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UNLOCKING DOMESTIC INVESTMENT FOR INDUSTRIAL DEVELOPMENT

DEPARTMENT OF POLICY, RESEARCH AND STATISTICS

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Unlocking domestic investment for industrial development

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1. Introduction: Domestic investment

Investment is crucial for growth and sustainable development; it boosts the competitiveness of countries, generates employment and reduces social and income disparities (UNCTAD 2010). Furthermore, investment is a fundamental driver of structural change of the economy, which in turn facilitates other forms of investment, be they private, domestic or public, over and above foreign direct investment (FDI), a basic imperative in most developing countries.

Public investment plays an important role for development, long-term growth and structural change as it supports the expansion of productive capacities, stimulates aggregate demand and allocates resources across the economy, especially in least developed countries. The rationale for a policy intervention is given by the existence of market failures and the need for structural transformation. *"Markets themselves are not very good at structural transformation partly because the sectors that are being displaced – resources that have to move from one sector to another – typically suffer large wealth and income losses, and are thus not well placed to make the investments required for redeployment. And well-understood capital market imperfections (based on information asymmetries) limit access to outside resources."* (Greenwald and Stiglitz, 2013, p.3) Moreover, industrial policy intervention is necessary due to *"market failures and private decisions in response to the market signals to generate an adequate level of manufacturing activity."* (Weiss, 2015, p. 1) The state can play a crucial role in compensating market imperfections by addressing liquidity—a key challenge that needs to be overcome—and as a long-term financier for investment projects in developing economies (OECD, 2015).

In view of the large body of literature on policy interventions aimed at facilitating the inflow of FDI, but also in light of the fact that such investments have effectively bypassed many developing countries, this working paper reviews policy instruments that can unlock domestic (particularly public) investment and thus foster growth and structural change in developing economies. The three main policy instruments governments use to channel public investment into the national industry are surveyed, namely Sovereign Wealth Funds (SWFs), equity funds (including venture capital) and "Industrial Development Corporations" (IDCs). IDCs can be characterized as public entities providing, among others, private equity and loans, and are positioned very close to development banks. The taxonomy of these policy instruments is based on Weiss (2015), with a particular focus on public goods provision in the capital market. This working paper is part of a series on policy instruments deployed by low- and middle-income countries in the pursuit of structural transformation.

The focus of this paper on domestic investment does not imply that FDI is less rewarding (on the contrary); however, as many low- and middle-income countries have failed to attract FDI, domestic investment represents a complementary (albeit not exclusive) strategy. The policy instruments and recommendations generally found in the literature to unlock private domestic investment do not differ considerably from those recommended to stimulate FDI. The relationship between FDI and domestic investment is usually observed from the angle of FDI in the literature or of outward FDI replacing domestic investment (crowding out effect) or of FDI stimulating further domestic investment (crowding in effect). This working paper provides further insights on the various relationship scenarios between FDI and domestic investment and on best practices for investment governance. The investment frameworks of best practice guides developed by international organizations usually apply to all types of domestic and foreign investment.

This paper is structured as follows: first, an introduction on domestic private and public investment as well as the relationship to FDI and the taxonomy used is provided, followed by good practices with several examples from the current literature. In the following section, three ways to channel public investment into the national industry are discussed (SWFs, private equity/venture capital funds and IDCs), supplemented by country case studies. The final section concludes.

Investment can be defined as the monetary outlay on real assets such as factory plants, inventories, real estate, etc. – all assets that contribute towards the provision or production of goods and services. Domestic investment involves private and public investors and is a vital component of total investment[1].

UNCTAD (2014 and 2015a) defines investment as one of the key drivers of structural change and as a prerequisite for economic growth. Investment plays a strategic role for policymakers in the promotion of growth in developing countries, particularly of long-term growth, for instance, by boosting the level and rate of investment, improving its productivity and ensuring that the investment reaches the economy's strategic industries (UNCTAD, 2014 and 2015a).

The share of domestic investment is large in developed countries in particular, sometimes higher than foreign capital. China as an emerging economy depends heavily on the accumulation of domestic investment (You and Solomon, 2015). In most developing countries, however, the opposite scenario is observable, as they lack internally sourced capital which hampers government efforts in the allocation of targeted investments (Moses et al., 2013). It is,

[1] Total investment of an economy is the sum of both domestic and foreign investible capital.

therefore, crucial for policymakers to create a good investment climate and opportunities for all investors (public-private, large-small and foreign-domestic) as well as a coherent policy framework. *"The heterogeneity of investors, the diversity of factors which drive investment decisions and the multiple policy objectives pursued by governments all call for a whole-of-government perspective so as to increase policy coherence."* (OECD, 2015:13). Moreover, capacity building is an important instrument for governments, particularly in low-income countries, which do not always possess the capacity and policy tools to derive the benefits of private investment. Low productivity gains, insufficient incentives to encourage innovation, enclaves for foreign investor activity and limited links with local counterparts as well as the informal economy pose challenging hurdles for governments (OECD, n.d.). In addition, policymakers must ensure that finance is also provided to SMEs and start-ups, which typically lack sufficient security and/or face higher risks. According to the OECD, such businesses are good candidates for equity-type finance than credit, and the state can play a crucial role as a long-term financier (OECD, 2015). Table 1 presents different key actors participating in an investment chain (Zahn, 2015).[2]

Table 1 Investment chain and key actors involved: Users of capital for investment

	Sources of capital	Asset pools (or primary intermediaries)	Markets
Principal institutions	Governments Households/individuals, e.g.: ○ Retail investors ○ High net worth individuals ○ Pensions ○ Insurance premiums Firms Philanthropic institutions or foundations Other institutions with capital reserves	Banks Pension funds Insurance companies Mutual funds Sovereign Wealth Funds Endowment funds Private equity Venture capital Impact investors	Equity Corporate debt Sovereign debt Other markets and financial instruments
Intermediaries	Investment banks and brokerage firms	Institutional asset managers	
Advisors	Financial advisors Wealth managers Investment consultants	Rating agencies	

Source: Zahn (2015:4)

[2] The UNCTAD document deals with investment in the Sustainable Development Goals and these actors are mentioned in the context of SDGs and considered a pool of possible finance for SDGs.

The policy instruments can be categorized in accordance with Weiss' (2015) industrial policy framework. Weiss provides a simplified set of concepts for policymakers with a taxonomy that separates areas and mechanisms for intervention, and he distinguishes between three different stages in his taxonomy – early, middle and late industrial policy related to different types of economy. Within each stage, he provides a set of general horizontal measures available to all firms and a set of selective vertical ones for priority targets (subsectors or specific firms) for six different policy domains: 1. capital (see Table 2), 2. products, 3. labour, 4. land, 5. market and 6. technology. The rationale behind Weiss' industrial policy intervention is to facilitate structural change in favour of higher productivity. The focus is on the creation or expansion of manufacturing activities (Weiss, 2015).

Table 2 Vertical and horizontal policy instruments for the capital market

Capital market	Market-based instruments	Public goods/direct provision instruments
Early stage	Direct credit, interest rate subsidies	Loan guarantees, Development Bank lending
Middle stage	Interest rate subsidies, loan guarantees	Financial regulation, Development Bank (first/second tier), lending, venture capital

Source: Weiss (2015, p. 15 and 23)

The promotion of domestic investment itself can have positive effects on the attraction of FDI. Evidence from a large cross-country study by Lautier and Moreaub (2012) over the time period 1984-2004 shows that domestic investment is a strong catalyst for FDI inflows in the host economy in developing countries. Hence, investment promotion policies directed towards domestic firms could attract foreign investors. Private investment by firms of developing countries signals profitable opportunities and stable conditions and consequently stimulates FDI, as MNCs are attracted to countries that offer adequate combinations of locational determinants such as conditions for stable operations and access to large markets. Two channels can be identified: agglomeration economies and information asymmetry (since domestic firms have better knowledge and access to domestic markets than foreign firms) (Lautier and Moreaub, 2012). Hence, the stimulation of domestic investment may imply positive consequences for FDI. Nevertheless, other studies such as Harrison and Revenga (1995 in Lautier and Moreaub, 2012) and McMillan (1999 in Lautier and Moreaub, 2012) do not find a correlation between domestic investment and the attraction of FDI (Lautier and Moreaub, 2012).

There is also no clear consensus in the academic debate on the link between FDI (through knowledge transfer) and domestic firms and its effects on private domestic investment. On the one hand, empirical evidence indicates that FDI crowds out domestic investment, implying that FDI has a limited effect on the development of domestic productivity (Morrissey and Udomkerdmongkol, 2012; Mutenyo et al., 2010; Titarenko, 2005 in Farla et al., 2013); on the other hand, FDI is found to stimulate private domestic investment (Al-Sadig, 2013; Ramirez, 2011; de Mello, 1999; Bosworth and Collins, 1999; Borensztein et al., 1998 in Farla et al., 2013). Some scholars find mixed results (Adams, 2009; Apergis et al., 2006; Agosin and Mayer, 2000; Misun and Tomsik, 2002 in Farla et al., 2013). Farla et al. (2013) conclude that FDI has a positive effect on the country's investment in general.

The effect of outward FDI (OFDI) (shifting production abroad) on domestic investment strongly depends on the motives for investing abroad. According to Al-Sadig (2013), the literature identifies three motives: efficiency-seeking, market-seeking and strategic asset-seeking. In the first scenario, firms aim to increase efficiency by transferring production facilities to countries with cheaper inputs (this implies that no initial reduction in domestic production and outward FDI stimulates the rate of domestic investment through firms exporting capital and intermediate goods). In the second scenario, the aim is to serve the host country's domestic and neighbouring markets; however, the effects of OFDI can be ambiguous: on the one hand, in case FDI does not substitute exports, the result may either be no or positive effects on the domestic investment rate. If OFDI substitutes exports or if a firm moves its production to a host country, OFDI reduces domestic investment. The third scenario entails obtaining assets that are unavailable at home. In this case, FDI might have positive effects on domestic investment due to access to new technologies and knowledge that might increase firms' productivity and introduce new activities in the home economy (Hejazi and Pauly, 2003; Al-Sadig, 2013).

FDI can be a major driver of structural change and can have significant spillover effects on local economic development if FDI is properly integrated in the local economy. The local economy must be able to reap the benefits. For example, resource rich countries with low quality governance rarely exhibit structural change (te Velde, 2006 in UNIDO, 2013), and least developed countries with the lowest GDP per capita exhibit the biggest share of FDI in the primary sector (UNCTAD, 2013b in UNIDO, 2013). Large, newly established and highly productive domestic firms seem to capture more likely benefits from FDI (Amendolagine et al., 2013 in UNIDO, 2013). Therefore, FDI often provides benefits to already highly productive firms rather than to those that need technology upgrades; thus, FDI may increase inequality further and has little impact on structural change. The government could step in to foster the

domestic industry and, in turn, structural change in the long run: *"So, for technology transfer to trickle down to domestic firms through FDI, governments need to promote local firms that can initially adopt and adapt technology from FDI, and support the development of domestic production linkages and networks, in which initial adopters play a conduit role in disseminating the foreign technology vertically and horizontally to related firms."* (UNIDO, 2013:116)

Domestic investment is also subject to institutions, political instability and corruption (as an increase in costs of production, which serves as a deterrent for domestic investment), among others (Morrissey and Udomkerdmongkol, 2012).

Policymakers use a variety of incentives and policy instruments to increase domestic (and foreign direct private) investment. A good business climate is an important precondition for incentives to work, as will be explained in the next section on best practices in investment policymaking. Examples of incentives and instruments include:

- Establishing special economic zones or industrial parks to promote specific activities in specific regions
- Setting up incubation programmes to assist the entry of domestic firms into specific industries or activities
- Supporting cluster building to promote cooperation between domestic firms that are in the same industry or perform similar activities (e.g., auto parts manufacturers)
- Financial, fiscal support or government guarantees for specific activities or technologies – risk financing
- Public R&D integrated in private sector activities and targeted to its needs (UNCTAD, 2011)
- Strengthening public-private development efforts[3].

As mentioned earlier, the literature on domestic direct investment (in stark contrast to the literature on FDI) is very scarce. Nevertheless, there is some empirical evidence on domestic investment policymaking in the sub-Saharan Africa region (Ndikumana, 2000) and the Caribbean (Roache, 2006). Ndigkumana (2000) finds that domestic investment in sub-Saharan Africa is positively affected by real per capita GDP growth (accelerator effect) and trade flows (measured either by exports, imports or the sum of both). External debt, public sector borrowing from the domestic financial system, the black market premium and inflation negatively affect domestic investment. Ndigkumana (2000) further notes that there is insufficient evidence that

[3] In Nigeria, for example, the weak trend of private investment is linked to the unfavourable investment climate, the periodically dysfunctional infrastructural base, insecurity, institutional failure and unsupportive economic policies (Moses et al., 2013).

government consumption has a negative effect on investment, and presents several channels policymakers can use to foster domestic investment in the sub-Saharan Africa region:

- Government consumption spending may crowd out domestic investment by raising interest rates, by reducing the pool of funds in the market and by increasing distortionary taxation on investment activities; however, government spending may likewise crowd in domestic investment through the accelerator channel (positive correlation of domestic investment and GDP growth) (UNCTAD, 2015b).
- Credit markets with regulations and borrowing privileges for the central government and other government entities could reduce private investors' access to credit; as governments can be bad debtors, the financial system's fragility may increase further and the investment climate further depressed.
- Inefficient government policies may result in high and unpredictable inflation rates in many African countries, which negatively affects investment by increasing macroeconomic uncertainty.
- Volume trade positively affects domestic investment, both through exports and imports; an increase in exports may lead to an increase in foreign exchange which is necessary for the purchase of imported capital goods and can expand the market for domestic products; an increase in imports can stimulate investment if it implies greater access to investment goods in international markets. Trade can also negatively affect domestic investment as the import of consumer goods may discourage domestic production.
- High debt implies that a higher share of domestic output is used to meet debt obligations and discourages domestic investment (Ndikumana, 2000).

Roache (2006) asserts that private domestic investment in the Caribbean is sensitive to the cost of capital (including cost of debt, equity and the impact of taxes). Local real interest rates, the corporate tax burden and global financial market conditions have a major influence on the private domestic capital stock in the Caribbean. Roache further suggests that public policy should focus on the cost of capital in order to increase private domestic investment in the Caribbean, as there is no reliable evidence that private domestic investment is affected by public investment and FDI. Conditions to lower the cost of capital should, in particular, be created by policymakers (Roache, 2006).

Sound investment policies need to be supported by strong framework conditions (such as a legal and regulatory framework and efficient related procedures) as well as by best practice.

Examples of policy frameworks and best practice in investment policies are discussed in the following section.

2 Best practice in investment promotion policymaking

Major drivers of economic development and sustainable investment include good governance, transparency, stability, openness, quality regulation and respect for the rule of law and predictability as well as strong institutions (OECD, 2015 and OSCE, 2006). Before turning to selective policies that promote domestic investment, we briefly summarize the debate on policymaking for investment. In the following section, components of current good practice from several international organizations are presented before we focus on the main topic of this paper, namely policy instruments that provide long-term financing to the national industry.

Box 1 Components of good practice (OSCE)

In *"Best-Practice Guide for a Positive Business and Investment Climate"*, the OSCE advises governments to commit to global or regional standards in commercial legislation to improve their business climate, transparency and legislative stability; to publish laws, regulations and government decisions; and to allow a period of notice and comment prior to final adoption of laws and regulations. The OSCE further highlights that if basic political and legal features are missing, fiscal and economic incentives such as low taxes and labour costs or abundant natural resources, for example, will not be as effective as they could be. As political instability and insecurity are major obstacles for most legitimate business activities, governments should protect both foreign and domestic investments against discriminatory sanctions and government interventions driven by political interest. Corruption, bureaucracy and lack of rule of law imply higher direct costs for the investor in terms of money and time. Good governance practices give clear signals to domestic and foreign investors on safe and stable political environments (OSCE, 2006).

According to the OSCE, governments should set up the following measures to create a good business climate framework:

Orienting macroeconomic policy towards economic growth: GDP growth is a critical indicator for corporate investors and raises the potential for investment;

Opening up the economy: Policies embracing trade liberalization, free flow of capital and free movement of workers stimulate economic activity.

Diversifying the economy: Complete reliance on extractive industries leaves an economy vulnerable to commodity price fluctuations and does not stimulate job creation.

Creating a strategy. Developing a medium-term strategy makes it easier for businesses to plan and show more transparency (OSCE, 2006).

Box 2 Good practice components of the OECD

The OECD defines a good investment climate as follows: *"A good investment climate helps to mobilize capital, skills, technology and intermediate inputs to allow firms to expand. It helps to channel resources to more productive uses, and, through competitive pressure and the discipline imposed by shareholders and creditors, ensures that all firms strive to improve their efficiency and allows inefficient ones to exit. It should allow enterprises to invest productively and profitably, but it is not just about reducing the cost of doing business and raising corporate profitability. It should also ensure that investment brings about the highest possible economic and social impact."* (OECD, 2015:14)

Investment Promotion Agencies (IPAs) are another instrument for attracting domestic and foreign investment, as they serve the needs of investors, promote business-friendly policies and cultivate and project a favourable image of the country as an investment destination (UNCTAD, 2015c). These IPAs can either be established as part of a ministry or as an independent agency. With reference to IPAs, certainly *"One size does not fit all"* – different approaches are required for different countries and different target enterprises (OECD, 2015).

A task force assigned by the OECD consisting of officials from 60 governments with the objective of mobilizing private investment that supports economic growth and sustainable development has developed the Policy Framework for Investments. The framework functions as a tool, providing a checklist of key policy issues for consideration by any government to boost investment. The OECD also emphasizes respect for the rule of law, quality regulation, transparency, openness and integrity as key prerequisites for investment policy. In the 2015 edition, the framework integrates investment policy, investment promotion and facilitation, trade policy, competition policy tax policy, corporate governance, policies to enable responsible business conduct, development of human resources for investment and an investment framework for green growth as well as investment in infrastructure and financing investment. Key questions and principles for effective horizontal policies and practices are listed below (supplemental questions in the fields of "transparency", "public consultation", "policy stability and predictability" and "periodic evaluation and review" are not quoted here) (OECD, n.d.).

Table 3 OECD key questions and principles

Core questions and principles
1. Are laws and regulations and their implementation and enforcement clear, transparent and readily accessible? Does this transparency cover procedural issues as well?
2. How does the government ensure that laws and regulations do not impose an unnecessary burden on investors? Is there a built-in mechanism to periodically review these burdens? Are these burdens measured and quantified?
3. How does the government ensure a sufficient degree of policy predictability for investors? Is there a review process for administrative decisions?
4. Has the government established effective public consultation mechanisms and procedures, including prior notification requirements, before enacting new laws and regulations?
5. In the exercise of its right to regulate and to deliver public services, does the government have mechanisms in place to ensure transparency of any discrimination against any group of investors and to periodically review their costs against the intended public purpose?
6. What mechanisms exist to manage and co-ordinate regulatory policy across different levels of government to ensure consistency and a transparent application of regulations?

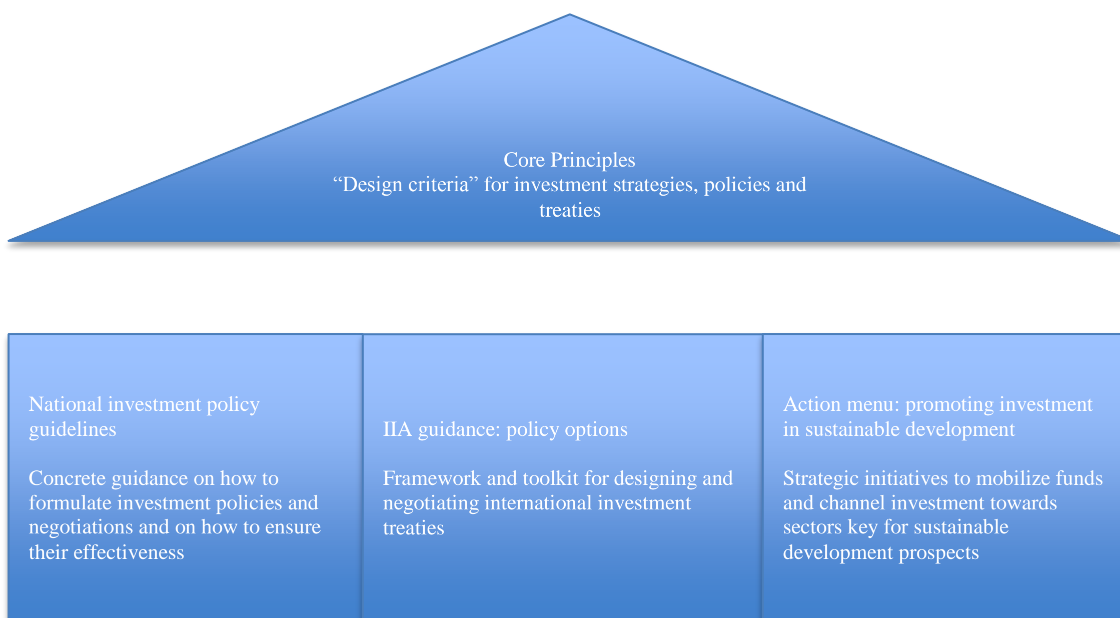
Source: OECD (2015:20)

The OECD highlights, among others, the essential components of domestic investment policy: non-discrimination, protection of investor's property rights (expropriation), securing land tenure and intellectual property rights protection. Non-discrimination is crucial for an attractive investment climate and ensures that all investors are treated equally, irrespective of their ownership. Nevertheless, there are exceptions, such as protection of infant industries, restrictions for foreign investors, foreign equity limits, profit and capital repatriation, land ownership for business purposes, branching limitations, reciprocity requirements, access to local finance, government procurement favouring locally-owned over foreign-established companies and potential discrimination between foreign and domestic investors (OECD, 2015).

Box 3 Good practice components of UNCTAD

UNCTAD (2015c) has developed an Investment Policy Framework for Sustainable Development. The framework is a reference for policymakers in formulating national investment policies, negotiating or reviewing International Investment Agreements (IIAs) and designing concrete policy initiatives to promote investment in priority sectors. The framework covers domestic and foreign investment and builds on three core principles (Figure 1).

Figure 1 Structure and components of UNCTAD's Investment Policy Framework for Sustainable Development



Source: UNCTAD (2015c: 3)

Furthermore, UNCTAD included ten core principles in its investment framework; the first three principles relate to the general process of policy development and the policymaking environment (which are relevant for investment policies), principles four to nine relate to the specifics and substance of investment policymaking while the tenth principle refers to cooperation in investment-related matters at international level (Table 3) (UNCTAD, 2015c).

Table 4 UNCTAD core principles for investment policymaking for sustainable development

Area	Core Principles
Investment for sustainable development	The overarching objective of investment policymaking is to promote investment for inclusive growth and sustainable development.
1 Policy coherence	Investment policies should be grounded in a country's overall development strategy. All policies that have an impact on investment should be coherent and synergetic at both the national and international level.
2 Public governance and institutions	Investment policies should be developed involving all stakeholders and embedded in an institutional framework based on the rule of law that adheres to high standards of public governance and ensures predictable, efficient and transparent procedures for investors.
3 Dynamic policymaking	Investment policies should be regularly reviewed for effectiveness and relevance and adapted to changing development dynamics.
4 Balanced rights and obligations	Investment policies should be balanced when setting out the rights and obligations of States and investors in the interest of development for all.
5 Right to regulate	Each country has the sovereign right to establish entry and operational conditions for foreign investment, subject to international commitments, in the interest of the public good and to minimize potential negative effects.
6 Openness to investment	In line with each country's development strategy, investment policy should establish open, stable and predictable entry conditions for investment.
7 Investment protection and treatment	Investment policies should provide adequate protection to established investors. The treatment of established investors should be non-discriminatory in nature.
8 Investment promotion and facilitation	Policies for investment promotion and facilitation should be aligned with sustainable development goals and designed to minimize the risk of harmful competition for investment.
9 Corporate governance and responsibility	Investment policies should promote and facilitate the adoption of and compliance with best international practices of corporate social responsibility and good corporate governance.
10 International cooperation	The international community should cooperate to address shared investment-for-development policy challenges, particularly in least developed countries. Collective efforts should also be made to avoid investment protectionism.

Source: UNCTAD (2015c:27)

In order to effectively mobilize investment in developing countries, particularly in LDCs, UNCTAD underscores the importance of defining the roles and creating synergies between public, private, domestic and foreign investment (UNCTAD, 2015c).

3 Three ways of channelling public domestic investment into the national industry

A well-functioning financial market is an important condition for fostering industrial development. The State can play an important role in the correction of market failures, as already mentioned. In part due to the global financial crisis, state-owned financial institutions have regained attention in the public debate over the last years (World Bank, 2015). Public capital plays a significant role in a country's industrialization path at all income levels, but particularly at lower income levels (Isaksson, 2010). According to Peres and Primi (2009), four types of state intervention exist to support industrial development: the State as a regulator, as a producer, as a consumer and as a final agent and investor. In investment policymaking, the State as regulator[4] (e.g., by setting tariffs and production levels of certain activities or by creating fiscal incentives or subsidies for industrial sectors) and the State as a final agent and investor (strategic intervention by influencing the credit market and promoting the allocation of public and private financial resources to industrial projects) are crucial (Primi and Peres, 2009).

In this section, three policy instruments used by governments of developing countries to channel investment into the national industry in order to foster and stimulate the manufacturing sector and structural change in the long run are discussed: Sovereign Wealth Funds (SWFs), the development of private equity and venture capital funds and "Industrial Development Corporations" (IDCs).

These three instruments can be categorized as 'public goods in the capital market in early, middle and late stages' in accordance with Weiss' taxonomy (2015). Sovereign Wealth Funds and private equity funds, together with IDCs, are typically used in the early and middle stages of public goods provision. These policy instruments are used by governments to facilitate industrials development: governments generally use vertical and horizontal policy measures, though vertical measures seem to be more common in practice. Independent of their vertical use, the nature of these policy instruments usually does not change.

[4] According to UNIDO, the distinction between generic and sectoral subsidies is crucial, as the former may encourage investment but not structural change (UNIDO, 2013).

In the following section, a brief overview of SWFs, private equity/venture capital funds and IDCs is presented, followed by country case studies in low as well as lower and upper middle-income countries.

3.1. Sovereign Wealth Funds

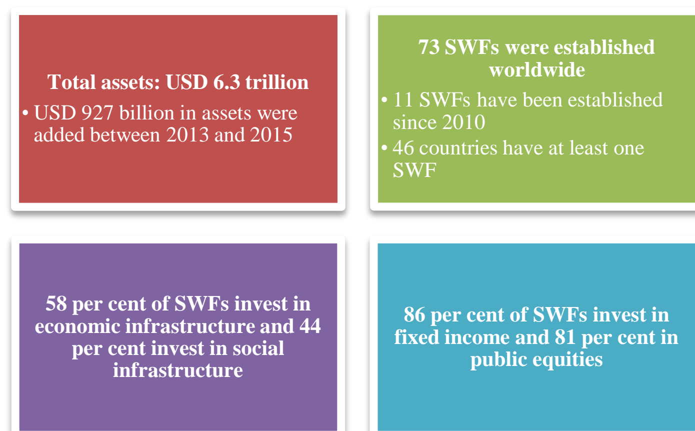
A Sovereign Wealth Fund is a state-owned investment fund that is commonly established from a balance of payment surpluses, official foreign currency operations, proceeds of privatizations, governmental transfer payments, fiscal surpluses and/ or receipts resulting from resource exports (SWFI, n.d.). The following funds are examples of different origin: from central bank reserves (China and Singapore, for example), from export of state-owned resources (Botswana, Chile, Abu Dhabi and Kuwait), from taxation of exports (Russia, Alaska), from fiscal surpluses (the Republic of Korea or New Zealand, for example) or from privatization receipts (Malaysia and Australia). SWFs can be classified in accordance with their nature and purpose into five different categories:

- Stabilization funds: to protect the budget and economy from commodity price volatility and external shocks
- Saving funds: to share wealth across generations by transforming non-renewable assets into diversified financial assets
- Reserve investment corporations: to reduce the negative carry costs of holding reserves or to earn higher return on ample reserves while the assets in the funds are still counted as reserves
- Pension reserve funds: to meet identified outflows in the future with respect to pension-related contingent-type liabilities on the government's balance sheet
- Development funds: to allocate resources to priority socio-economic projects (Al-Hassan et al., 2013). Development SWFs can further be defined as publicly sponsored commercial investment funds that combine financial performance objectives with development objectives (Clark and Monk, 2015).

According to Preqin, SWFs surpassed the USD 5 trillion mark, with total assets estimated at USD 5.4 trillion, for the first time in October 2013, increasing to USD 6.3 trillion in March 2015. SWFs have recorded a global increase of more than USD 900 billion in assets under management (AUM) since October 2013. Although oil and commodity prices decreased in 2014, the main source of funding for many of the largest SWFs, government funding and reserves as well as investment returns, generated continuous growth in assets. Furthermore, in

previous years, growth was partially driven by the creation of new SWFs. Figure 2 presents some of the key facts for SWFs (Preqin, 2013; 2015).

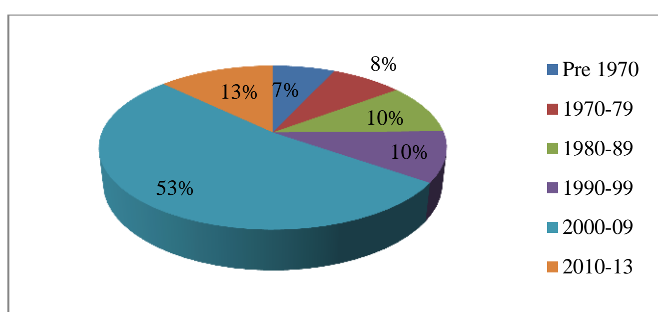
Figure 2 SWFs at a glance



Source: Preqin (2015:2)

There has been a significant increase in the number of SFWs in operation since 2000, with 53 per cent of SWFs having been established between 2000 and 2009 (Figure 3). Between 2010 and 2013, 13 per cent of SWFs were launched, and in the next few years, countries such as Bolivia, Bangladesh, India, Sierra Leone and Panama are planning to establish new funds (Preqin, 2013).

Figure 3 Breakdown of SWFs per year of establishment (pre-1970-2013)



Source: Preqin (2013:3)

Asian SWFs represented the largest share of capital by region (share of aggregate AUM), accounting for 44 per cent of industry's total assets in 2015, followed by MENA with 34 per cent, Europe with 16 per cent, North America with 3 per cent, Australasia with 2 per cent, the LAC region with 1 per cent and Africa (excluding MENA) with 0.20 per cent in 2015 (Preqin, 2015). Below, SWFs are listed with total assets under management by region in 2015 (Table 5).

Table 5 Sovereign Wealth Funds total AUM by region

Region	AUM
Asia	USD 2,746 billion
Middle East	USD 1,977 billion
Europe	USD 1,040 billion
North America	USD 219 billion
Africa	USD 150 billion
Australasia	USD 104 billion
Latin America and Caribbean	USD 72 billion

Source: Preqin (2015:2)

Potentially competitive returns in developing countries and major reductions in traditional sources of long-term financing after the financial crisis have been one of the main motivations among governments in developing economies to allow and encourage national SWFs to invest domestically. These funds can support the increase of economic growth and prosperity for current and future generations and can be used to ease the volatility of resource-driven revenues and to diversify wealth (AFDB, 2013). Traditionally, SWFs primarily invested in traditional assets in high-income countries, such as equities and fixed income securities. In recent years, the funds have increasingly been invested in alternative assets in developing countries, such as real estate, infrastructure and private equity. The global financial crisis was determinative for many governments to seek other sources of long-term finance to mitigate the negative consequences of the global credit crunch (Preqin, 2015; World Bank, 2015). The rise of emerging markets and the commodity boom of the 2000s were main triggers for the increase in the establishment of SWFs. Many governments in developing countries began investing in their domestic markets, as the country case studies of Angola, Kazakhstan, Malaysia and Nigeria demonstrate (following section); funds with a domestic investment mandate were also established in Colombia, Morocco, Mozambique, Sierra Leone, Tanzania, Uganda and Zambia (World Bank, 2014; Santiso, 2008). Nevertheless, the impact of SWF investments in developing countries should not, according to the World Bank, be overstated as the total value of transactions of developing countries continues to remain small. More than 80 per cent of all SWF deals between 2010 and 2013 occurred between high-income countries (World Bank, 2015).

The history of SWFs dates back to the 1950s, with the oldest SWF created in 1953, the Kuwait Investment Authority. Singapore was one of the pioneer countries in Asia to create such a fund,

establishing Temasek in 1974, followed by the Government Investment Corporation of Singapore (GIC) in 1981, with the aim of increasing return on investment of its external surpluses by targeting international portfolio investments (Santiso, 2008). Today, the majority of developing countries' SWFs have become major actors of development finance (Santiso, 2008), particularly low-income countries invest predominantly in infrastructure and macroeconomic stabilization (Table 6). The selected middle-income countries in the case studies invested more in their national industrial development. Usually, priority industries are identified, though horizontal investments are made in the manufacturing industry, as in the case of Gabon and Senegal (Tables 6, 7 and 10).

Table 6 Sovereign Wealth Funds and their priority targets in selected low-income countries

Country	SWF	Year of creation	Investment sectors	Origin	Asset value (USD billion)*	LMTI rating**	Further information
Angola	Fondo Soberano de Angola	2012	Hotel industry Infrastructure Mining Timber Energy Agriculture Education Health care	Oil	4.88	8	http://www.fundosoberano.ao
Rwanda	AGACIRO	2014	Financial sector	n.a.	n.a.	n.a.	http://www.agaciro.org
Nigeria	Nigeria Sovereign Investment Authority	2011	Future generations fund (40% of total assets) Infrastructure fund (40% of total assets) Stabilization fund (20% of total assets)	Oil	0.89	9	http://nsia.com.ng

Sources: Author's elaboration based on Fundo Soberano de Angola (n.d), AGACIRO Development Fund (n.d), NSIA (n.d.), Sovereign Wealth Center (n.d.) and SWFI (2015).

*) See assets under management: http://www.sovereignwealthcenter.com/fund-profiles.html, Accessed 4.2. 2016.

**) See SWFI (2015).

Table 7 Sovereign Wealth Funds and their priority targets in selected middle-income countries

Country	SWF	Year of creation	Investment sectors	Origin	Asset value (USD billion)*	LMTI rating**	Further information
Gabon	Fonds Gabonais d'investisse-ments strategiques (FGIS)	2012	Manufacturing Wood Mines Hydrocarbon Transportation General trade Insurance Materials Hotel industry Telecommunications Automobile industry Banking Services	Oil	1.00	n.a.	http://www.fgis-gabon.com/
Senegal	Fonds souverain d'investisse-ments stratégiques (FONSIS)	2012	Logistics Industrial hubs Infrastructure Energy Mining Social housing Agriculture services	Holding companies	1.00	n.a.	http://www.fonsis.org/
Kazakhstan	Samruk-Kazyna National Welfare Fund	2008	Oil and gas Power energy Metallurgy Chemistry and	Holding companies	49.90	2	http://sk.kz/

			petrochemicals Infrastructure				
Malaysia	Kazanah Nasional Berhard	1993	Agrifood Aviation Creative & media Education Financial services Health care Infrastructure & construction Innovation & technology Leisure & tourism Life sciences Power Property Sustainable development Telecommunications	Self-funded/ government linked companies	34.90	9	http://www.khazanah.com.my

Source: Author's elaboration based on Preqin (2015), Gelb et al. (2014) and websites of the SWFs (see further information in Table 7)

*) See assets under management: http://www.sovereignwealthcenter.com/fund-profiles.html, Accessed 4.2.2016.

**) SWFI (2015).

However, domestic investments by SWFs also imply risks, including destabilization of macroeconomic management and undermining the quality of public investments (political rather than economic aims may motivate the government (ADBG, 2013)). To prevent mismanagement and failure to achieve objectives, domestic investments by SWFs should be considered in the context of a sustainable public investment plan. Furthermore, a clear separation between the government as a promoter of investments and as an owner of the SWF is recommended (Gelb et al., 2014). Transparency and good governance should be a priority and may improve the effectiveness of SWFs (Gelb et al., 2014; World Bank, 2015). The Santiago Principles (Box 4) were agreed between countries with SWFs, investment recipient countries and international organizations in October 2008 to promote global transparency, good governance, accountability and prudent investment practices.

Box 4 Objectives of the Santiago Principles

- Helping to maintain a stable global financial system and free flow of capital and investment
- Complying with all applicable regulatory and disclosure requirements in the countries in which SWFs invest
- Ensuring that SWFs invest on the basis of economic and financial risk and return-related considerations, and
- Ensuring that SWFs have in place a transparent and sound governance structure that provides adequate operational controls, risk management and accountability (IFSWF, 2014; IWG-SWF, 2008).

Table 8 presents an investment appraisal framework for investors by PwC (Preqin, 2013:9).

Table 8 Overall investment appraisal framework for investors by PwC

Investment Appraisal Framework – Critical success factors			
Strategy	**Decision-making process**	**Post-investment management**	**Measurement**
Setting the risk return appetite and benchmark returns	Understanding value and realization strategies	Ensuring successful post-investment management of assets and aligning incentives to strategy	Defining, measuring and understanding returns
The strategy should dictate the risk appetite and targeted returns, both of which should be defined and reflected throughout the investment process.	*A clear understanding is required of value drivers, key sensitivities, value creation and realization strategies for each investment. These should be tracked as part of regular post-investment reviews.*	*Active tracking and delivery on value creation and risks identified in the investment process. In addition, incentivization plans should be aligned to achieving the long-term objectives of the Sovereign Wealth Fund.*	*It is crucial to clearly define and track financial and socio-economic returns (if applicable) using measures appropriate for each asset, but with broad consistency across investments to allow for robust internal and external communications of returns.*

Source: Preqin (2013:9)

Box 5 The Linaburg-Maduell Transparency Index

The Sovereign Wealth Fund Institute (SWFI) developed a method to rate the transparency of SWFs in 2008, called the Linaburg-Maduell Transparency Index. The index is based on ten core principles that depict SWF transparency. Each principle (Table 9) represents 1 point of transparency in the index rating (with a minimum fund rating of 1 – however, the SWFI recommends a minimum rating of 8 to ensure transparency). These ratings may change as funds release additional information (see case of Nigeria[5]) (SWFI, 2015).

[5] Nigeria had a rating of 1 point in 2011 in comparison to 9 points in 2015 (SWFI, 2015 and Weber and Weeghel, 2011).

Table 9 Linaburg-Maduell Transparency Index (LMTI)

Point	Principles of the Linaburg-Maduell Transparency Index
+1	Fund provides history including reason for creation, origins of wealth and government ownership structure
+1	Fund provides up-to-date, independently audited annual reports
+1	Fund provides ownership percentage of company holdings and geographic locations of holdings
+1	Fund provides total portfolio market value, returns and management compensation
+1	Fund provides guidelines in reference to ethical standards, investment policies and enforcement of guidelines
+1	Fund provides clear strategies and objectives
+1	If applicable, the fund clearly identifies subsidiaries and contact information
+1	If applicable, the fund identifies external managers
+1	Fund manages its own website
+1	Fund provides main office location address and contact information, such as telephone and fax

Source: SWFI (2015)

Capacity building plays an important role for SWFs to increase the quality of public investment programmes. Gelb et al. (2014) recommend the following four possible approaches:

a. Screening investments for commercial or near-commercial financial returns
b. Investor partnerships, possibly including other SWFs and development lenders as well as private investors, to diversify risk and increase implementation capacity
c. Institutional design of the governance of the SWF to credibly insulate it from political pressure, strengthen accountability, ensure oversight and bring technical skills to bear on investment decisions
d. Full transparency, in particular on individual domestic investments and their financial performance.

Countries with weaker governance may struggle and need to improve good practice to mitigate risks (Gelb et al., 2014).

Box 6 "Bad practice" of Sovereign Wealth Funds

Clark and Monk (2015) identify three common failures or "bad practice" of SWFs for development:

1. Deadweight loss: SWFs for development should avoid investing in assets or conducting transactions that either the government or the free market could and may rapidly and effectively on their own.
2. Unintended consequences: SWFs for development should learn from government and market failures in order to avoid making short-term decisions that lead to long-term problems at the domestic level.
3. "Bridges to nowhere": development-oriented investment strategies require more (not less) rigour in identifying risks and undertaking investments than traditional strategies. SWFs for development should be aware of their organizational strengths and weaknesses to focus on their advantages.

Source: Clark and Monk, 2015

In the following section, country case studies of SWFs for development investing in the domestic industry are presented.

3.2 Sovereign Wealth Fund country case studies

Case studies of SWFs in lower and upper middle-income countries—Gabon, Senegal, Malaysia and Kazakhstan—are presented in this section. All of these funds channel their investments into national industrial development and use vertical and horizontal public policy interventions. Their origin, year of establishment, assets under management and priority sectors of the SWFs differ from country to country. Additionally, one case study of a high-income country as a showcase for funds aiming at structural change is included: the Saudi Industrial Development Fund of the Kingdom of Saudi Arabia. This fund exemplifies the successful diversification of a nation's industry (see Box 7).

Table 10 Sovereign Wealth Funds for development and their priority targets in selected middle-income countries

Country	SWF	Aim	Year of creation	Investment sectors	Origin	Asset value (USD billion)*	LMTI**
Gabon	Fonds Gabonais d'investissements strategiques (FGIS)	To assist Gabon in developing new industries capable of generating enough revenue to replace oil revenues	2012	Manufacturing Wood Mines Hydrocarbon Transportation General trade Insurance Materials Hotel industry Telecommunication Automobile industry Banking Services	Oil	1.00	n.a.
Senegal	Fonds souverain d'investissement stratégiques (FONSIS)	To grow the country's assets and boost its economy by taking the lead as investor and partner of the private sector	2012	Logistics Industrial hubs Infrastructure Energy Mining Social housing Agriculture services	Holding companies	1.00	n.a.
Kazakhstan	Samruk-Kazyna National Welfare Fund	To increase competitiveness and sustainability of the national economy and to prevent a potential	2008	Oil and gas Power energy Metallurgy Chemistry and petrochemicals	Holding companies	49.90	2

		negative impact of world market changes on the country's economic growth		Infrastructure			
Malaysia	Kazanah Nasional Berhad	Driving various strategic industries and national initiatives, contributing to the development of Malaysia's long-term interests with the vision of being the leading regional strategic investment house that creates sustainable value for a globally competitive Malaysia	1993	Agrifood Aviation Creative & media Education Financial services Health care Infrastructure & construction Innovation & technology Leisure & tourism Life sciences Power Property Sustainable development Telecommunications	Self-funded/ government-linked companies	34.90	9

Source: Author's elaboration based on Preqin (2015), Gelb et al. (2014), FGIS (n.d.), FONSIS (n.d.), Khazanah (n.d.) and Samruk Kazyna (n.d.)

*) See assets under management: http://www.sovereignwealthcenter.com/fund-profiles.html, Accessed 4.2.2016.

**) See SWFI (2015).

Box 7 Saudi Industrial Development Fund

The Saudi Industrial Development Fund (SIDF) was established in 1974 by Royal Decree No. 3, aiming to support private sector (industrial) development. The fund was created with an initial capital of SR 500 million and provides medium- and long-term loans to establish new factories and expand, upgrade and modernize existing ones. Furthermore, the fund provides administrative, financial, technical and marketing consultancies and advice to the manufacturing industry. The national industrial figures indicate that successful diversification of the national industry was achieved over time. While in 1974, there were 198 factories, the number rose to 6,471 by 2013. Similarly, the number of total finance increased from SR 12,333 million to SR 883,350 million, and the number of employees increased from 33,928 to 843,912, respectively. SIDF's finance guidelines target the setting up of new industrial projects (with finance of fixed assets and 25 per cent of the working capital for the first year), the expansion of existing projects with the objective of increasing production capacity or adding new products, the modernization or replacement of machinery (adding new technologies and increasing resource efficiency), the finance of relocation project costs, industrial support and logistical service projects inside industrial cities and the building of private industrial cities. All industrial projects with a valid industrial licence, which are able to contribute value added to the national economy, are eligible for SIDF financing. Further priority conditions for funding projects include economic viability, provision of training and employment opportunities for Saudi nationals, the use of locally sourced raw materials, coordination or integration with other projects in the country, replacement of imports by local products, target export opportunities and use of advanced technology. Funding ranges from less than SR 300 million to SR 1,200 million, depending on the company characteristics and its regional location. Looking at the cumulative loan commitments until 2014, the sectoral distribution shows a priority for chemical industries with SR 45,443 million, followed by engineering industries with SR 23,367 million, consumer industries with SR 20,129 million, cement industries with SR 11,603 million, other building materials industries with SR 12,599 million and other industries with SR 4,846 million.

Source: SIDF (n.d.)

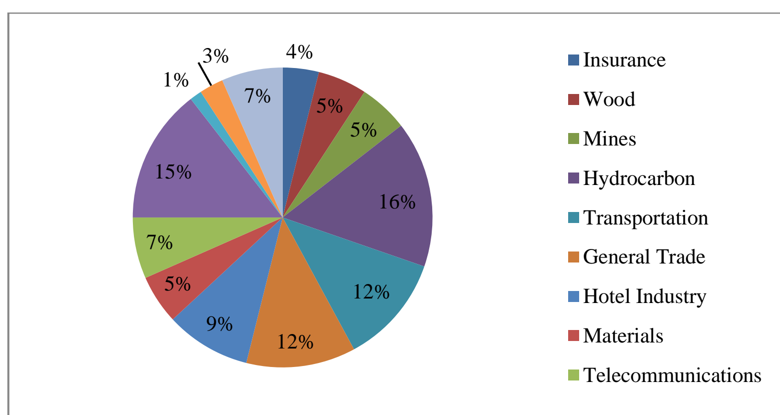
3.2.1 Fonds Gabonais d'investissements strategiques (FGIS) - Gabon (upper middle-income country)

Gabon's Sovereign Wealth Fund (FGIS) was established by Law 005/2012 by the Gabonese government to assist the country in developing new industries that are capable of generating sufficient revenue to replace oil revenues. The government is pursuing structural change

through strategic investments in the national industry and is directing the Gabonese economy towards further local value added and growth. SMEs, in particular, are a focus of the FGIS, as they are the main job creators in Gabon's economy. The fund's investments must be consistent with the objectives of the "Strategic Plan for an Emerging Gabon" and promote diversification of the economy across three pillars: Industrial Gabon, Gabon of Services and Green Gabon.

FGIS investments range from direct investments to financing of funds and bonds, whereas direct investments are realized with 15 per cent in the industrial sector, 12 per cent in the automobile industry, among others (Figure 4) (FGIS, n.d.).

Figure 4 Direct investments by industry



Source: FGIS (n.d.)

3.2.2 Senegal's Sovereign Fund for Strategic Investment (FONSIS) - Senegal (lower middle-income country)

Senegal's Sovereign Fund for Strategic Investment (FONSIS) was established by the State of Senegal by Law 2012-34 of December 2012, and invests equity and quasi-equity in projects with a high potential for economic growth, wealth and employment creation. The fund aims to increase the country's assets and boost its economy by taking the lead as investor and partner of the private sector. Its initial share of capital of CFA 3 billion was wholly held by the State of Senegal. The key objectives of FONSIS include realizing direct or indirect investments to accelerate the national economy's development, developing national champions in key industries, re-evaluating and optimizing assets received from the State of Senegal as well as enhancing private equity growth in Senegal. Up to 20 per cent of FONSIS' resources are dedicated to a private-equity sub-fund targeting local SMEs. Furthermore, FONSIS primarily invests in the priority industries defined in the Plan Senegal Emergent, namely logistics and industrial hubs, infrastructure, energy, mining, social housing and agriculture as well as the services sector. The investment criteria range from CFA 50 to 300 million for total project investments in the SME sub-fund and over CFA 300 million from FONSIS. The investment

horizon ranges from 5 years to 7 years for the SME sub-fund and at least 5 years for FONSIS, with a minimum net internal rate of return of 12 per cent. Funding methods comprise equity, quasi-equity (convertible and subordinated loans), fundraising, strategic advice and industry expertise as well as research of partnerships and markets. FONSIS resources consist of in-cash share capital, in-kind share capital in the form of state-owned assets, grants from the State through budget allocation, debt raised for specific investment opportunities, resources from unilateral, bilateral and multilateral cooperations as well as dividends from portfolio companies. Moreover, according to the FONSIS website, FONSIS takes account of the best practices of the Santiago Principles (FONSIS, n.d.).

3.2.3 Samruk-Kazyna National Welfare Fund - Kazakhstan (upper middle-income country)

The SWF Samruk-Kazyna was established by Decree No. 669 by the President of the Republic of Kazakhstan in October 2008. The fund seeks to increase the national economy's competitiveness and sustainability and to prevent a potentially negative impact of world market changes on the country's economic growth as well as to modernize and diversify the national economy and strengthen inter-industry and interregional links. The fund activities' key objective is to manage share holdings of national development institutions, national companies and other legal entities for maximization of their long-range value, and to enhance the competitiveness of international markets. Priority industries include metallurgy, chemistry, oil and gas, power energy and petrochemicals as well as infrastructure. Small and medium business support is another key objective of the fund. The assets (union of property or property rights owned by the company in the form of fixed assets, intangible assets, material inventories, cash, investments and cash requirements to other businesses and individuals) amount to KZT 689,766 million in the nuclear industry, after oil and gas with KZT 7,558,186 million and transport with KZT 2,487,477 million (Samruk Kazyna, n.d.).

3.2.4 Khazanah Nasional Berhad - Malaysia (upper middle-income country)

The Khazanah Nasional Berhad is a strategic investment fund of the Government of Malaysia, created to hold and manage the government's commercial assets and to undertake strategic investments on behalf of the nation. Khazanah Nasional Berhard was incorporated in 1993 under the Companies Act of 1965 as a public limited company and began its operations in 1994. The fund plays a catalytic role in driving various strategic industries and national initiatives, contributing to the development of Malaysia's long-term interests with the vision to be the leading regional strategic investment house that creates sustainable value for a globally competitive Malaysia. Furthermore, Khazanah Nasional Berhard has a long-term commitment to creating stronger links between real economic and financial activities.

Although the fund does not exclusively invest in Malaysia, the majority of investments, namely nearly 60 per cent of realisable asset value is invested in Malaysia while around 40 per cent is invested abroad. When looking at the portfolio segmentation by location of company, Malaysian companies receive 85 per cent of value of allocated investments. The remainder is invested abroad. The portfolio covers various sectors and industries in the public and private sector. Within the manufacturing sector, innovation and technology are a priority, supporting SilTerra Malaysia, a leading wafer foundry provider that offers complementary metal-oxide semiconductor wafer technology to global semiconductor partners. Furthermore, the fund indirectly supports life science manufacturing companies through investments in an intermediary private equity partner and a venture investor in life sciences that focuses on medical technologies, health care biotechnology, bio-renewables and bio-industrials. Moreover, the fund invests in innovative and sustainable waste management and renewable energy solutions in the national industry, among others.

The total realizable asset value (RAV, defined as the market value of all equities, securities and cash held) amounted to RM 150 billion in December 2015 and net worth adjusted (NWA, defined as RAW less total liabilities and adjusted to measure value created) at RM 109 billion (in December 2015). The portfolio segmentation in per cent shows that 0.4 per cent is invested in life sciences, 1.3 per cent in sustainable development and 2.3 per cent in innovation and technology. Media and communication at 22 per cent, health care at 17.2 per cent and power at 15.3 per cent are the largest positions in the portfolio.

The fund further complies with some good practice policies such as disclosure of performance and operations, independent external auditors, annual public key information, stakeholder engagement, risk management policies and code of business ethics, among others (Khazanah, n.d.).

3.3 Private equity and venture capital funds

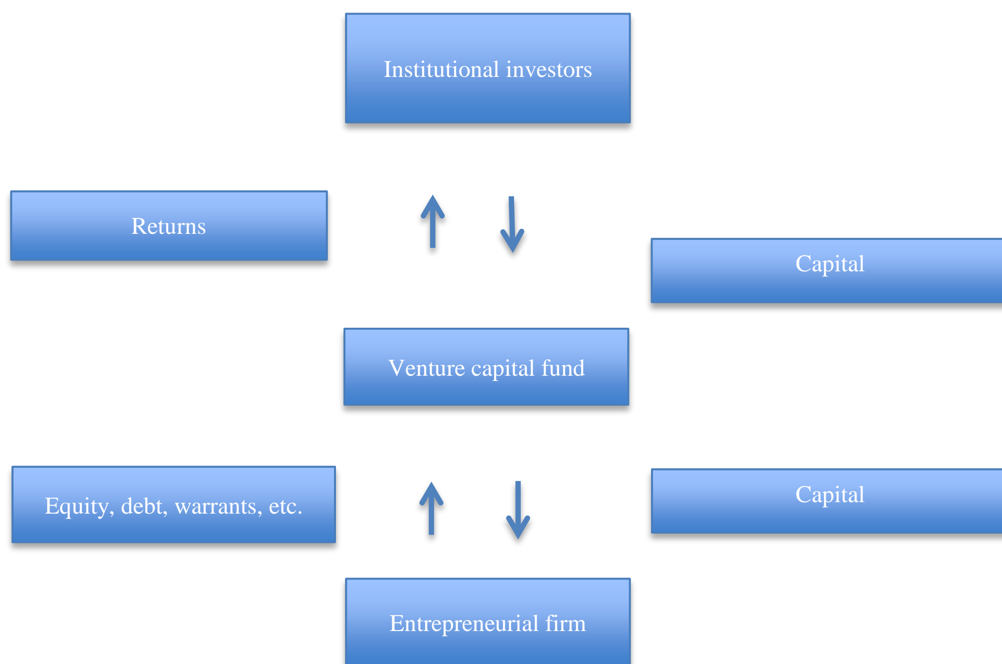
Private equity and venture capital funds are financial intermediaries between sources of funds (typically institutional investors) and high growth/high-tech entrepreneurial firms. More specifically, private equity refers to an asset class in which investors purchase illiquid equity (or equity-like) securities of operating companies. This equity is not publicly traded. In exchange for their capital, private equity investors obtain ownership stakes in a company and typically hold these securities for a period of three to seven years. The investors expect attractive risk-adjusted financial returns upon exiting the investment, either through sale, a merger or by taking the investee company public (Divakaran et al., 2014; World Bank, 2015). Funds are typically

established as limited partnerships.[6] Rather than directly investing into businesses, most institutions prefer to use fund structures which allow a more efficient use of capital and diversification. Although private equity is considered relatively high risk, it has high returns and risks can be diversified on a range of businesses (depending on fund structure) (AFDB, n.d.).

Private equity investments cover a wide range of deals and include seed, expansion and pre-offering financing rounds as well as buy-outs and turnaround investments. While private equity covers all of these transactions, venture capital only refers to funding provided in early stages. Venture capital deals are associated with high risks but also with large potential rewards (Haberich, 2011). Private equity investors generally take an active role in the company's operations by improving management practices, facilitating knowledge transfer and innovation or creating economies of scale and scope. As private equity investors bring a set of skills, they can add value to investee companies and offer benefits to firms in developing countries through knowledge spillovers (World Bank, 2015).

Figure 5 presents the basic intermediation structure of venture capital and private equity funds based on Cumming and Johan (2013):

Figure 5 Basic intermediation structure of venture capital and private equity funds



Source: Cumming and Johan (2013)

[6] A limited partnership is a contract between institutional investors who become limited partners – pension funds, banks, life insurance companies, and endowments and have rights as partners but trade "management" rights over the fund for limited liability, and the fund manager who is designated the general partner (the partner that assumes responsibility for the day-to-day operations and management of the fund as well as total liability in return for negligible buy-ins) (AFDB, n.d.).

Venture capital funds are typically set up with at least USD 50 million in capital committed from institutional investors and often exceed USD 100 million, whereas fund managers typically receive compensation in the form of a management fee and a performance fee or carried interest. Venture capital funds invest in start-up entrepreneurial firms that typically require at least USD 1 million up to USD 20 million in capital, while private equity funds invest in more established firms (Cumming and Johan, 2013).

Private equity has become an increasingly important source of long-term finance in developing countries. According to Preqin (2016), private equity assets under management reached a new peak with USD 2.4 trillion in June 2015. The Probitas Partners' Private Equity Institutional Investor Trends for 2015 Survey examined investors' preferences in emerging markets and found that 44 per cent preferred investing in China, 22 per cent in Brazil, 16 per cent in Pan-Latin America and 15 per cent in Indonesia and in India (Probitas and Partners, 2015). In general, private equity investments tend to take place in small groups of industries such as technology, healthcare and telecommunications, and private equity firms usually operate as part of a larger financial corporation (see, for instance, IDCs in Section 3.3) or as limited liability partnerships that raise funds independently. Private equity funds can assume different forms and can be categorized into three main categories: early-stage or venture capital funds, industry-specific or growth funds and later-stage or buy-out funds (each category can be divided into several subtypes of funds and investment strategies – see Table 11) (World Bank, 2015).

Venture capital amounted to USD 136 billion of the aggregate value of 9.241 venture capital deals[7] in 2015 (Preqin, 2016). By region, 62 per cent of investors targeted the US market for venture capital investments, followed by Europe with 45 per cent, Asia with 28 per cent and Latin America with 7 per cent according to Preqin's Venture Capital Investor Survey of October 2014 (conducted with 100 venture capital investors). The most attractive sector investment opportunities for venture capital investors are information technology with 75 per cent, health care with 64 per cent, telecom, media and communications with 47 per cent, business services with 40 per cent, clean technology with 37 per cent, energy and utilities with 33 per cent, consumer discretionary with 20 per cent, infrastructure with 18 per cent, food and agriculture with 18 per cent, industrials with 10 per cent, real estate with 9 per cent and materials with 8 per cent. Whereas the majority of venture capital investors originate from North America with 56 per cent, followed by Europe with 25 per cent and Asia with 11 per cent. The attractiveness of venture capital lies in portfolio diversification, in fulfilling the mandate objectives, the chance to capitalize on the emergence of promising start-ups and to boost local economies (Preqin, 2014).

[7] Excluding add-ons, grants, mergers, secondary stock purchases and venture debt.

Nevertheless, Hobday and Perini (2009) state that the role of investments by the formal venture market for start-ups is often overestimated, as the majority of investments comes from other sources, particularly from informal investments (Hobday and Perini, 2009). The World Bank, on the contrary, emphasizes the significant link between private equity investments and innovation in developed markets, as venture capital can increase innovation significantly, on the one hand, while private equity investors can play an important role in facilitating technology transfers in developing countries, on the other. Furthermore, private equity investors can support firms with finance in developing countries with less developed credit markets. Another positive effect might be improved real economic activity through firm ownership and, consequently, improved industry performance and economic growth.

Table 11 Types of private equity funds and investment strategies

Fund type	Definition	Related private equity fund types
Early stage or venture capital funds	Early stage/VC funds invest in start-ups and early stage entrepreneurial firms, frequently pairing their capital with an array of other business resources (such as networks for additional hiring and specialized consultants, improving management, identifying alliances and acquisitions, and searching for appropriate market applications)	"Angel investors", seed financing, start-up financing
Industry-specific funds	Industry-specific funds offer investee companies focused industry knowledge and relationships, making them particularly well equipped to get deeply involved in key strategic decisions and to assist in efforts to grow through acquisitions. Except in the largest economies, an industry focus usually precludes a geographic focus	Industry focus could range from real estate, infrastructure, biotech information technology and media and telecom to agribusiness, climate change, education, health care, microfinance and forestry, etc.
Late stage or buy-out funds	Buy-out funds invest in mature companies, often using substantial debt to simultaneously reduce the capital the fund puts in and increase the return on that capital. These investments frequently aim to improve the profitability of the investee firm through reorganization and replacement of top managers	Leveraged buy-out (LBO) funds, "special situations investing"

Source: World Bank (2015:133)

Significant threats to private equity performance can be attributable to insufficiently developed local capital markets, as the exit options are often reduced. Consequently, private equity investors have difficulties using local sources or debt to increase their margins. Therefore, policymakers' support for developing the capital market could enhance viable exit strategies for private equity investors. Furthermore, as private equity flows are highly affected by the quality of legal and market institutions, developing countries need to strengthen their legal and institutional frameworks (World Bank, 2015). Governments can further support private equity, particularly venture capital to foster innovation, employment and productivity growth in their countries and to correct market failures associated with innovation and entrepreneurial finance. Government instruments range from financial incentives (tax incentives/tax investor credits, loan guarantee schemes, equity guarantee schemes), outright subsidies and preferential regulations on public provision of investment capital (Brandner et al., 2015 and OECD, 1997). Nevertheless, critics of government activity in venture capital markets often point out problems of political pressure, rent-seeking and bureaucratic inefficiency (Brandner et al., 2015 and OECD, 1997). Therefore, careful attention should be given to the design and management of these government incentives, taking good practice into account to ensure that the public funds are allocated to the desired targets (OECD, 1997). Weiss (2015) argues that although middle-income country capital markets often still lack long-term investments, their system of financial intermediation usually improve (in comparison to countries with lower income levels), accompanied by an emerging private venture capital market. Policymakers' support can, according to Weiss (2015), either be effected by marked-based interventions or public good provision: *"Market-based measures such as interest rate subsidies and credit guarantees can still be used, but the expectation is that they will either be targeted at key high risk activities so the interest rate charged does not reflect the full risk premium involved or they will be explicitly used for social purposes like subsidising SME lending for employment generation objectives. Public good interventions include setting a sound regulatory framework for the financial sector in general, either through the Central Bank or a separate financial authority, as well as supporting the development of the private venture capital sector for high-risk investments. This can involve training, drawing on international best practice as well as matching potential entrepreneurs with venture capital investors, possibly as part of incubator programmes."* (Weiss 2015, p.33)

3.4 Private equity and venture capital fund: Country case studies

In this section, case studies on private equity and venture capital funds in Mauritius, Nigeria and Brazil are examined. These funds have investment in national industrial development in

common. Capital market policy instruments are used vertically or horizontally, depending on the country. Moreover, the year of creation, aim, investment sectors and fund sizes differ depending on the country and its context.

3.4.1 NRF Equity Investment Ltd fund - Mauritius (upper middle-income country)

The Government of Mauritius and the commercial banks in Mauritius set up a private equity fund, NRF Equity Investment Ltd, in 2012. The fund had an initial capital of RS 250 million for equity and capital investment for small and medium enterprises in Mauritius, targeting all industries, particularly entrepreneurial businesses seeking to restructure, expand or move up their value chain. The fund itself is managed by BDO & Co, a firm with experience in restructuring, turnaround, private equity and deal structuring as well as supporting entrepreneurs by, for instance, implementing operational and financial management improvements. The fund's concrete objectives are the provision of risk capital to SMEs with a proven track record of entrepreneurial and growth potential, assisting targeted enterprises in building value through expansion and strategic management support, acquiring a minority equity stake of minimum 25 per cent and maximum 49 per cent, and providing a minimum investment of RS 10 million and a maximum of RS 50 million with an exit within 5 to 7 years. The fund targets all well-established SMEs incorporated in Mauritius' manufacturing sector, agro-business, services and ICT. The targeted SMEs must further demonstrate a proven track record of a minimum of 3 years and have a minimum turnover of RS 10 million (NRF, n.d.).

Table 12 Overview of country case studies

Country	Fund	Type	Aim	Year of creation	Investment sectors	Ownership	Fund size
Mauritius	NRF Equity Investment Ltd. fund	Private equity	Providing risk capital to SMEs with entrepreneurial and growth potential with a proven track record, assisting targeted enterprises in building value through expansion and strategic management support	2012	SMEs in Manufacturing Agro-business Service ICT	Government of Mauritius and commercial banks in Mauritius	RS 250 million (initial capital)
Nigeria	Unique Venture Capital Ltd. SMEEIS fund	Private equity/ venture capital	Providing "smart" private equity and business finance to SMEs, the UVC SMEEIS Fund, encouraging innovative emerging market entrepreneurs and boosting economic growth in UVC's operational area	2004	Real estate sector Service Microfinance	3 major Nigerian banks	NGN 6 billion commitments
Brazil	BNDESPAR	Private equity/ venture capital	Aiming to support the process for capitalization and development of Brazilian companies	1982	Various	Government of Brazil	n.a.

Source: Author's elaboration based on UVCMCL (n.d.), BNDES (n.d.) and NRF (n.d.)

3.4.2 Unique Venture Capital (UVC) SMEEIS Fund - Nigeria (lower middle-income country)

Unique Venture Capital (UVC) Management Company Ltd. is a private venture capital investment firm that was established by five major Nigerian banks in 2004 with the vision of unleashing the power of emerging market entrepreneurs for positive development. The aim of the fund is the provision of "smart" private equity and business finance to SMEs, the UVC SMEEIS Fund, encouraging innovative emerging market entrepreneurs and boosting economic growth in the UVC's operational area. The company added more venture capital funds to their management portfolio over time. The UVC SMEEIS Fund has a fund size of NGN 6 billion of commitments and a target investment size of up to NGN 200 million. The typical equity ownership is up to 40 per cent and the minimum investment return amounts to 30 per cent. The Fund prioritizes the real sector with 60 per cent, the service sector with 30 per cent and the microfinance sector with 10 per cent. Trading and financial service funding is excluded. Types of investment range from early stage, expansion financing to acquisition and management buy-outs. The investment criteria for funding include companies with captive markets and sustainable growth in per capita consumption, emerging and high growth industries, possible high export opportunities and possible multiplier effect and SMEs. Furthermore, the business must be located in Nigeria and the requirement shall not exceed NGN 200 million, and the net assets (excluding land) should not exceed NGN 500 million. The preferred investment time ranges from 3 to 5 years. The services of UVC range from venture capital and private equity financing, financial advisory services, management consultancy for project management and financing. Investment in the manufacturing sector amounts to NGN 154 million in companies in Lagos and Kaduna. Other sectors of investment include agriculture and services (UVCMCL, n.d.). Nevertheless, transparency and SME capacity need to be strengthened in Nigeria due to the high fraud occurrence and lacking capacity building and trainings (World Bank, 2015).

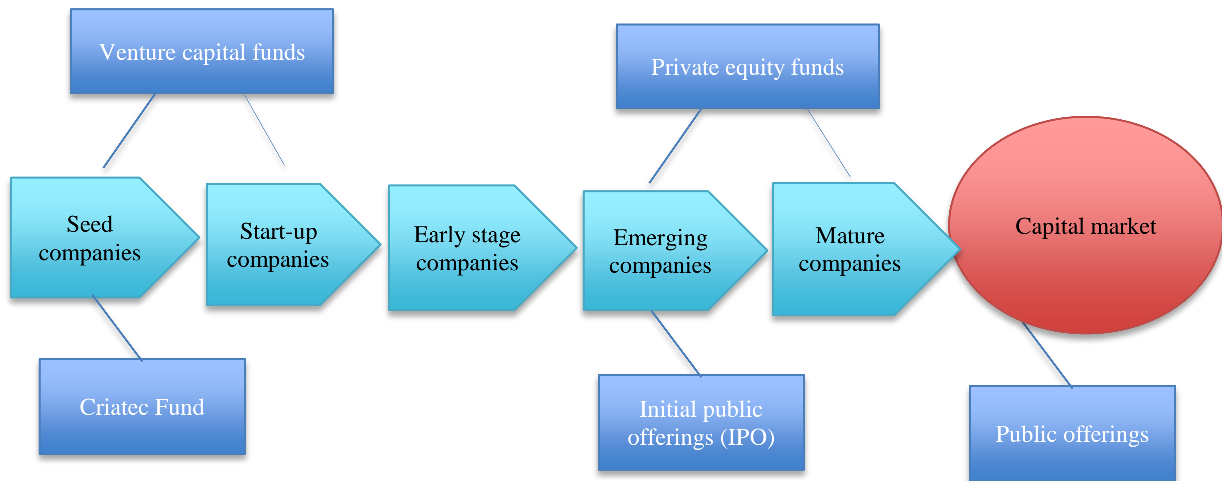
3.4.3 BNDESPAR – Brazil (upper middle-income country)

BNDESPAR is a fully owned subsidiary of Brazil's development bank Banco Nacional de Desenvolvimiento Economico e Social (BNDES[8]). BNDESPAR was established in 1982 and its operations are based on the strategic guidelines formulated jointly with BNDES. They support the process of capitalization and development of Brazilian companies. The financial instruments of BNDESPAR include temporary equity and minority interests. The current objectives of BNDESPAR include strengthening the capital structures of companies and support for new

[8] BNDES is a 100% state-owned company under private law, a key instrument for the implementation of industrial and infrastructure policies of the Government of Brazil. BNDES is Brazil's main provider of long-term financing and currently focuses on infrastructure, heavy industry, technological development, energy, agribusiness, exports, urban and social development, social inclusion, innovation, sustainability as well as SMEs (BNDES, n.d.).

investments in the economy, support for the restructuring of industry through mergers and acquisitions, support for the development of emerging companies and SMEs, as well as the development of closed private equity funds and contribution to the development of the capital market. The investment chain of BNDESPAR is illustrated below.

Figure 6 Chain of investment of BNDESPAR



Source: BNDES (2015)

The BNDESPAR portfolio of June 2015 involved 158 companies, 141 companies on equity interest and 47 investment funds. Equity investments amounted to BRL 50.5 billion of non-associated companies, BRL 15.8 billion of associated companies and BRL 1.9 billion of investments in equity funds. In the third quarter of 2015, BNDESPAR's profit reached BRL 1,314 billion.[9] Some current project examples of BNDESPAR are the creation of CRIATEC III, an investment fund focusing on investments in seed capital, primarily in biotechnology, ICT, new materials, nanotechnology and agribusiness sectors; and the Sugarcane Technology Center for R&D as well as the commercialization of new varieties of sugarcane. Brazil's venture capital industry has also been improving since 1995 due to the currency plan "Real Plan", the reduction of inflation and lower interest rates as well as the privatization of public enterprises. The main investment of Brazil's venture capital still comes from local investors, such as BNDES, pension funds and other institutional investors (BNDES, 2011; BNDES, n.d.).

Lazzarini and Musaccio (2011) examine minority equity purchases by development banks as a way to pursue industrial policy in developing countries. They created a database with basic financial information and ownership for 296 Brazilian firms between 1995 and 2003 and found positive and significant effects of BNDES' minority equity stakes on firm performance in terms of return on assets. The shareholdership of BNDES alleviates capital constraints by publicly

traded companies and improves the capacity to undertake long-term investments. They find negative effects, particularly with BNDES holding equity from state-owned groups, which may be caused by reasons other than efficiency (Lazzarini and Musaccio, 2011).

3.5 Industrial Development Corporations

Industrial Development Corporations (IDCs) usually refer to government-owned entities with proximity to development banks. They exist globally, though they are called differently in different countries (in this paper, all entities will be referred to as IDCs for simplification reasons). IDCs frequently emerge as important private equity and venture capital investors, pursuing national development objectives. In this paper, the main focus is on IDCs as private equity investors, channelling investments into the national industry. The following case studies examine IDCs in South Africa, Zambia, Kenya, Swaziland, Chile and Barbados. These entities aim to promote the development of the national industry or specific industrial sectors with horizontal and selective capital market policy instruments.

IDCs are important for economic development and structural change, as they can play an important role in mobilizing domestic resources to promote industrial development. As long-term financing in developing countries is usually limited and their capital markets are often underdeveloped, IDCs can provide crucial investments to the national industry, especially to SMEs. According to statistics of the World Bank, only 66 per cent of small firms and 78 per cent of medium-sized firms in developing countries have long-term liabilities compared to 80 per cent and 92 per cent, respectively, in high-income countries. The World Bank recommends well-designed private-public risk-sharing arrangements to support the mobilization of financing for long-term projects, presuming that political capture and misallocation of resources are avoided (World Bank, 2015). Moreover, Lazzarini and Musaccio (2011) highlight that in the context of poorly developed capital markets, government-backed, long-term equity can promote the necessary capital expenditures to achieve efficiency gains. They underline the role of the government to *"focus investments where there is a clear need to undertake productive capital expenditures by well-run private firms unable to finance these investments through existing capital markets."* (Lazzarini and Musaccio, 2011:22). IDCs can be a useful catalyst for the national industry and support well-run companies, presuming that the respective capabilities and transparency as well as good practice exist. An overview of the IDC case studies is presented in Table 13.

Table 13 Case studies on Industrial Development Corporations

Country	Type	Aim	Year of creation	Investment sectors	Ownership
South Africa	Industrial Development Corporation	To enhance the sustainable industrial capability and innovation of South Africa by boosting economic growth and industrial development of South Africa and the region	1940	Agro-processing & agriculture Automotive & transport equipment Basic & speciality chemicals Chemical products & pharmaceuticals Clothing & textiles Heavy manufacturing Industrial infrastructure Light manufacturing & tourism Machinery & equipment Media & motion pictures -Metals & mining -new industries	100% Government of South Africa
Zambia	Industrial Development Corporation	To expand industrialization capacity, promote job creation and domestic wealth formation across key economic sectors and achieve structural economic transformation in the long term	2014	ManufacturingAgriculture Forestry Financial services Mining Energy Telecommunications Logistics Medical Education Tourism Real estate & media	100% Government of Zambia

Kenya	Industrial and Commercial Development Corporation	To focus on industrial growth and development in Kenya, promote businesses in the manufacturing sector as well as in agro-processing, financial services and education sectors	1954	Manufacturing Agro-processing Education Financial services Wholesale & retail trade Health care Real estate Energy ICT Tourism Transport Entertainment Mining	100% Government of Kenya
Swaziland	Industrial Development Company	To create wealth for the Swazi economy, increase the value of shareholder investments, practice cost-efficient management and achieve profits in its operations	1987	Manufacturing Commerce Agroindustry Tourism Service Mining	Swaziland Government, Swaziland National Provident Fund, Intenueron Investment Trust, Standard Bank Swaziland, Nedbank Swaziland Limited
Chile	Chile Development and Growth Fund (Chilean Economic Development Agency)	To foster financing and development of small and medium Chilean companies with high growth potential	2011	SME	Government of Chile

Barbados	Barbados Investment and Development Corporation	To contribute to diversification and growth of the economy through new investments, increased exports and employment creation by fostering the development of competitive business enterprises	1992	SME Manufacturing Agriculture Fishing	Government of Barbados

Source: Author’s elaboration based on IDC SA (n.d.), IDC Z (n.d.), ICDC (n.d.), SIDC (n.d.), CORFO (n.d.) and BIDC (n.d.)

3.5.1 Industrial Development Corporation - South Africa (upper middle-income country)

The Industrial Development Corporation in South Africa (IDC SA) was established in 1940 by an Act of Parliament (IDC Act No. 22) and is fully owned by the South African government under the supervision of the Economic Development Department of South Africa. The objective is to enhance South Africa's sustainable industrial capability and innovation by boosting the country's and region's economic growth and industrial development. IDC SA funds entrepreneurs, new enterprises and supports expanding companies. The mandate of IDC SA is the development of industrial capacity, specifically in manufactured goods, and initially, to mitigate the disruption of trade between Europe and South Africa during the Second World War. Since the 1990s, IDC SA has also been investing in the rest of Africa with a priority for industries in mining, agriculture, manufacturing, tourism and telecommunications. IDC SA aligns its activities with the National Development Plan, the New Growth Path and the Industrial Policy Action Plan to achieve objectives such as job creation, regional development and integration, economic empowerment of communities and growing black industrialists, the promotion of environmentally sustainable growth as well as support for the SME sector.

IDC SA focuses on three key areas: 1) enhancing the value chain in mining, metals and chemical industries; 2) supporting agro-processing and new industries as well as building industrial infrastructure; and 3) ensuring the success of projects with a high impact on industrial growth and long-term effects on the national economy. Funding, investment and support is offered to the following sectors and industries: agro-processing and agriculture, automotive and transport equipment, basic and speciality chemicals, chemical products and pharmaceuticals, clothing and textiles, heavy manufacturing, industrial infrastructure, light manufacturing and tourism, machinery and equipment, media and motion pictures, metals and mining as well as new industries. The funding criteria and amount differ between the different industries. The following table presents three industries and their funding criteria: automotive and transport equipment, clothing and textiles and new industries.

Furthermore, IDC SA offers special schemes which target various developmental mandates such as job creation, youth and women empowerment, funding of innovation and increasing the competitiveness of manufactured goods. Examples include the "Manufacturing Competitiveness Enhancement Programme", "The Gro-E Youth Scheme" and the "Clothing and Textiles Competitiveness Programme", among others.

Table 14 Funding criteria for selected industries

	Automotive and transport equipment	Clothing and textiles	New industries
Target industries	Manufacture of motor vehicles, trailers & semi-trailers Manufacture of parts and accessories for motor vehicles and their engines Manufacture of rail locomotives and rolling stock Building and repairing of boats and ships Manufacture of aircraft and spacecraft Manufacture of motorcycles and bicycles	Natural fibres, including cashmere, wool and mohair beneficiation Synthetic fibre production Spinning of yarns, knitting and weaving of fabrics Dyeing, printing and finishing of fabrics Non-woven textiles Household textiles Clothing manufacturing Footwear Leather tanning Leather products	Additive manufacturing Alternative fuel vehicles Fuel cells Medical technologies Mining technologies Renewable energy Water infrastructure
Expected outcome of funding	Increased capacity in the assembly industry driving demand for local component manufacturers Expand and extend existing industries to create and/or preserve jobs and drive sustainable economic growth Enable the local industry to achieve its potential and become globally competitive	Expand and extend existing industries to create and/or preserve jobs and drive economic growth Enable the local clothing and textiles industry to achieve its potential and become globally competitive	Establish sustainable new industries with significant growth and job creation potential Enable localization of manufacturing Stimulate entrepreneurship in technology innovation with a special focus on the creation of new black technopreneurs
Funding provision	Preference is given to financing fixed assets and the fixed share of growth in working capital requirements and new or existing projects or businesses that have a significant development impact	Preference is given to financing fixed assets and the fixed share of growth of working capital requirements; supporting projects and/or businesses with a high development impact and supplying distress funding for troubled companies that have a clear turnaround plan	Equity (ordinary shares and shareholder loans)
Funding requirements	Minimum of ZAR 1 million Security Compliance with international and local environmental standards Reasonable financial contribution from business owners along the following	Security Compliance with international environmental standards Relevant bargaining council compliance Shareholders/owners are expected to make a material contribution, generally 35%	Maximum of ZAR 40 million per project with a maximum of ZAR 15 million in the first round Requirement of significant minority equity stake of between 25% and 50%

	broad guidelines: *33% of total assets for going concerns *40% for start-ups, depending on industry norms and risk profile *preference that exposure does not exceed that of the owner *Contribution of historically disadvantaged persons under special circumstances may be lowered *Business must exhibit economic merit in terms of profitability and sustainability	of total assets for going concerns and 45%-50% for start-ups, depending on the industry norms and risks involved *Preference that exposure does not exceed that of the owner	Intellectual property (IP) must be owned by the company of investment Development of intellectual property must be done in-house or further developed in-house IP should preferably be patentable Competent team required Key founding shareholders should be involved in the business on a full-time basis Business should display good prospects of being economically viable
Further funding criteria	Acquisitions, take-overs and buy-ins by historically disadvantaged partners, expansions of existing businesses and SMEs have further/special funding criteria		

Source: IDC SA (n.d.)

The funding for start-ups and existing businesses is up to a maximum of ZAR 1 billion and debt of ZAR 1 million. The IDC SA funding is generated through income from loan and equity investments, exits from mature investments, borrowings from commercial banks as well as development finance institutions and other lenders. The funding instruments range from debt, equity and quasi-equity to guarantees, trade finance and venture capital. Minimum requirements for funding are security, compliance with international environmental standards, financial contribution by shareholders/owners, economic merits (in terms of profitability and sustainability) and a focus on broad-based black economic empowerment and black industrialists is important (IDC SA, n.d.).

3.5.2 Industrial Development Corporation - Zambia (lower middle-income country)

The Industrial Development Corporation of Zambia (IDC Z) was established in early 2014 as an investment company wholly owned by the Government of Zambia. The IDC Z's main objectives are to expand industrialization capacity, promote job creation and domestic wealth formation across key economic sectors and achieve structural economic transformation in the long run. The activities of IDC Z range from co-investing alongside of private sector investors

as well as through evaluation, pricing and lowering the investment risk profile to serving as an investment holding company for state-owned enterprises and new investments that ultimately generate earnings for the proposed Zambia Sovereign Wealth Fund. The priority sectors of IDC Z are very broad and apart from manufacturing also include agriculture, forestry, financial services, mining, energy, telecommunications, logistics, medical, education, tourism, real estate and media. Within the manufacturing sector, the aim is to foster sustainable industrialization and job creation with increased production of value added products and the exploitation of export markets. IDC Z is investing in Lusaka South Multi-Facility Economic Zone Limited, Mulunghushi Textiles Limited, Mupepetwe Development Company, Nitrogen Chemicals of Zambia Limited and Zamcapitol Enterprises Limited. The net portfolio value of IDC Z amounts to USD 2 billion, with a targeted GDP growth rate of 8 per cent per annum; 34 companies are in the portfolio and around 480,000 jobs have been created in the last four years. IDC Z's financial instruments range from equity and quasi-equity to debt, venture capital and wholesale funding via intermediaries (IDC Z, n.d.).

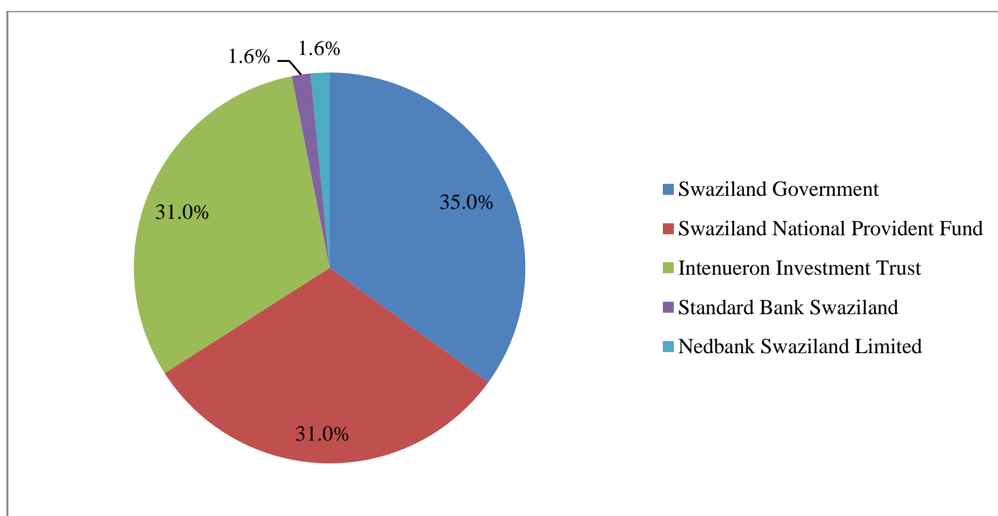
3.5.3 Industrial and Commercial Development Corporation - Kenya (lower middle income country)

The Industrial and Commercial Development Corporation (ICDC) was established in 1954 under the Act of Parliament Cap. 445 as a finance and investment company, fully owned by the Government of Kenya. ICDC focuses on industrial growth and development in Kenya, the promotion of businesses in the manufacturing sector as well as in agro-processing, financial services and education. ICDC distinguishes between low, medium and high priority industries. Manufacturing, agro-processing, education and financial services are considered high priority industries, while wholesale and retail trade, health care, real estate, energy, ICT, tourism, transport and entertainment are medium priority and mining a low priority industry. High priority segments include existing young businesses (2-5 years old), medium sized corporates with an annual turnover below KES 500 million, international investors wishing to invest in Kenya and distressed enterprises in need of a turnaround. Medium priority segments include entrepreneurs with sound technical expertise, some professional and financial standing, large corporates with an annual turnover over KES 500 million, local governments and commercial public institutions. The products and services offered by ICDC include equity products, debt products, guarantee products and technical advisory services. Within the equity product category, ICDC offers joint ventures, strategic partnership and quasi-equity, with a minimum investment amount of KES 10 million and a maximum ICDC shareholding of 35 per cent for each category (ICDC, n.d.).

3.5.4 Swaziland Industrial Development Company - Swaziland (lower middle-income country)

The Swaziland Industrial Development Company (SIDC) was established as a joint venture in 1987 between the government of the Kingdom of Swaziland and major international financial institutions in order to finance private business projects. SIDC is a private development financial institution providing equity financing, asset leasing, long-term loans, industrial land and buildings as well as expert advice and guidance to local and international investors. In 2008, these financial institutions sold their shareholding to Swaziland National Provident Fund [10] and Interneuron Swaziland Limited [11]. The figure below presents the current shareholders.

Figure 7 SIDC shareholders



Source: SIDC (n.d.)

The main objectives of SIDC are the creation of wealth for the Swazi economy, increasing the value of its shareholders' investments, practicing cost-efficient management and achieving profits in its operations. SIDC's priority sectors, apart from industry, include property development, mining, agribusiness, tourism, commerce, services and SMEs. To qualify for funding, the business must be technically and economically feasible, financially viable, soundly managed with priority for projects that provide permanent employment, generate or save foreign exchange, utilize local resources and increase the value added in production, transfer appropriate technology and skills and encourage linkages with existing industries (SIDC, n.d.).

[10] The Swaziland National Provident Fund was established in 1974 as a savings scheme with the main purpose of providing benefits for employed persons when they retire from regular employment in old age or in the event of becoming incapacitated. (Source: http://www.snpf.co.sz/).

[11] Interneuron Swaziland (Pty) Limited is a registered Asset Manager with the objective of supporting retirement funds that exclusively invest funds within Swaziland (see: http://www.interneuron.co.sz/).

The major priority sector of SIDC is manufacturing, followed by commerce, agroindustry, tourism, services and mining. The figure below illustrates the distribution of equity and loan finance (no exact figures are provided).

Figure 8 Sectoral distribution SIDC

Source: SIDC (n.d.)

3.5.5 Chile Development and Growth Fund /Chilean Economic Development Agency - Chile (high-income country)

The Development and Growth Fund is an investment fund, which was established in 2011 by the Chilean Economic Development Agency (CORFO) with the aim of fostering financing and development of small and medium Chilean companies with a high growth potential, and which are in an expansion phase.

CORFO was established in 1939 by the Chilean government to foster national productive activity. CORFO's mission "*is to improve the competitiveness and the productive diversification of the country by encouraging investment, innovation and entrepreneurship, strengthening in addition the human capital and technological capabilities to achieve a sustainable and territorially balanced development."* (CORFO, n.d.). The agency aims to contribute to the improvement of the country's competitiveness by fostering high potential business opportunities in strategical industries, generating an enhanced environment for productivity, innovation and entrepreneurship. CORFO supports five main pillars: innovation, entrepreneurship, financing, business productivity and technological capabilities.

The Development and Growth Fund's instruments vary from partial equity interest to granting loans. The Fund holds a shareholder percentage of the company and actively participates in the management. Funding is restricted to SMEs legally incorporated in Chile, whose equity does not exceed UF 200,000 (Unidades de Fomento, a Chilean peso-denominated unit indexed by inflation) at the time of the first investment, and who provide concrete business plans and are in an expansion phase (characterized by limited growth due to lack of capital) (CORFO, n.d.).

3.5.6 Barbados Investment and Development Corporation - Barbados (high-income country)

The Barbados Investment and Development Corporation (BIDC) is a government organization with the mandate to contribute to the diversification and growth of Barbados' economy through new investments, increased exports and employment creation based on the development of competitive business enterprises. BIDC was established in 1992 in accordance with the Barbados Investment and Development Corporation Act, with three core units: export and business development, business support services and finance and properties. It supports the manufacturing and small enterprise sector with financing. The prerequisites for financing include registration with the Customs and Excise Department (in case of a manufacturing firm) or the Ministry of Industry, International Business, Commerce and Small Business Development (in case of a small business). Several other business incentives such as tax exemptions are provided for companies in the manufacturing, agriculture and fishing sector. BIDC's finance instruments cover:

- Equity and venture capital
    - The Barbados Investment Fund (providing equity financing for small and medium-sized businesses operating in Barbados and engaged in manufacturing, agro-industry, tourism and several service sub-industries)
    - The Enterprise Growth Fund Ltd. (providing loan financing, venture capital and technical assistance through a range of funds to companies in the productive sector), including
        - The Industrial Investment and Employment Fund (IIEF – providing local manufacturers with loan financing on attractive terms)
        - Innovation Fund (providing seed capital and technical expertise to entrepreneurs who have innovative ideas) as well as
        - Small Business Venture Capital and Barbados Business Enterprise Corporation.
- Special technical assistance programmes to export credit insurance schemes
- Enhanced credit guarantee schemes
- Export rediscount facility
- Tourism and manufacturing guarantee facility
- Industrial credit fund technical assistance grant, among others (BIDC, n.d.).

4. Conclusion

In view of the central role investment plays as a driver of structural transformation and modernization, it is not surprising that many governments, especially in low-income countries, have focused much of their attention on policies aimed at boosting the volume of investment in the country. The rationale for such attempts is solidly rooted in the literature on the failure of capital markets to correctly signal the profitability of long-term ventures, such as industrialization, to investors. As a result of the dramatic increase in the volume of FDI, much of the literature on the topic focuses on policies aimed at attracting and securing FDI. A great deal of the insights emerging from such experiences is valuable for all developing countries, and a brief overview has been provided at the beginning of this paper. It must, however, be noted that the majority of lowest income countries have been largely by-passed by FDI flows and hence, this paper has deliberately focused on policies to mobilize domestic investment as a complementary measure to strengthen economic growth and achieve structural change. Public policy investment instruments represent viable policy tools to trigger investment, presuming that they are used in a transparent and responsible manner, target the country's socio-economic development and are not used to pursue political interest. Good practice and a comprehensive investment policy framework can significantly increase the success of fostering the capital markets of developing countries and guarantee long-term investment. In this working paper, three such instruments were presented: Sovereign Wealth Funds, private equity and venture capital funds and Industrial Development Corporations. The experience of low- and middle-income countries has been discussed, without an attempt to distil good practice, as valuable food-for–thought for governments intending to strengthen their national industry by allocating funds to the manufacturing sector (vertical or horizontal) and particularly, to strengthen SMEs and innovative firms. These instruments also allow developing countries to diversify their industry and enable countries to follow a structural change path away from commodity-based development towards a modern industrial economy.

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