitive challenges of conforming to the expectations of advanced country (export) markets.

Figure 7 plots the life cycle of private equity from seed financing by venture capital at the start-up phase of a company, through to the initial public offering and stock market launch.

This life cycle well reflect the private equity activity in industrialised countries in which private equity industry is well established (notably the US, Western Europe and Japan).

The majority of private equity activity in emerging markets is conducted by foreign institutions in companies that are already fairly well established (including privatisations), and the minimum deal size usually means that private equity for non-state companies only commences at the 'third round financing' stage depicted in the diagram, as a company is seeking to expand. Deal size also means that only a small proportion of (larger) SMEs in emerging markets can seriously consider private equity, of which an even smaller proportion will ultimately enact an IPO, particularly in those developing countries where the domestic equity market is small, dormant, or simply non-existent. Consequently, strategic sales are often the exit route for private equity investors in emerging markets, rather than public offerings.

<u>**Strengthen Private Equity Market means:**</u>

Foster Stock Markets

Increase investment funds opportunities

Create the base to develop corporate bond markets

Stimulate M&A market and consequently FDI

In conjunction with governments, financial and industrial private sector entities, UNIDO could create fellowship exchange programs that would send professionals with financial, capital markets, corporate finance, or economy policy experience to developing countries to work in public and private institutions for a certain period. In exchange, each participating developing countries institutions would commit individuals for training at qualified investment or commercial banks in developed countries.

2.2 IPO activity and Stock Markets

UNIDO, through its planning knowledge, strategic view, and technical support could act as a supporter of IPO activity and Stock Markets .

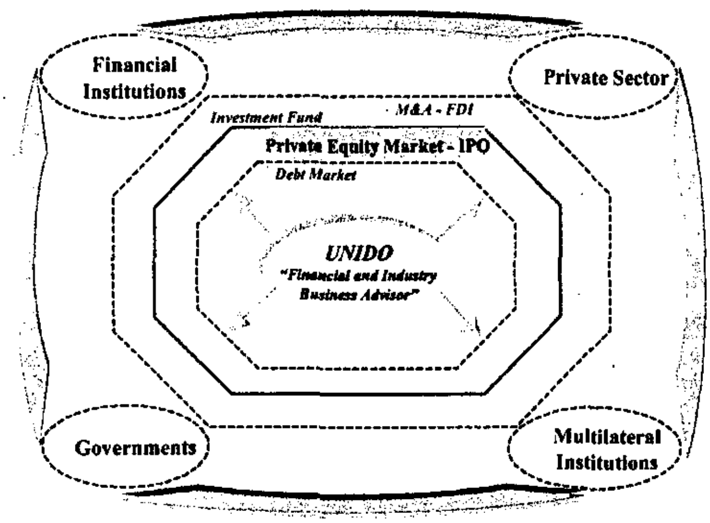
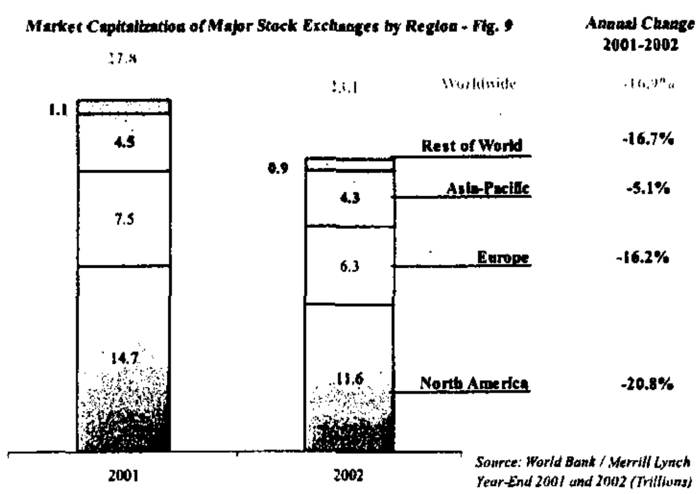


Fig. 4 – A model for the interrelations of financial instruments, Private Equity Market and IPO

Many emerging market stock exchanges around the world are small, expensive and stagnant. They have "thin" structures, low liquidity dynamics, and are only able to accommodate a small proportion of growth capital (see fig.9).



Some developing countries could develop local securities markets in order to provide a more stable source of funding and greater financial systems stabilities for the benefit of local firms, but other not have a sufficiently large macro-economic, corporate or financial basis to develop a stock market.

A stock market requires a 'hinterland' of financial institutions on which to develop, otherwise it will stagnate. At present some developing countries stock market suffer from the identified weaknesses. They need to be support to pursue regional stock markets, or establish strategic alliances with stock markets in neighbouring countries instead or be merged with others.

Flotation is a route by which a company can extend its sources of finance (including bank credit) to a larger pool of individual investors, including large financial institutions. 'Going public' entails both pros and cons, some of which are shown in fig.10. All these items have to be analysed and weighed, ideally with the support of a competent financial advisor.

Going public: reasons for	Going public: reasons against
• Realizing investment by existing shareholders	• Listing expensive and time-consuming
• Access new sources of capital	• Ongoing obligations expensive and costly
• Higher valuation	• Restrictions on directors' business activities
• Funding of expansion / acquisition	• Increase outside pressure on the directors of the company
• Increased business / market credibility	• Tax implications for selling shareholders
• International visibility	• Introduction of minority shareholders with conflicting views
• Enhanced status and corporate image	• Dilution of control leads (eventually) to vulnerability
• Employee share and incentive schemes	

Fig. 10 Going public: reasons for and against

One of the key issues in developing local securities markets as a stable source of funding is the development of an adequate domestic and international investor base. The development of an adequate domestic investor base (including institutional investors) enables the creation of suitable financing vehicles and instruments to channel savings into the local capital and financial market.

At present, a lack of transparency and weaknesses in corporate governance standards weigh negatively on emerging market equity performance. Another negative factor in many emerging markets is that a few prominent companies and banks constitute the bulk of the market, and quite often the 'free float' constitutes a small fraction of the companies' total capitalization.

In many cases, these companies tend to be privatised utilities, natural resource and transportation-related companies, or banks, which continue to maintain direct or indirect links to the state, and therefore have limited opportunities for future growth[7].

[7] This contributes to the "thin" structures of emerging markets.

As a result, private investors tend to have limited appetite for stock markets in developing countries, as they do not provide adequate exposure to the real growth opportunities provided by the numerous private firms that are unlisted.

UNIDO could advise funds to allocate a portion of their assets to emerging market equities. UNIDO can also play a role as advisor with "crossover investors", such as pension funds and insurance companies, and "tactical investors", such as hedge funds, favoring their action toward emerging markets.

The role of a Stock Exchange is to balance of issuers' and investors' interests, ensure suitability of applicants, to operate an open and efficient market, to enable full and timely disclosure of information, promote investor confidence, and safeguard rights of equity holders. UNIDO could advise Stock Exchange institutions operating in developing countries, notably in formulating the kinds of listing and reporting polices and corporate governance principles that would have a beneficial impact on institutional investor appetite.

UNIDO could support network coordination between Stock Exchanges operating in the same geographic area (Latin America, Africa, South East Asia), and related Governments.

UNIDO could also advise local companies before listing on emerging markets stock exchange and to take right the decision if and when going public.

2.3 Supporting investment funds in emerging markets

In the field of (non-private equity) investment funds, UNIDO could act as an advisor to financial institutions, addressing their effort and attention towards emerging markets (fig.11), rather than launching directly investment funds.

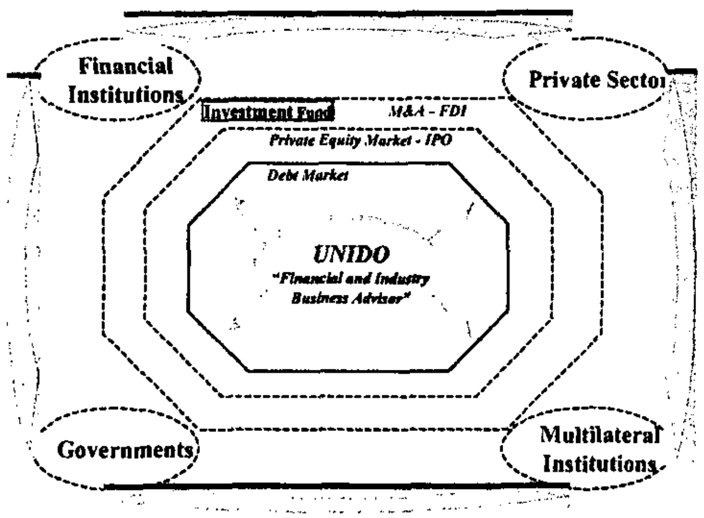


Fig. 11 – A model for the interrelations of financial instruments, Investment Fund

Investment funds vary significantly in structure and format; they can be public or private, focus on specific locations or industries, be open or closed-ended, etc. Investment funds can allocate their assets through different financial instruments such as common shares, preferred shares, convertible and non-convertible bonds, and other securities (fig.12).

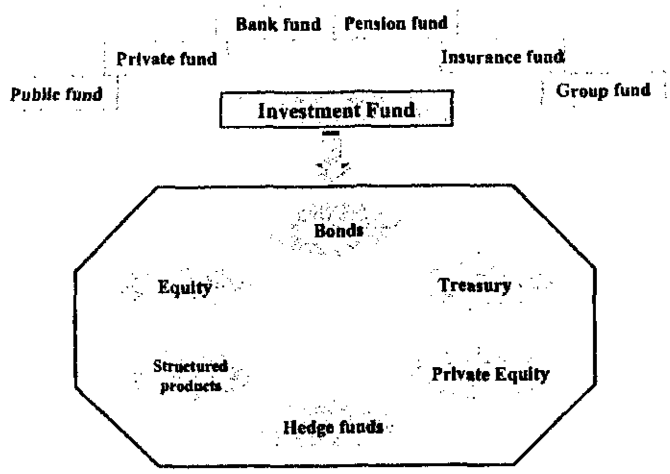


Fig. 12 – Actors and instruments

In developing countries, the principal supply of local funding is usually in the form of short-term deposits, often because of low-per capita income and low wealth accumulation. In contrast, the demand for funds is often of a long-term nature, reflecting the need for industrial business investment and infra-structural investment. This maturity mismatch between the supply of funds and the demand for funds remains a fundamental problem. Without resolving this problem, industrial development cannot be sustained and banking crises can occur, as was seen in Southeast Asia in 1997.

Financial institutions in emerging markets generally transform mobilised short-term savings from households into short-term loans to enterprises and roll-over them to meet borrowers' long-term financial requirements but only to a limited extent. This approach has strategic limitations and additional risks, which serve to hinder the development of long-term industrial trajectories and undermine the strength of local financial markets.

Securities markets (shares, bonds, convertible instruments, warrants, options, etc.) are able to mobilize long-tem funds and to finance long-term investment.

Introducing a diversified investment strategy means a flexible and open model. Diversification also requires adaptable people and organizational cultures that support change and innovation in capital markets.

Developing countries can benefit from investment funds that are disposed to long-term investment and well-defined strategies for industrial development.

Building a diversified international portfolio is important, not just to maximise returns, but also to reduce levels of risk. Although the overall volatility of emerging market assets has been higher than that of developed country assets, for the purpose of reducing portfolio risk, the correlation between returns of different assets matters more than the volatility of individual assets.

According to private banker experts, there is an economic justification for holding emerging markets assets of up to 10% of the total portfolio. Yet, at present, emerging market assets represent only 2% to 3% of international investors' total assets.

The principal barriers to investing in emerging markets often pertain to the following:

- Problems of market liquidity;
- Insufficient standards of corporate governance and financial disclosure;
- Risk aversion; the financial crises and contagion that have hit numerous emerging markets in recent years have resulted in a much more cautious stance by international investors;
- Asset-liability modelling typically discourages investments in asset classes that are under-researched, and where there is limited availability of historical data;
- Issues relating to foreign exchange, taxation and capital controls.

Despite all these problems, numerous investment banking and research strategists believe that this is a good time to make strategic investments in emerging markets.

UNIDO could advise funds on strategies toward emerging with respect particularly to encouraging funds to work on investor education.

A lack of knowledge on developing countries and inexperience in analysing information from emerging markets is acting as a barrier to increased investment. This suggests that there could be some public policy role in providing analysis on developing country stock markets at least until the market is big enough to support such functions in the private sector on a widespread bases.

UNIDO could also advise developed countries to set up funds able to provide equity and debt financing for new business ventures.

By investing risk capital in profitable private enterprise, together with competent co-investors, investment funds contribute to economic growth and business development in developing countries.

2.4 Debt instruments: from overdraft to perpetual

Debt financing of varying kinds, provided by different sources (eg. commercial banks, the money market, capital market or private placement), are commonly classified by maturity:

- Short term: bank overdraft, bank loan, factoring, and commercial paper.
- Medium term: bank term loan, revolving loan, leasing, medium term notes.
- Long term: bank loan, mortgage, plain vanilla bond, bond (eg. zero coupon or deep discount bond), private placement.

Debt sustainability in developing countries

Defining an appropriate forward-looking debt and borrowing strategy for developing countries is fundamental in order to help those countries to fulfil their development financial needs, in a way that avoids a repetition of the debt crises from which many of them are only now emerging. This includes corporate (or private sector) debt.

Many issues relevant for debt sustainability in low-income countries are the same as in other countries, but some additional factors also play a role. Some characteristics warrant important modifications in the analysis of debt sustainability: notably, countries' dependence on aid flows; the nature of the external and internal shocks to which they are subject; and constraints on their ability to generate the resources necessary to repay their debts.

The diversity of low-income countries also needs to be taken into account in assessing debt sustainability. Some countries are affected by conflict (Central Africa Republic), other are in the process of transition to market economies (Mongolia, etc.), and still others are on the threshold of becoming emerging markets (India, Vietnam, etc.).

For countries that UNIDO and its partners are disposed to support, it is important to design appropriate borrowing policies, taking into consideration the existing international policy environment with respect to international financial institutions' SAPs (Structural Adjustment Programs) and HIPC (Heavily Indebted Poor Countries) programs.

Many developing countries receive very little private capital in the form of Foreign Direct Investment, and hardly any commercial loans, but instead depend on official grants and concessional loans to finance their investment needs.

With weak public institutions, poor governance, and generally low implementation capacity, resources in some developing countries are often misused and mismanaged. But even if resources are invested in projects that are expected to generate positive payoffs, returns are typically highly uncertain, often diminished by structural rigidities and weak polices, or wiped out by natural disaster and conflict.

Diverse types of constraints affect developing countries' ability to generate the resources necessary to service their debts: foreign-exchange constraints, fiscal constraints, limited fungibility of resources (foreign aid for debt service), political or moral considerations, etc.

UNIDO and the debt field (fig.13)

Given that the achievement of development objectives depends not only on external financing but also on domestic polices, the need for debt relief and grants would require a country-by-country policy response. UNIDO can play an important role in this activity.

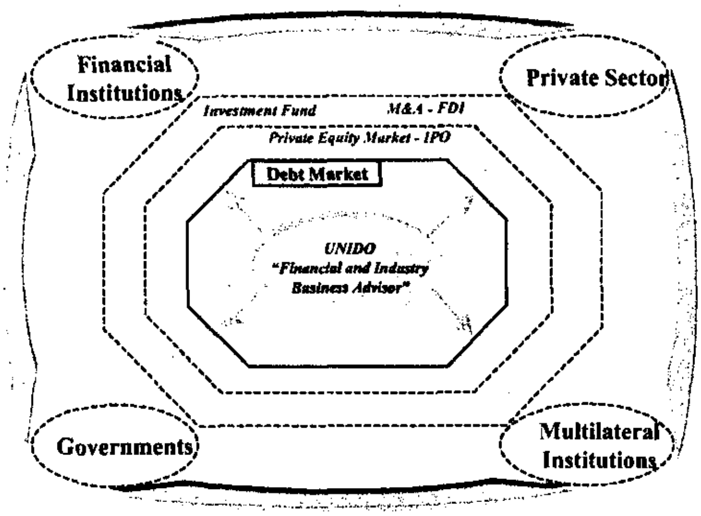


Fig. 13 – A model for the interrelations of financial instruments, Debt Market

UNIDO might support government agencies that play an important role in promoting the necessary institutions and infrastructure, and are important as regulators of the market.

The financial architecture of emerging markets has been strengthened in recent years, but considerably more needs to be done. Stability has to be supported by the developed world's commitment to transparency in financial transactions, and the adoption of international financial reporting standards.

After depressed equity markets in the developed world over recent years, investor appetite for debt issues in emerging markets has been increasing.

UNIDO as financial advisor to authorities, financial institutions and companies could also promote and foster a wider use of debt financing using financial instruments. More specifically, UNIDO could work in order to reinforce the availability of long-term debt capital that is essential to the growth of the private sector in developing countries.

In order to procure bank finance, a company will generally need to provide evidence that it is being well managed, that any debt can be repaid, and that adequate security can be provided.

UNIDO could support enterprises through training management to use the right approach and language in preparing documents required in order to be able to approach the financial community.

UNIDO could act as advisor in order to foster governments to develop bond markets.

2.4.1 Developing a government bond market

Emerging market bonds offering, through fixed-income products, a record of strong risk-adjusted returns and low correlations with other asset classes represents an excellent tool in portfolio optimisation.

A mature domestic bond market offers a wide range of opportunities for funding the government and the private sector, with the government debt market typically creating opportunities for other non-government issuers. Development of a government bond market provides important benefits at macroeconomic and microeconomic policy levels.

In the context of capital market reform, particularly Asian and Latin American emerging economies are seeking to develop their domestic bond markets in order to reduce currency and maturity mismatches, alleviate the dominance of bank lending, and mobilize domestic savings to provide domestic issuers with alternative and sometimes cheaper sources of long term funding.

Investors in developed bond markets can range from small-scale retail investors to wholesale domestic and foreign institutional investors. For developing countries, it is more important to pay attention to the role and behaviour of foreign institutional investors, because they play an important role in ensuring demand for fixed-income products.

Developing a government bond market supports the development of debt markets for the sub-national public sector and the corporate sector, most notably in terms of benchmarking.

UNIDO could act as advisor supporting enterprises to exploit the corporate bond market.

2.4.2 Developing a non government bond market

Developing government debt securities is one way to develop a benchmark yield curve for the pricing of local corporate bonds. Lack of a reliable benchmark yield curve of longer maturity is an impediment to the development of corporate bond and other securities markets. A good example is Singapore, which has made excellent progress in recent years in its effort to build a viable corporate bond market.

A government bond market, if functioning satisfactorily, can significantly increase investors' confidence in the overall bond market, and in the whole capital market.

Corporate bond markets remain severely under-developed in many developing countries, and particularly in Asia, when compared with the equity markets.

There are three fundamental factors behind the under-development of fixed income securities markets in developing countries, even after government bond markets provide the benchmark for yield curves in the market:

- Information asymmetry is very acute between issuing companies and the investing public in the corporate bond market. Public investors, as compared with banks, know little about issuing companies (on issues like their management performance, investment projects, balance sheet, strategic plan, and future perspectives, etc.).
- The relatively small number of large, reputable private firms that can issue a sufficiently large amount of corporate bonds.
- Underdeveloped informational, legal, and institutional infrastructure. The protection of the investing public from dishonest issuers, fraud, and insider-trading requires well-developed legal and regulatory frameworks for the oversight and due diligence functions.
- A lack of sufficient custodial services.

Others problems pertaining to issuing corporate bonds in developing markets are represented by:

- Trading volumes: the low trading volumes on domestic bond markets in developing countries. The volume is often not large enough to provide sufficient liquidity and depth to allow investors to enter and exit market positions rapidly.
- Exchange rate risk: in developing markets, investors face additional uncertainty stemming from the fluctuation in exchange rates. Investors typically prefer to operate in markets where exchange rate risk is well managed, minimised and can be priced.

Banks can be both major buyers and issuers of corporate bonds in developing countries.

Prior to any decision UNIDO takes in advising governments and companies on the bond market, it will need to clearly identify and analyse the particularities of the specific economy, the level of competition, and all the problems that characterize the developing country in question.

2.4.3 A new way to get financing: the securitization process

Securitization is a rapidly growing source of temporary and ongoing financing for many companies across the globe, since it involves the use of financial assets to obtain direct access to investors.

Securitization is the process of creating a "pass-through", such as the mortgage "pass-through" security, by which pooled assets become standard securities backed by those assets. Also, it refers to the replacement of non-marketable loans and/or cash flows provided by financial intermediaries with negotiable securities issued in the public capital markets.

As suggested by the definition of securitization, more than one asset can be securitised. In the United States and other international markets a clear distinction is made between "mortgage-backed" securities (MBS), where the underlying asset of the security is residential mortgages, and "asset-backed" securities (ABS), where the security is backed by any other assets except residential mortgages. Such assets include credit card receivables, auto loans, corporate loans or any other assets that are homogeneous and have reliable loss and prepayment data.

A typical securitization process (fig. 14) consists in the following steps:

a. The lender, also called the originator (typically a financial institution or large company), makes a loan to a borrower (the obligor). The loan amount is transferred to the obligor and the obligor directs all repayments of the loan to the originator.

b. The loan is "warehoused" or kept by the originator, until the originator has a sufficient volume of similar loans to a variety of originators.

c. The originator sells the loans to a special purpose vehicle (SPV) – a legal entity created by the originator, which may take on the form of a trust, a group of underwriters or a receivables investment company.

d. The special purpose vehicle pays for the loans by simultaneously selling certificates, representing ownership of the loans, to investors. The funds obtained from investors are passed to the originator.

e. A credit rating agency rates the securities issued by the SPV.

f. A servicer is appointed, which provides administration for the duration of the issue. In many cases, the originator performs the role of servicer.

g. A trustee can also be appointed to ensure that investors are paid in accordance with the terms of the securities and to monitor the performance of the servicer.

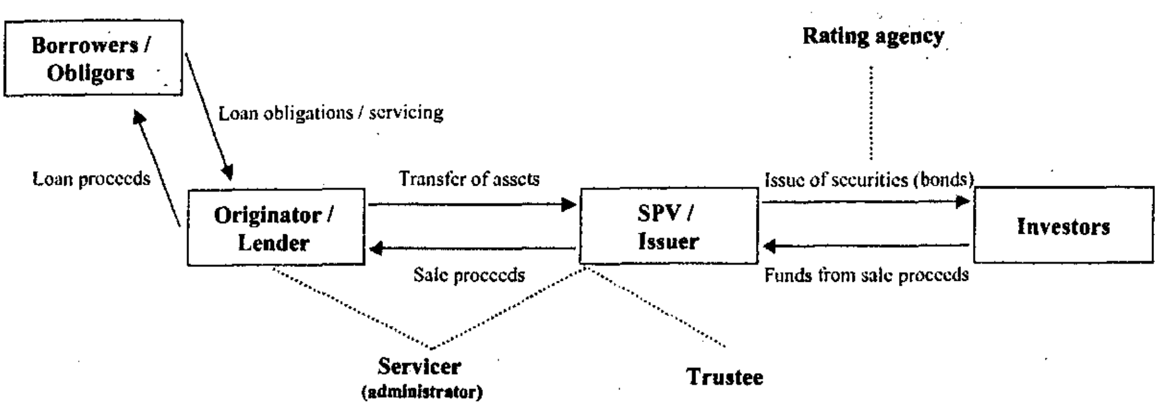


Fig. 14 The securitization process

The securitization process is feasible if the following minimum requirements are satisfied:

- The receivables on the assets purchased by the SPV must be sufficient to cover the commitments to the investors on the securities issued to finance this purpose.
- The originator must be able to transfer the receivables to the SPV without expense, formality, or consent of debtors.
- The SPV must be structured as a bankruptcy-remote entity to prevent potential bankruptcy of the originator from affecting the investors.
- The sale must be structured as a "true sale" where the assets and receivables are transferred to the SPV in order to minimise other creditor claims against the securitised assets. Therefore, the receivables are no longer assets of the originator and the securities issued to finance the loan not a liability of the originator.

The rating agencies also plays an essential role in the securitization transaction and is instrumental in determining the level of credit enhancement necessary to obtain a specific rating.

Addressing its effort on selected countries, UNIDO could verify if and how securitization and bonds issue could be an advantageous alternative source of funds for enterprises in developing countries.

UNIDO could also support institutional and private actors to understand the structure and functioning of a securitization transaction, and to acquaint them about risks, benefits and limitations.

Pilot projects, focused on selected countries, could also be developed to analyse the regulatory environment for securitization and propose improvements in terms of policies framework, tax treatment, accounting standards and legal system.

2.4.4 The challenge of rating in developing countries

Developing countries, and African countries in particular, should be encouraged to seek a sovereign credit rating by an international credit rating.

Emerging markets in Africa should develop credit information infrastructures, including credit ratings as a priority, in order to develop non government bond markets and generally to attract Foreign Direct Investment.

Establishment of rating agencies in developing countries and small countries is difficult, but with advances in telecommunications and technology, the lower up-front and operating costs of establishing a rating agency should facilitate rating agency entry into new risky markets.

Rating agencies that already exit in emerging markets have to be supported to utilise international methodologies, so as to increase the credibility of their rating judgement. At present, there is a significant gap between local and international credit rating agencies in their evaluation of the same issuing company in emerging markets, and it is desirable to close this gap. For example, local rating companies are generally more lenient towards issuers, while western ones are more stringent.

One important factor behind this large rating gap is the different scales used by the two groups. International rating agencies utilise a "global scale" that attempts to assess all issuers around the world with the same yardstick, while local agencies use "national scales" that only compare domestic companies, with no adjustments for sovereign risk.

In order to reinforce capital markets in emerging countries UNIDO might support:

- International rating agencies to conduct more research on corporate systems.
- Local rating agencies to build public confidence in their ratings, by refining and disclosing their own methodologies, conducting audits regularly, improving their financial structure and diversifying their revenue sources.
- Development, strengthening and growth of regional associations of credit rating agencies, and foster connections between local associations and western rating agencies associations.
- Organized forum, seminars, periodical training, and meetings where rating agencies can share information, and define common policies and procedures.

2.5 Merger & Acquisition instruments

UNIDO can play a role on supporting developing countries to take part in greater M&A deal flow (fig.15).

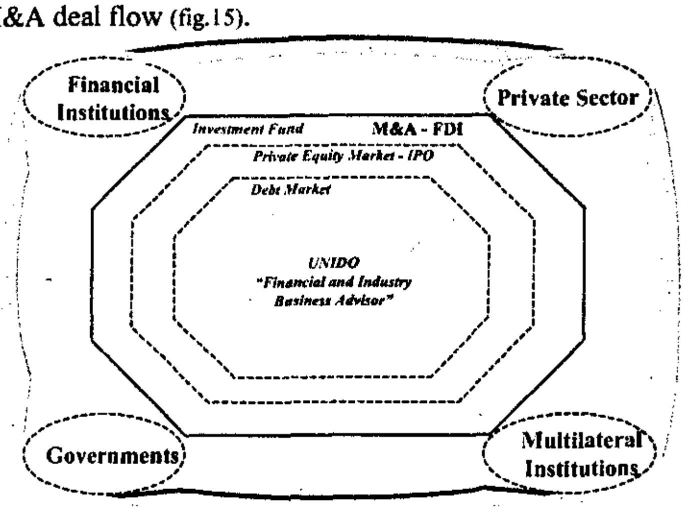


Fig. 15 – A model for the interrelations of financial instruments, M&A - FDI

Advising in the M&A process on the buy-side entails undertaking a series of operations to: define a value strategy; undertake the identification of targets; carry out research on targets; evaluate the commercial benefits and risk of a transaction; perform valuations; assist in developing strategy, optimal acquisition structure and pricing; assist in raising the finance and implement the acquisition of the target.

On the sell-side, the advisor can provide project management for the sale of businesses or companies, including devising the disposal strategy, preparing valuations, preparing information memoranda, identifying and approaching likely purchases, soliciting offers, managing the due diligence process, leading or assisting with sale negotiations, coordinating legal documentation and assisting with completion (fig.15).

A global marketplace for firms is emerging, as companies are being bought and sold across borders on an increasing scale. Cross-border M&A flows increased from $151 billion in 1990 to $ 720 billion in 1999, and have risen from 70% to almost 90% of FDI, although much of this is cross-border M&A activity between developed countries.

The transition process of M&A

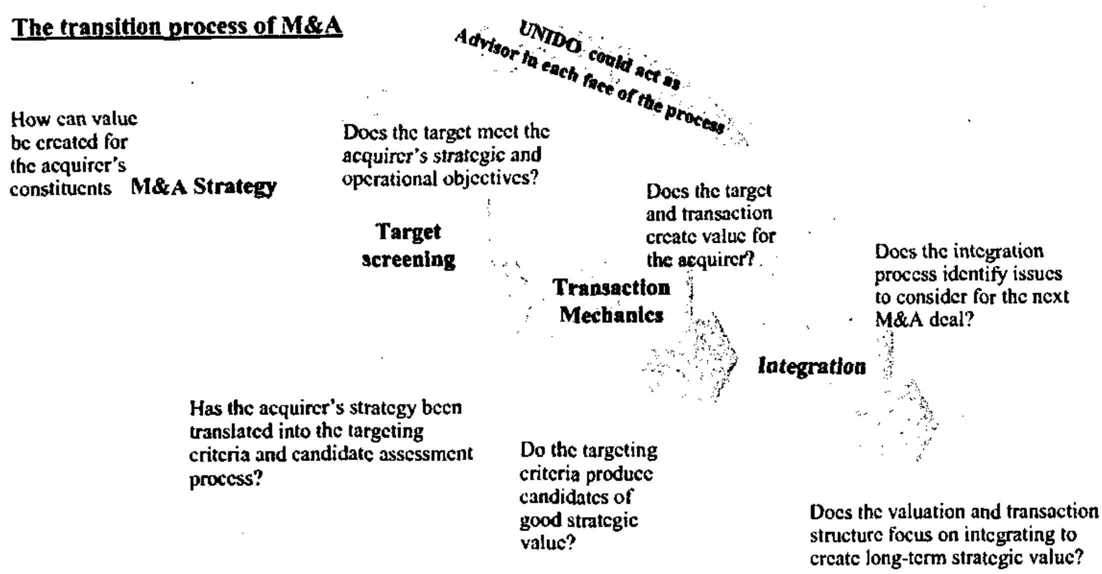


Fig. 16 – The transition process of M&A

2.6 Catalysing Foreign Direct Investment

Before addressing the intermediating role UNIDO could play in catalyzing FDI, through capital and financial market instruments (in addition to the kind of technical co-operation assistance already provided), it is important to note an emerging trend in FDI activity. An appreciation of these trends, from a financial sector prospective, is vital for designing possible UNIDO interventions through the capital and financial markets.

The FDI situation in the 1990s

The key elements of the rapid expansion in the 1990s were: FDI flows increasing across all regions roughly throughout the first half of the 1990s. These flows continued to increase in Latin America and Eastern Europe during the decade, largely offseting a slowdown in flows to Asia after 1996. The distribution of FDI flows to developing countries was asymmetrical, with China, Brazil and Mexico accounting for about 60% of FDI inflows to the developing universe. There was also a sharp increase in cross-border M&A activity.

The continued sluggishness of the global economy, in combination with weak equity prices, has weighed down on global FDI flows since roughly 2000. This trend has also been apparent in many developing countries.

Over the last three years, FDI flows declined by about 20%. This decline is explained largely by a reduction in flows to Latin America, concentrated in Argentina and Brazil. Large-scale M&A in the region has also declined sharply as the process of privatization in many countries is winding down.

Analysts have attributed the recent slowdown in FDI flows to a number of factors: a decline in M&A activity in Asia, after an initial spurt following the Asian crisis; the completion of many large scale privatizations in Latin America; weakening earnings growth by multinational corporations, reducing their volition to acquire or build new assets; and a shift by multinationals from expansion to consolidation, as global growth has slowed.

UNIDO as a catalyst of FDI inflows

Technical assistance services play an integral role in catalysing Foreign Direct Investment, by helping developing countries to define and implement strategies to promote investment. Governments and institutions need assistance in reforming their investment policy frameworks, liberalising investment regulations, updating their investment promotion strategies and activities, and strengthening their institutional capacities.

Operating as advisor to the financial community, and working together with governments and international organizations, UNIDO can act as catalyst of FDI flows into emerging market countries.

UNIDO could offer assistance serving investors, lenders, and host country governments, by supporting private enterprise and promoting foreign investment.

FDI favours knowledge transfers and also bring learning and education.

The knowledge and educational gap between developed and developing countries is as significant as the saving gap or the investment and financial gap.

- Investment and financial sources can introduce technology and this can lead to production and use of new commodities; but investment brings technology and technological components normally demand development of new skills and experience.
- Human capital upgrading such as educational training programs are key elements for successful development.

3. Relation between UNIDO and Financial Community

This chapter works through the proposed model, addressing UNIDO's role as advisor with each of the group of actors identified earlier (also see fig. 17).

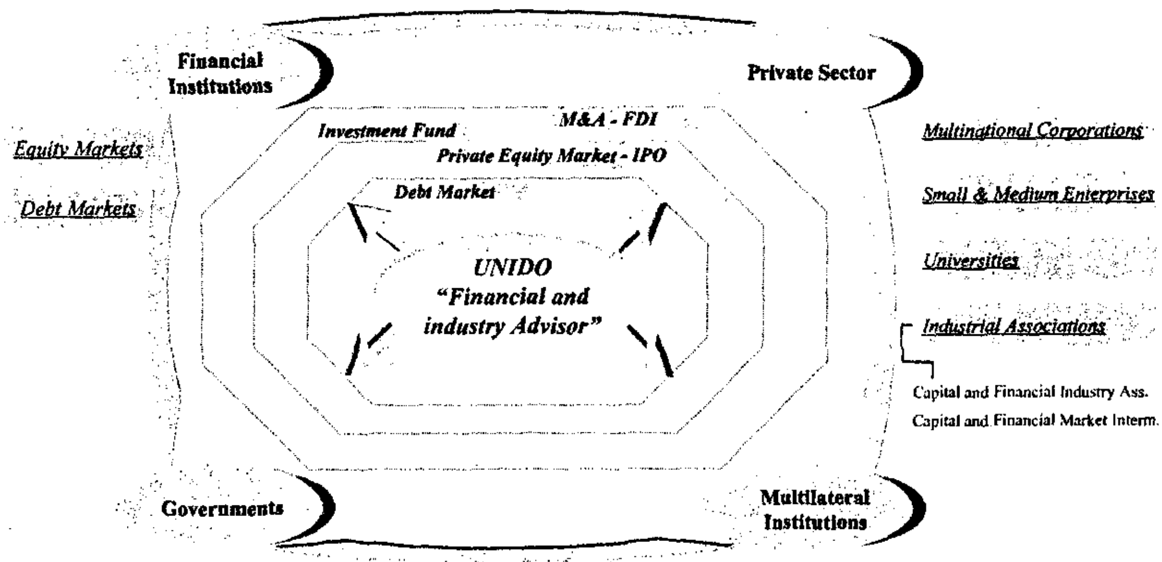


Fig. 17 - a business model for UNIDO, field and actors relation

3.1 Financial Institutions

Financial sector consolidation in emerging markets

Financial sector consolidation, which has been evident in mature markets, is now under way in some emerging markets, although there have been important regional differences on the depth and pace of this consolidation.

The migration of routine financial activities to low-cost financial centres is altering the financial systems of some emerging markets, and has the potential to link them more closely to the major international financial markets.

Consolidation in emerging financial markets has frequently been a vehicle for restructuring the financial systems following major financial crises; whereas in the more mature markets, consolidation has more often been enacted in a bid to reduce excess capacity and increase efficiency.

The regulatory authorities of financial markets have often played a major role in fostering the consolidation process.

The process of financial sector consolidation in emerging markets provides an opportunity to re-define the optimum policies for capital market development, improve market discipline, and coordinate efforts for improved supervision of financial institutions that are growing and diversifying their capacities in the field of financial services.

Dealing with consolidation will involve redesigning supervisory capacities, to more effectively monitor the activities of large complex financial institutions, and establishing clear entry and exit rules.

UNIDO: advisor to Financial Institutions

UNIDO might advise financial institutions and governments to go through a consolidation process, M&A deals, and steady growth in the application of e-technology (Internet, Extranet, etc.) for improved delivery of financial services.

- *Banks,*
- *Merchant Banks,*
- *Investment Banks,*
- *International Funds,*
- *Emerging Markets Funds,*
- *Debt Funds,*
- *Bond Funds,*
- *Private Equity Funds,*
- *Venture Capitals, Incubators,*
- ...

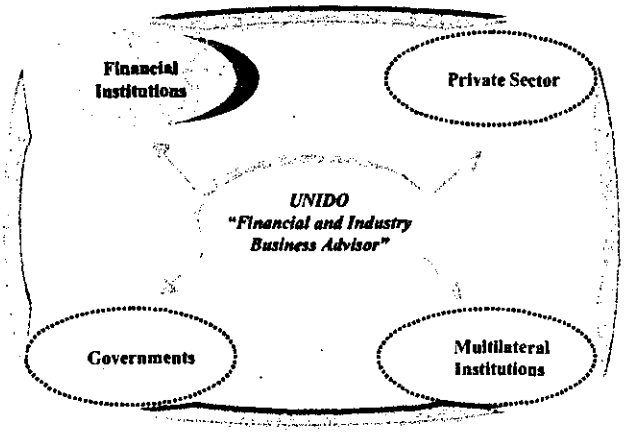


Fig. 18 – UNIDO and Financial Institutions

UNIDO suggestions related to project based operations in developing countries, could be useful for financial institutions that are seeking to provide financing, whether it be in the form of loans or equity investments.

UNIDO might work with financial institutions to encourage them to provide smaller long-term loans to small and medium-size companies in order to increase geographic coverage of financial services in emerging markets.

UNIDO could assist private financial institutions in the establishment of partnerships with governments and multilateral institutions at country or local level. The partnerships would be related to financial programs (both on debt and equity) aimed at supporting selected enterprises and their new projects and investments.

UNIDO might support the development of new private equity funds intended to focus on high potential companies in emerging markets

UNIDO as financial and industry advisor could:

- Assist financial institutions to identify and design the processes necessary to select enterprises and assess projects and investments' viability;
- Promote and support networks of local financial institutions in specific geographic areas, or specific developing countries, to facilitate exchange of information and experience, and cooperation in local development strategies and initiatives;
- Identify strengths and weaknesses, opportunity and threats focusing on selected geographic areas or industries;
- Encourage institutions to adopt polices and principles in accordance with an undertaking to provide loans and equity only to those "subjects" that can demonstrate their ability and willingness to comply with comprehensive processes, aimed at ensuring that projects are developed in a socially responsible manner.

UNIDO can help funds, intending to invest capital in emerging markets, to reach quality and efficiency through selectivity. In order to guarantee high quality and increase the chance of success in terms of rate of return, UNIDO could support financial institutions in offering lists of selected companies in selected industries and specific geographic areas.

It is interesting to note that investment funds dedicated to developing countries, (such as Norfund, IFU, Finnfund) have found it difficult to invest capital in developing countries. This difficult is due in part to an inability to identify suitable projects, companies and investment assets.

A selected company must be a profitable venture with growth potential, requiring medium or long term funding to capitalize on its market potential. Companies must have capable management who share a robust commitment to transparency and compliance with national accounting, tax, and environmental standards and labour practices[8].

Prerequisites for UNIDO could be profitability and long-term financial viability. Other selection criteria UNIDO will consider could relate to the company's impact on factors that further economic development, including:

- Job creation and working conditions;
- Transfer of resources and technology;
- Improvement of domestic management skills;
- Fostering of broader public participation in company ownership;

[8] This regulation dimension could also benefit from UNIDO intervention.

➢ Environmental issues;

➢ Corporate Governance.

UNIDO could support private equity funds to strive for closer co-operation with sister organizations and other development finance institutions, with the objective to create a well-functioning network that promotes effective risk-spreading, and help to secure financing in situations where the size of the developing country projects exceeds the single fund's risk.

3.2 Private sector

"... *marginalisation, not globalisation, threatens development and developing countries* ..."

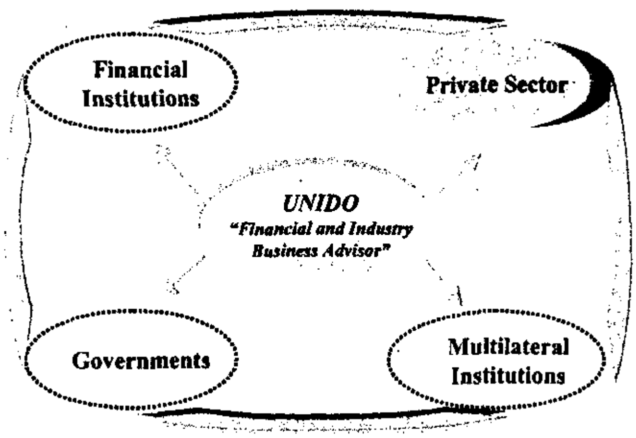


Fig. 19 – UNIDO and Private Sector

3.2.1 UNIDO as an advisor to Multinational Enterprises

International and global corporations hold and manage real economic power, intermediating transversally between governments and political institutions.

Therefore it is critical to advise and push the private sector to play a significant and needed role in addressing development goals, such as poverty eradication, primary education, reduction of child mortality, as well as ensuring environmental sustainability and enabling a global partnership for development.

UNIDO might identify critical areas of rapid and sustainable industrial development and map strategies for integrated action plans that are not effectively addressed by governments or donors.

The task of UNIDO would be to collaborate with Multinational Enterprises having as the company's objective to provide returns for its shareholders in a socially and environmentally responsible manner.

Multinational Enterprises can address social issues, not only through financing social projects, but also in the way they conduct their business, and the products and services they deliver.

When a corporation is expanding its business internationally, emerging markets needs to define closely with the advisor an entry strategy (market entry, strategy planning, business planning, foreign investment approval).

UNIDO could support in real terms several Multinational Enterprises in developing countries to overcome problems related to different field such as:

- Taxation (transfer pricing, tax and business registration...);
- Accounting (reporting systems, key performance indicators, internal audit...);
- People (visa/immigration, international assignments, payroll, employment requirements).

3.2.2 UNIDO as advisor to Small and Medium-Sized Enterprises

Small and Medium Enterprises, so crucial for employment, innovation, investment and growth in most countries, are generally not well served by banking and financial sectors in emerging markets.

If developing countries want enterprises to enter the formal economy at an accelerated pace, it is important to support SMEs to better access global markets and international sources of capital.

UNIDO may serve as an advisor to companies in attracting financial resources, and through financial resources, harness technology transfer and technical managerial know how. These resources can be mobilized through equity investment and debt instruments.

UNIDO intends to assist companies that do not have access to medium or long term financing from the capital and financial markets ... to do what ?.

UNIDO could support enterprises in developing countries to establish business alliances with foreign partners by providing access to financial institutions.

UNIDO can facilitate investment projects by disseminating screened and appraised project proposals among financial institutions interested in seeking direct investment opportunities in developing countries.

As a financial advisor, UNIDO will support selected companies to prepare all documents required by the financial institutions, such as a well-defined business model and strategy, business plan, information memorandum and valuation analysis.

In the private equity field, UNIDO advice could include identifying transaction opportunities and requirements, assessing the business and proposed transaction, assessing negotiation parameters, developing an optimal transaction structure, selecting and approaching appropriate financial institutions, negotiating with financiers, vendors and other parties, managing the due diligence process and overall project to completion.

"...building human capital is critical to the long-term growth and prosperity of every countries..."

3.2.3 UNIDO and Higher Education and Training Institutions

The greatest deficiency in Small and Medium Enterprises development is in management education and technical know how. A strong cultural gap, diversity in language and ways of thinking removes enterprises from the attention of financial institutions.

Many subsidized funding schemes have failed to attract Small and Medium Enterprises applicants because the applicants could not meet the minimum requirements of producing audited accounts, or at least a well thought-through business plan.

UNIDO could collaborate with universities in order to educate entrepreneurs, managers and consultants to interface better with the capital markets. This could comprise of:

- Supporting universities in developing countries to meet leading universities in the world and share economy and finance knowledge.
- Promote dialogue and agreements between universities and financial institutions
- Bring enterprises nearer to financial institutions, through seminars, executive courses and specific programs.
- Issue publications such as surveys of capital market competitiveness, countries financial player mapping and financial instruments mapping.

UNIDO could propose to universities post graduate programs or business school fellowship exchange programs, whereby both students, workers and professors would be sent to developing countries institutions for a certain period. In exchange, developing countries would commit individuals for training at qualified educational institutions in developed countries. Exchanges could be financed by private sector actors such as corporations, associations, investment and commercial banks, or by public sector such as governments and multilateral institutions.

Working closely with universities and join universities know-how to own projects, UNIDO will also increments credibility toward governments and will mobilize more easily funds related to specific projects.

One of the greatest challenges in financial sector development is education and training. It is important to spend more time, effort and resources on financial education, targeting Small and Medium-Sized Enterprises in particular, as well as journalists, lawyers and financial communities in developing countries.

3.2.4 UNIDO and Industrial Associations

Industrial associations can vary greatly in form and operations. They can range from large, well-resourced national organizations, to small operations run by a single, unpaid coordinator. The most common categories are:

- Trade associations, representing a single sector, organized locally or, more often, nationally;
- Chambers of Commerce and Industry, representing the private sector within a specific area;
- Umbrella associations that are federations of smaller bodies, organized nationally to deal with government.

UNIDO could increase its ability to interact with industrial associations, appreciate and exploit their deep knowledge of an industry sector to bring the associated enterprises to financial markets.

Business associations can play a key role in facilitating cooperation between private sector, financial institutions and governments.

UNIDO might increase its support of international collaboration between international and regional associations and financial institutions and also organize networking of industrial associations operating in different countries. This role could be played by ITPOs network that should develop also financial intermediation dimensions to their work.

Provide information and facilitate exchange of programs, ideas, know-how, policies. It is extremely important work together with industrial information on the educational side, in order to exchange knowledge and set up the right training programs, seminars and conferences

Provide information and analysis to policy makers, business leaders and public institutions, to assist them in better appreciating the potential offered by financial markets and new financial instruments to accelerate industrial growth.

It is considered crucial to provide funds to develop national small business institutions that can coordinate comprehensive programs for SME support in select developing countries. Associations could provide streamlined access to assistance programs that address technical and managerial weaknesses, and financing programs including loan guarantees, equipment and export finance. Associations could also guarantee coordination of linkages to multinational corporations.

3.3 UNIDO as advisor to Governments

UNIDO as an advisor to Governments on financial market instruments and operations.

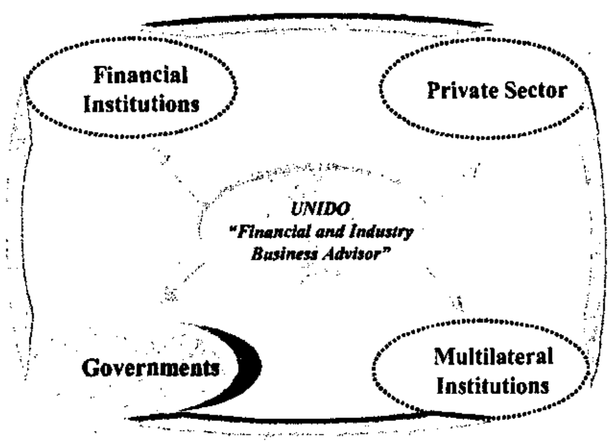


Fig. 20 – UNIDO and Governments

UNIDO, through its delivery of policy assistance to Governments, could offer assistance to design specific policies and strategies to promote the financial community within the new economic context in developing countries. It could promote cooperation among groups of countries faced with similar development challenges by organizing regional dialogue on policy issues through seminars and networking of regional research institutions.

UNIDO could advise Governments in enforcing legal and regulatory frameworks, through appropriate reforms and also to harmonize and standardize regulatory frameworks relating to financial institutions' activity.

UNIDO could encourage Governments to create the optimal financial regulatory regimes, so as to have systems that are both appropriate but also broadly congruent with those in more advanced countries. .

UNIDO could also assist Governments in the formulation, packaging and promotion of "private financing of industrial infrastructure" projects, using financial instruments.

In capital and financial market fields, as well as cooperate with Governments and Ministries to make externally supported projects more sustainable and cost-effective through public-private partnerships, again using financial instruments.

3.4 Multilateral Institutions

UNIDO could facilitate dialogue between multilateral institutions to develop programs in the field of capital and financial markets.

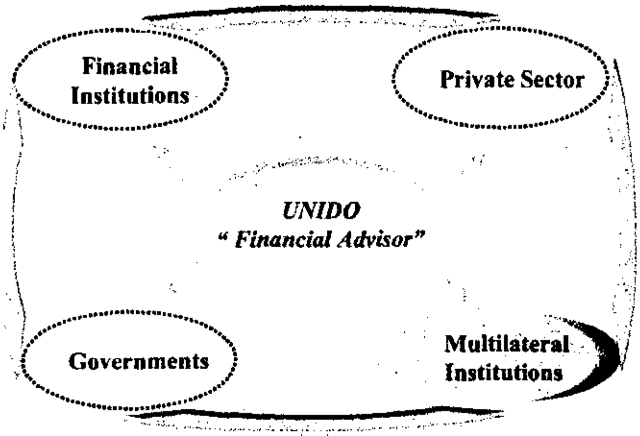


Fig. 21 – UNIDO and Multilateral Institutions

Many multilateral institutions (including the regional development banks) are aware of the importance of strengthening financial systems, and are working to set up and develop different type of funds and financial instruments for use by the financial institutions.

- An example of this approach to economic development is an initiative of the International Finance Corporation (IFC – private sector arm of the World Bank Group), has built up a portfolio of investments in emerging market investment funds representing a commitment of USD 1 billion in about 100 funds, over 80% of which are private equity. IFC is the largest multilateral source of loan and equity financing for private sector projects in the developing world[9].
- Several government agencies and multilateral institutions, banks, are following this approach to development and have established or sponsored investment funds.
- Various organizations, such as Asia Pacific Economic Cooperation, Development of Domestic Bond Markets, IMF, World Bank, and others are paying increasing attention to the private equity market and domestic bond markets in developing countries, and to stock exchanges in general, as a means of channelling funds other than FDI.

[9] However its ROI is not impressive in comparision with other fund performances.

UNIDO could work closely with government and industry in identifying and formulating projects to be submitted to multilateral institutions and to national, regional, bilateral and multilateral investment funds. In this way private and public sectors would gain access to financial support, to allow them to obtain the investments needed to develop technologies and advance production systems.

Favourable coordination of multilateral institutions, and bilateral and multilateral funds, is essential if governments want to effectively control their development processes. Coordination will be important not just in terms of providing resources but also for monitoring participation, designing and implementation of programs, and for monitoring how effective banks and funds are in reforming their methods and policy prescriptions. Coordination will also be important for sharing knowledge of best practices in donor organisation and working methods.

4. Concluding remarks

This draft report highlights, ambitiously, and sometimes in a provocative tone, possible different roles that UNIDO could potentially play as advisor to various groups of actors: Financial Institutions, Private Sector (corporations, medium-sized enterprises, universities, industrial associations), Governments,. Multilateral institutions.

Capital and financial markets show the necessity of, and demand for, advisory initiatives and services in order to support emerging markets development in the fields of investment, debt markets, private equity, M&A and FDI. Typically of this necessity is the need for focusing attention on specific geographic areas or countries, and selected financial market segments or instruments.

For possible successful relations with selected actors the report asks, interalia, the following questions: has UNIDO the right competences, has UNIDO the interest and the intention to develop competences required to act as advisor in the financial markets? The text herein attempts to bring the organisation closer to possible valid responses to these searching questions.

The report points out the necessity to open a discourse with other players in the financial emerging markets, such as multination institutions, governments, and the private actors (international financial associations and merchant banks) in order to validate UNIDO's profile in relation to its potential role and to test the numerous initiatives proposed.

Extremely important is the development of the private equity market, as a basic and essential factor to foster corporate bond and stock markets.

It is considered important to apply a "bottom up" strategy, applying the model illustrated by starting from local needs and specific requests and then, from this specific starting point, going forward to enlarge the possible range of action towards other financial fields and offering support to other actors in the financial community. Any project that will be developed, should consider local requirements and use as much as possible local resources and capabilities. This approach, in itself, will assist in building up capacity.

***

To test the wider potentiality of proposed UNIDO initiatives in emerging financial markets, it might be advisable to pursue a slightly larger number of smaller pilot projects[10] within the report's suggestions:

- Private Equity – projects in the selected developing country or sub-region where private equity and venture capital activity has not been particularly vigorous (preferable a sub-region, rather than a single country);
- IPO and Stock Market – projects in the selected developing country or sub-region where the equity markets are not sufficiently robust;

[10] The budgets for these pilot projects might only need be US $15-30,000 each, given that they are envisaged as exploratory research projects.

- Corporate bond market – projects in the selected developing country or sub-region where there is a functioning sovereign debt market, but little corporate bond market activity;
- Investment fund – projects in the selected developing country or sub-region where investment funds have not been particularly active;
- FDI (including cross-border M&A) – projects in the selected developing country or sub-region where inflows of FDI have been disappointing.

Based on the hints and suggestions provided in the report that will be better defined after testing pilot projects, a number of potential interventions can be discerned as UNIDO services that would be particularly worthy of further development.

These potential interventions can be broadly divided into "soft" and "hard" initiatives.

In terms of **"soft" interventions**, this would relate to initiatives aimed at improving the general enabling environment oriented to companies in developing countries seeking capital market access and financing. These would include designing and providing: education, training, information and database initiatives aimed at increasing the propensity of companies in developing countries to better understand the potential role played by capital markets in their corporate growth strategies and to better position themselves to harness non-bank sources of long-term funding. Related to this, initiatives aimed specifically at improving standards of corporate governance and financial transparency would also be of utility, particularly in highlighting the potential rewards to be gained by companies that make advances in areas like minority shareholder rights. Such "soft" initiatives would allow UNIDO to collaborate with government agencies, regulatory bodies and particular NGOs with which it already has established relations.

In terms of **"hard" interventions**, this would relate to more technical assistance initiatives. This category might include: strengthening and refining credit rating and credit scoring activities in specific countries, along the lines discussed in the report; assessing the potential to create regional equity markets, specifically to cater for larger SMEs in countries where the existing equity markets are inadequate; assisting in the securitisation (ie. collating, bundling and then selling) of financial assets in developing countries, specifically in order to better recycle identifiable idle funds; sustain local private equity and venture capital industry, and acting in coordination with donors or other agencies that have complementary expertise in the field; advise and provide well-calibrated coordination services between donors, developing countries, multilateral banks, and other agencies already active in the field of capital and financial market development.

At present the three proposals illustrated in Annex A have been selected in relation to UNIDO regional programs and on going initiatives. They are:

a. Securitisation transaction and issuance of bonds in Argentina;
b. Private Equity and Venture Capital industry in Uruguay and its interrelation with MERCOSUR countries;
c. The challenge of rating in Argentina.

ANNEX A – **Proposals**

Proposal n.1

Pilot project aimed at determining whether **securitization**[11] and consequently **corporate bonds** are a viable source of capital for enterprises, and liquidity, for financial institutions in Argentina's emerging market.

UNIDO's Industrial Technology Branch (IPT) under the overall supervision of the Programme Development and Technical Cooperation Division (PTC) will implement the project.

It is foreseen that international and local consultants, expert in advanced financial instruments, will work in collaborating with UNIDO's professionals in structuring the project framework and in providing additional content where necessary.

The project will be developed in partnership with identified and pre-selected local financial institutions and associations.

Objective

The project intends to determine and verify the validity and reliability of securitization and bonds issue as an accepted method of funding medium-sized enterprises and additional sources of liquidity for small financial institutions normally divorced from the main capital and financial markets.

The project includes an investigation into the reasons for the lack of growth and the problems currently experienced in the financial market with reference to advanced instruments.

The project objective is to determine whether securitization might be implemented with success in the Argentina market, and to promote the implementation of securitization transactions both for financial institutions and enterprises.

The analysis will have to cover how to overcome problems of scale in the market and indicate industries or geographic area for feasible start up with an operative project.

Planned activities to reach outcomes

1. Review literature and utilize public sources, government studies, data banks and research departments to gather relevant information, data, and reports to analyse the sector.
2. Examine the mechanics and development of securitization with respect to emerging markets. What is securitization? How does it work? What are the risks, benefits and costs of securitization?

[11] SECURITISATION is the process of creating a pass-through, such as the mortgage pass-through security, by which the pooled assets become standard securities backed by those assets. Also, refers to the replacement of non-marketable loans and/or cash flows provided by financial intermediaries with negotiable securities issued in the public capital markets.

3. Highlight the distinctions between "mortgage-backed" securities (MBS), where the underlying asset of the security is residential mortgages, and "asset-backed" securities (ABS) or Asset Backed Commercial Paper (ABCP), where the security is backed by any other asset expect residential mortgages.

4. Verify the possibility to launch securitization multiple-seller programmes in Argentina.

5. Hold interviews with current experts and relevant parties in the Argentina securitization market (financial institutions, audit companies, financial consultants companies, industrial institutions, public authorities, local and international rating agencies).

6. Identify who, in terms of enterprises and institutions, could act as a players (originator/lender, SPV/issuer, Investors, Rating Agency) in a securitization transaction in Argentina market.

    a. Originators: verify the knowledge levels on securitization of possible originators such as.

    b. Special Purpose Vehicle (SPV): verify and individuate lack/ gap/weakness about the accounting and legal regulations, tax treatment. Describe action that may be taken in Argentina to ensure bankruptcy remoteness of the vehicles. Examine the Argentina context and the regulatory environment of securitization in Argentina. Verify how and if the legal system in Argentina guarantee a "true sale" between originator and SPV.

    c. Investors: verify who could invest in securities issue by the SPV in Argentina markets.

    d. Rating agencies: highlight the role of the rating agency in securitization transactions.

7. Contact Universities and Business schools and verify the possibility to organize, jointly with UNIDO, training and seminars aimed to bring entrepreneurs culture closer to advanced financial instruments.

8. Verify interest of selected government and local institutions to foster securitization and bonds Market utilizing UNDIO bureau and UNIDO field offices.

Outcomes

I. Preliminary market report:

Illustration of the result of the investigation and the strengths, weaknesses, opportunities and threats related to the analysed financial instruments.

Highlighting of all the risks and benefits related to securitization with specific focus to Argentina market:

- ✓ Risk to: issuers (SPV), investors, originators.

- ✓ Benefits to: originators, investors, borrowers

Identification of barriers to securitization in Argentina and highlighting of how to overcome barriers and particularly how to overcome the problem of "costly process" and the legal-regulatory uncertainties.

II. Analysis of actors, initiatives and rules:

Mapping all securitization transactions carried out in Argentina in the past 10 years. Analyse reasons of failures and successes.

Identification and information on possible geographic areas to promote and develop securitization transactions. Identification of investor and underwriter consensus in support of accepting and adhering to such pilot transactions.

Regulatory framework analyses:

- ✓ Identify and address ways for improving policies framework, and improving the standards and practices of the securitization process. Illustrate common rules and best practices for the all securitization process that are agreeable to by all parties.
- ✓ Illustrate the expected change of the environment, especially with regard to the demand and supply conditions. Supply and demand for asset-backed and mortgage-backed securities are expected to increase?
- ✓ Illustrate the influence of the new Basel regulations on securitization for financial institutions and enterprises in Argentina.
- ✓ Explain tax treatment of securitization in Argentina and highlight advantages and disadvantages.
- ✓ How to protect the rights of the investors? Illustrate the role of a trustee. Policy and legal framework analysis.

Accounting standards analysis with regards to securitization, as well as the levels of the local auditor expertise and understanding of the related market.

Highlight problems connected to Capital market, Stock Exchange and bonds instruments with focus on Argentina market.

III. Identify and define:

The present structure of the industry and characteristics. Also illustrate the behaviour of the firms operating in Argentina. Indicate if securitization might be implemented and could be exploit with success in the Argentina Markets.

Success of securitization depends significantly on the regulatory environment of a country. Suggest areas of intervention in terms of policies, legal and tax framework. Indicate also the institutions to involve and support. Propose how to foster dialogue in Argentina to enable public and business leaders to discuss concrete initiatives.

Delineate the critical state of the Financial Market in Argentina and estimate how past problems affect development and growth of new financial instruments.

Define how to overcome problems of scale and indicated interesting industries in terms of profitability, cash flows, and growth rate could be suitable to involve. Define a pilot project (geographical, industry, asset types, originators, target investors, etc.) intended to bring together selected small and medium enterprises in order to start up a securitization transaction and successfully allocate the related bond.

Estimated budget:

The tentative budget of US $100,000 for this initiative can be summarized as follows:

Bu.li	Description	Euro
11-50	1 international consultant. The consultant will have 4-month assignment and will work in close relation with the national consultant, the UNIDO IPT branch staff and UNIDO local representative in Argentina.	**50,000**
11-50	1 junior international consultant. The consultant will have 4-month assignment and will join the UNIDO staff in Vienna. The consultant will be involved in data search, archive documents, and will support to the preparation of the report and organization of closing workshop.	**10.000**
15-00	Project travel, which include promotional activities in target country to identify correct counterparts to be involved in the research preparation and in the implementation of followings projects. As well some travel to contact European counterpart, expert and industries authorities.	**25,000**
16-00	Mission costs for technical assistance by branches / regional office.	**5,000**
17-00	1 National expert. They will have a 4-month assignment. They will analyse in detail the national environment and they will prepare a local research following the guideline assigned by the international consultant and UNIDO staff.	**15,000**
35-00	1 Workshop (2 days) to present the findings research and propose a detail project and respective action plans.	**15,000**

Proposal n.2

Pilot project on **Private Equity and Venture Capital Industry in Uruguay** and its interrelation with MERCOSUR Countries (Argentina, Brazil, Paraguay)[12].

The project will prepare and support subsequent action plans aimed at bringing pertinent industry actors together and attract the attentions of international financial institutions.

UNIDO's Industrial Technology Branch (IPT), under the overall supervision of the Programme Development and Technical Cooperation Division (PTC), will implement the project.

It is foreseen that international and local consultants, expert in the PE and VC industry, will work in collaboration with UNIDO professionals in structuring the project framework, and in providing additional content where necessary.

The project will be developed in partnership with identified and pre-selected local financial institutions and associations.

Objectives

The aim of the project will be to assess the viability of developing private equity and venture capital activity in the target country, in order to support small and medium enterprises' access to the financial market.

The research will seek to identify and analyse different ways to mobilize and attract funds in the target country, and undertake a feasibility study on the potential to gather players able to set up dedicated funds for specific industries.

More specifically, the pilot project will analyse four areas where action could be taken to facilitate venture capital and private equity activity in the target country.

Two areas address the requirements of entrepreneurship at the host country level:

- Promoting an entrepreneurial environment by increasing incentives for entrepreneurial investment (support venture capital, private equity and entrepreneurial education);

[12] Uruguay and its capital Montevideo, represent a relevant financial market in Latin American. Uruguay is geographically well positioned and strategically well connected with all the other MERCOSUR countries. Uruguay offers some important benefits such as: legal guarantee for repatriation of capitals and profits, full and perpetual corporate tax exemptions in free trade zone, lowest banking charges in the region. As far as the economy outlook is concerned, it is important to underline that "the long-waited debt-exchange received an enthusiastic response. The success of the debt exchange means that Uruguay does not need to tap international capital markets for at least five years, when the first of the extended maturities falls due. As such, it has been granted a five-year breathing space in which to place the economy on a sustainable growth path, allowing time to rebuild finances after the crisis of 2002" – Latin American Monitor July 2003, Business Monitor International.

- Ensuring that venture capital, private equity and entrepreneurial activity are taken into consideration in all policy-making (tax and legal policy, framework of equity ownership, foreign investment, safeguard the interest of entrepreneurship, etc.);

Two areas address structural requirements for efficient private equity investment activity:

- Facilitating fund formation (eg. structural efficiency, and the need of international investors);
- Developing long-term capital sources (eg. encouraging pension fund investment in private equity).

Planned activities to reach outcomes

1. Utilizing data banks and research departments to gather information, data, and reports analysing the private equity activity in the target country.
2. Contact Local Private Equity and Venture Capital Associations and single International PE and VC Funds located in the following markets: London, Paris, Frankfort, Milan, Madrid.
3. Contact investment banks with Private Equity capabilities.
4. Analyse and discuss existing projects; as well individuate objectives, outputs, problems, deficiency and future assumptions of completed projects. Study the possibility to launch new project and mobilize funds in cooperation.
5. Contact Universities and Business schools to evaluate the possibility to organize, jointly with UNIDO, training and seminars aimed to bring entrepreneurs culture closer to private equity deals.
6. Verifying interest of selected government and local institutions to foster Private Equity activity, utilizing UNIDO bureau and field offices.
7. Define ways to mobilize funds in order to strengthen Private Equity activity.

Outcomes

I. Market research:

- History, present situation, expected development of private equity industries in the indicated countries. Correlation level of these markets. Highlight the importance of these correlation and ways to foster this correlation. Point out capital gathered and capital invested over in the last years.

II. Mapping of actors and players in the emerging market:

- List and identify by category such as incubator, venture capital, private equity, all the actors operating in the indicated market.
- Identify unsuccessful players and their reasons for failure.

- Classify the actors by the risk level of their average investments and by the size of their investment.
- Identify the indirect actors operating in the industry, such as consultants, associations, brokers etc.
- List deals already signed and the related operations structure. Indicate all related information such as market, industry, technology level, capital invested, financial headlines (debt/equity proportion), etc.
- List the different exit strategies available.
- List and gather information from potential national and international investors interested to join new dedicated investment funds.

III. Identify and define:

- *Most interesting industries, in terms of profitability, cash flow and growth rate.*
- Indicate the advice and technical support the fund and its advisors should provide to the companies, besides financial and capital support, in terms of: business model definition, corporate strategy, management systems, industry expertise, quality standard, set up new partnership, supporting due diligence and audit process, corporate governance, transparency policies.
- Delineate the standards of corporate governance the companies should meet in order to protect the rights of minority shareholders, such as the fund.
- Indicate the standard level of existing management and the level of skill and knowledge the management of the invested companies should normally have.

Estimated budget:

The tentative budget of US $ 150,000 for this initiative can be summarized as follows:

Bu.li	**Description**	**Euro**
11-50	1 international consultant. The consultant will have 4-month assignment and will work in close relation with the national consultant, the UNIDO IPT branch staff and UNIDO LA representative in Uruguay. The consultant will have to present his findings at a specific workshop.	**60,000**
11-50	1 international consultant. The consultant will have 4-month assignment and will join the UNIDO staff in Vienna. The consultant will be involved in data search, archive documents, and will support to the preparation of the report and organization of final workshop.	**20.000**
15-00	Project travel, which include promotional activities in target	**30,000**

	country and if required in correlated MERCOSUR countries, to identify correct counterparts to be involved in the research preparation and in the implementation of followings projects. As well some travel to contact European counterpart, expert and industries authorities.	
16-00	Mission costs for technical assistance by branches / regional office.	**10,000**
17-00	1 National expert. A 4-month assignment, to analyse in detail the national environment and conduct research under the supervision of the international consultant and UNIDO staff.	**10,000**
35-00	1 Workshop (2 days) to present the research findings and discuss a detail project and respective action plans.	**20,000**

Proposal n.3

"... rating is a priority in order to develop share and bond markets ..."

Pilot project on developing the provision of Credit **Rating in Argentina,** in order to facilitate the corporate sector's improved access to credit.

UNIDO's Industrial Technology Branch (IPT), under the overall supervision of the Programme Development and Technical Cooperation Division (PTC), will implement the project.

It is foreseen that international and local consultants, specialised in credit rating, will work in collaborating with UNIDO's professionals in structuring the project framework, and in providing additional content as necessary. The project will also be developed in partnership with local financial institutions and associations.

Objectives

The aim of the analysis will be to study how Rating Agencies can facilitate access to the capital market for small and medium enterprises.

In addition, the research will state if it is feasible to establish new agencies that can bring eligible SMEs closer to rating agencies.

With "Basel2" we refer to new rules put out by the Basel Committee for the international finance system for better managing risk management and credit access using common criteria.

The banking and financial community is moving to adopt these rules by 2008.

The main critical issues, for every operator, are the impact of this new system on the small and medium-sized company and any potential reduction in access to credit.

The possibility for approaching this critical situation and, at the same time, supporting Small and Medium Enterprises is to involve the institutional operators (Governments, Scientific Centers, and Associations) which can furnish the guide lines about information and methodology necessary to sustain the innovation inherent in these rules and to develop the local economic system.

Rating provides an opportunity for the credit system to review the traditional process of credit access through support to economic actors with strong chances of growth and a good financial situation.

For estimating the company rating it is necessary to set up relationships with the local and international credit system under common criteria.

The rating assignment can produce as a first outcome, which could permit new approaches, include:

- Reductions of money rates;
- Design of new way for supporting small and medium enterprises by instruments like project finance or the valuations of feasibility study.

Planned activities and outcomes

1. Utilizing public sources, government studies, data bank and research department to gather information, data, and reports analysing the sector.

2. List local and international agencies already operating in the Argentina markets both for Corporations and SMEs.

3. Contact International Rating Companies such as Standard & Poor's, Moody's, Fitch Ratings, to verify:

   - All the training programs for banker and entrepreneurs for emerging market that at present they offer;

   - The projects related to SME they are preparing, if any;

   - The projects related to Financial Institutions in order to fit the Basel 2 requirements.

   - The projects they are implementing in order to advise Governments and Authorities of developing countries to close the legal and polices gap relating the Basel 2.

4. Evaluate possibility of collaboration with these rating agencies and verify the possibility to launch new project and mobilize funds in cooperation.

5. Contact local rating agencies to find out how they could be supported to utilise international methodologies to ensure the credibility of their rating judgment.

6. Analyses the policies and legal structure of local rating agencies and propose efficient and practical methodologies that are utilisable by local agencies.

7. Contact Universities, Business schools, Stock Exchanges, Public and Private Financial Institutions and verifying the possibility to organize, jointly with UNIDO, training and seminars aimed to bring entrepreneurs closer to rating industries.

8. Verifying interest of selected government and local institutions to foster rating industries utilizing UNIDO bureau and UNIDO field offices.

9. Define projects and verify ways and means to mobilize funds in order to strengthen rating industries.

Outcomes

1. The mission of this study, as result of specific research, is to analyse the characteristics of economic system, market references and company targets. The output will permit the refinement of two big issues:

   - Territorial Governance: Vision and design of possible player's roles, innovative services and relationship between different players.

   - Rating Methodology: Design of Valuation Methodology for companies that belong to regional system.

2. The project will conclude with a workshop to present the project's findings.

3. A follow up of the pilot phase will entail promoting and disseminating the results.

Further, the results of the first phase could be useful in:

- Defining and testing a rating methodology for local agencies targeted at SMEs.
- Mobilising funds to launch rating agencies dedicated to SMEs.
- Conceptualising, designing and implementing a training program for entrepreneurs and managers aimed at reducing the gap between financial institutions and enterprises.

Estimated budget:

The tentative budget of US $ 100,000 for this initiative can be summarized as follows:

Bu.li	**Description**	**Euro**
11-50	1 international consultant. The consultant will have 4-month assignment and will work in close relation with the national consultant, the UNIDO IPT branch staff and UNIDO local representative in Argentina.	**30,000**
11-50	1 junior international consultant. The consultant will have 4-month assignment and will join the UNIDO staff in Vienna. The consultant will be involved in data search, archive documents, and will support to the preparation of the report and organization of closing workshop.	**10.000**
15-00	Project travel, which includes promotional activities in target country to identify correct counterparts to be involved in the research preparation and in the implementation of followings projects. As well some travel to contact European counterpart, expert and industries authorities.	**25,000**
16-00	Mission costs for technical assistance by branches / regional office.	**5,000**
17-00	1 National expert. The consultant will have a 4-month assignment, to analyse in detail the national environment and to conduct research under the supervision of the international consultant and UNIDO staff.	**15,000**
35-00	1 Workshop (2 days) to present the research findings, and discuss a detailed project and respective action plans.	**15,000**

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CEPAL – Comisión Económica para América Latina y el Caribe, http://www.eclac.cl/
CIDA - Canadian International Development Agency, http://www.acdi-cida.gc.ca/index-e.htm
Colombia Compite, http://www.colombiacompite.gov.co/index.asp
Debt Markets Development Initiative, http://www.debtmarkets.org/
Deloitte Touche Tohmatsu Emerging Markets, http://www.public.deloitte.com/emergingmarkets/
EDFI - European Development Financial Institutions, http://www.edfi.be/
EMDB Emerging Market Data Base, http://www.ifc.org/emdb/
European Commission, http://europa.eu.int/comm/enterprise/entrepreneurship/financing/index.htm

FIAS - Foreign Investment Advisory Service, http://www.fias.net/
GEF - Global Environment Facility, http://www.gefweb.org/
Global Trade & Technology Network - http://www.usgtn.net/
HIPC - Heavily Indebted Poor Countries, http://www.worldbank.org/hipc/
ICI Mutual Fund Connection Home Page, http://www.ici.org/
IDS Policy Briefing 13, http://www.ids.ac.uk/ids/bookshop/briefs/brief6.html
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MIGA - The Multilateral Investment Guarantee Agency, http://www.miga.org/
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OPIC The Overseas Private Investment Corporation, http://www.opic.gov/
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Poverty Reduction Strategy Papers, http://www.worldbank.org/poverty/strategies/index.htm
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Acquisitions Monthly Updated daily, global mergers, acquisitions and buyouts, league tables and merger finance, http://www.acquisitions-monthly.com/
AEEG Home Page American Entrepreneurs for Economic Growth, http://www.aeeg.org/
Afic - Association Francaise des Investisseurs en Capital, http://www.afic.asso.fr/
APCRI Associação Portuguesa de Capital de Risco, http://www.apcri.pt/
ASCRI - Asociación Espanola de entidades de Capital – Riesgo, http://www.ascri.org/ascri/ascriweb.nsf
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MerillLynchResearch, http://www.ml.com/direct/research.htm
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RedHerring.com The Business of Innovation, http://www.redherring.com/
SAVCA South African Venture Capitalists Association, http://www.savca.co.za/
SECA Swiss Private Equity & Corporate Finance Association, http://www.seca.ch/
Standard & Poor's, http://www2.standardandpoors.com
Venture Capital Resource Directory, http://www.vfinance.com/

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