Time for a Third Wave of Enterprise Funds

AUTHORS
Daniel F. Runde
Romina Bandura
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Executive Summary

What Are Enterprise Funds?

- Enterprise funds are an innovative U.S. foreign policy tool created in the early 1990s that use U.S. government funding to stimulate economic development by investing in the private sectors of developing countries. Unlike grants or loans directed to foreign governments, enterprise funds use U.S. government funding to invest in private equity and credit in emerging markets. They are strong complements of other U.S. development efforts.

- There have been two waves of enterprise funds to date: the first wave was during President George H.W. Bush’s administration in the early 1990s and the second wave was during the presidency of Barack Obama in early 2011. The enterprise funds of the 1990s were aimed at bolstering the private sector in former Communist states in Central and Eastern Europe and the former Soviet Union. The second wave of enterprise funds was partly a response to the Arab Spring, to provide essential capital and private-sector expertise in two fragile yet strategically important countries to the United States: Egypt and Tunisia.

Why Are Enterprise Funds Unique?

- Enterprise funds are a unique but underutilized instrument of U.S. foreign policy that leverage the expertise of the private sector to drive economic development, and when properly managed, return 100 percent of their appropriated funds to the U.S. government.

- Although enterprise funds are authorized and funded by the U.S. government, they do not add another layer of bureaucracy. These institutions function like private equity funds; they are independently managed by outside investment professionals that take significant risks and use creative investment strategies to advance private-sector development abroad.

- They are unique organizations in their management and development approach and embody the core U.S. private-sector values of freedom, risk taking, and creativity. Few countries outside the United States have pursued a similar endeavor.

- Enterprise funds are one of the most successful and innovative development programs created by the U.S. government. Since their formation over 25 years ago, they have invested over $1.5 billion in strengthening the private sectors of developing countries, attracted billions in additional foreign investment, and generated significant proceeds that have been returned to the U.S. government. Their ability to repay money to the United States is especially timely as the administration moves to consolidate different foreign assistance programs and spend U.S. taxpayer money more effectively. Enterprise funds have been instrumental in creating a new investment industry in developing countries, bringing about changes in laws and regulations, and developing new economic sectors.

Why a Third Wave of Enterprise Funds? Why Now?

- Today’s global challenges are different from the geopolitical shocks that took place in the 1990s with the fall of the Soviet Union or the Arab Spring in 2010. Current challenges...
include rising migration, a youth bulge in developing countries, and countering China’s influence in development finance.

- The developing world is also different than it was 25 years ago: most countries have some level of a functioning private sector, the global private equity industry is more sophisticated, and there is greater private capital available for development impact. Over the years, the U.S. government and its partners have gained significant experience in creating and managing enterprise funds. Moreover, technology, in the form of mobile banking and online platforms, has impacted the way consumers purchase goods, pay for taxes and services, and access finance.

- Despite the success of two waves of enterprise funds, they remain an underutilized U.S. development tool. These trends represent an opportunity for the United States to update the enterprise fund model and authorize a third wave of enterprise funds to help spur private-sector growth and create jobs. Given their flexibility and successful track record, enterprise funds should be a front-and-center instrument for the U.S. government to help address pressing global challenges. The financial and policy successes of enterprise funds deserve to be scaled and replicated.

**What Updates Are Needed to the Enterprise Funds Model?**

- At a time of increasing global migration, changes to U.S. development assistance, the rise of China, and growing consensus on the need to employ the private sector for development, enterprise funds, with a few updates to the model, can be transformational.

- An enterprise fund model to fit twenty-first-century challenges would include the following upgrades: (1) allowing impact investors to coinvest in enterprise funds; (2) defining success for enterprise funds (beyond financial returns) at the outset; and (3) considering critical sectors and following a regional approach for smaller countries to gain efficiencies.

**Where to Launch the Next Wave of Enterprise Funds?**

- The first group of candidates would include countries with geostrategic importance to the United States. In the short run, given security and demographic challenges, enterprise funds could be established in the Middle East region (Jordan and Lebanon) and in North Korea, the latter depending on a successful negotiation outcome. The second group of candidates would include countries that have significant migration challenges that lack private capital and have weak private sectors. In the medium to long run, countries that would benefit from an enterprise fund would include the Northern Triangle countries (El Salvador, Guatemala, and Honduras), Haiti, Ethiopia, and—assuming that political and economic reforms continue—Zimbabwe.

- These countries offer a starting point—not an end in itself. Ultimately, the choice of countries for the next round of enterprise funds will follow a political decisionmaking process.
01 Introduction

Enterprise funds are an innovative U.S. foreign policy tool created in the early 1990s that use U.S. government funding to stimulate economic development by investing in the private sectors of developing countries. Unlike grants or loans directed to foreign governments, enterprise funds use U.S. government funding to invest in private equity and credit in emerging markets. Enterprise funds are a unique but underutilized instrument of U.S. foreign policy that leverage the expertise of the private sector to drive economic development, and when properly managed, return 100 percent of their appropriated funds to the U.S. government. At a time of increasing global migration and transnational threats, increasing competition from China, declining U.S. development assistance, and growing consensus on the need to employ the private sector to help advance economic growth, enterprise funds, with a few updates to the model, can be a transformational tool of U.S. foreign policy.

Enterprise funds are unique and forward-thinking because they can simultaneously “do development” and generate financial returns for the United States. As the Trump administration works to consolidate U.S. development finance initiatives and serve as an effective steward of taxpayer funds, enterprise funds can help achieve this objective. Enterprise funds can complement existing U.S. development efforts by creating new synergies with the U.S. Agency for International Development (USAID), Overseas Private Investment Corporation (OPIC), the Export-Import Bank, and the newly proposed International Development Finance Corporation (IDFC) to further U.S. foreign policy objectives. Their successful track record in Europe and Central Asia in the 1990s, and now in the Middle East, merits serious consideration from policymakers.

This paper makes the case for launching a third wave of enterprise funds. It provides an overview of the enterprise fund model and its achievements, offers suggestions for improvements, and recommends six countries and one region in which current economic and political conditions are ripe for the launch of new enterprise funds. Using a set of criteria, we identify two categories of countries as candidates for a new round of enterprise funds. Ultimately, the choice for the next round of enterprise funds will follow a political decisionmaking process. The objective of this paper is to inform policymakers on the merits of enterprise funds as a strategy for sustainable economic development and to offer a select list of countries of geostrategic importance to the United States where enterprise funds could be established in the immediate future.
02 Enterprise Funds are a Successful U.S. Private-Sector-Led Development Program

Enterprise funds function much like private investment funds, "by taking risks and providing equity financing, as well as debt and technical assistance," and are supervised by private boards of directors accountable to their shareholders—in this case, USAID. Enterprise funds are a flexible, diplomatic tool that can be used in different circumstances to advance U.S. interests and simultaneously tackle development challenges. With U.S. government funding, enterprise funds promote entrepreneurship, serve as a catalyst for attracting additional foreign investment, and generate financial proceeds that are returned to United States Treasury. Enterprise funds also advance U.S. interests and security by helping stabilize economies overseas.

Although enterprise funds are authorized and funded by the U.S. government, they do not add another layer of bureaucracy. These institutions function like private equity funds; they are independently managed by investment professionals that take significant risks and use creative investment strategies to advance private-sector development abroad.

Overall, enterprise funds have been a successful U.S. development tool: they have leveraged the expertise of the U.S. private sector, achieved sustainable economic development impacts, and returned a significant portion of their original grant funds to the U.S. Treasury. Taken as a whole, the United States has invested more than $1.5 billion in the enterprise funds program to date (versus $31 billion in annual foreign assistance) which has yielded significant financial and developmental rentals. For example, the enterprise funds of the 1990s were able to leverage approximately $6.9 billion in additional private investments, support 300,000 jobs, and reinvest $1.7 billion of the net proceeds from investments. Enterprise funds have increased the U.S. development reach by working hand in hand with the private sector.

"Since their formation in the 1990s, enterprise funds have created and saved thousands of jobs, transformed industry sectors, increased the levels of business experience and corporate governance, and have been an important U.S. foreign policy success."

U.S. Department of State, "Regional Program—Enterprise Funds"

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3 Ibid., 15.
There have been two waves of enterprise funds to date: the first wave began under the administration of President George H.W. Bush in the early 1990s after the collapse of the Soviet Union. The second wave started under the Obama administration in early 2011.\(^8\)

The enterprise funds of the 1990s were established to bolster the nascent private sectors in the former Communist states of Central and Eastern Europe and the Soviet Union. The second wave of enterprise funds came as a response to the Arab Spring when President Obama established the Egyptian-American Enterprise Fund (EAEF) and the Tunisian-American Enterprise Fund (TAEF) to help strengthen the private sectors of two fragile yet strategically important countries to the United States.

The financial and policy achievements of enterprise funds offer important insights into why they deserve to be scaled and replicated. For instance, the Polish-American Enterprise Fund (PAEF), established in 1990, when no private investment industry existed in Poland nor, for that matter, in Eastern Europe, helped create a new investment industry, introduce regulatory changes in the private sector, and seed a cadre of investment professionals that continue to operate today. Through a series of smart decisions, the PAEF eventually evolved into Enterprise Investors (EI), “the largest and most experienced private equity firm in Poland and Central and Eastern Europe.”\(^9\) Since 1990, this investment fund, which was spun off from the original PAEF, successfully leveraged its original U.S. government funding to nine funds, with a total capital exceeding $2.9 billion, of which $2.1 billion invested in 140 companies. EI successfully exited 126 companies, accumulating over $4.3 billion in total gross proceeds.\(^10\)

03  Why a New Wave of Enterprise Funds? Enterprise Funds as a Strategic Tool for U.S. Foreign Policy

Since the 1990s, the United States has gained significant experience in creating and managing enterprise funds. The private equity industry has become more sophisticated both at home and abroad and the size of private capital flows has increased dramatically. Moreover, technology has changed the way global citizens conduct business, with mobile banking and online platforms improving the way consumers purchase goods, pay for taxes and services, and access finance. The next generation of enterprise funds will be able to capitalize on these technological advances and the lessons learned from the experience of past funds.

Enterprise funds are one of the most successful and innovative development programs created by the U.S. government. Since their formation over 25 years ago, they have invested over $1.5 billion in strengthening the private sectors of developing countries, attracted billions in additional foreign investment, and generated significant proceeds that have been returned to the U.S. government. Their ability to repay money to the United States is especially timely as the administration moves to consolidate different foreign assistance programs and spend U.S. taxpayer money more effectively. Given their flexibility and successful track record, enterprise funds can be at the forefront of the private-sector-led development model that helps address pressing global challenges, such as rising migration and job creation, while serving as an effective counterweight to China’s growing influence in development finance.

Enterprise Funds Embody a Private-Sector-Driven Development Model

At a time where the United States is seeking to realign foreign assistance programs and make government more efficient and accountable to the American people, the enterprise fund model should be regarded as a key tool aligning with that vision. Enterprise funds promote efficiency, effectiveness, and better stewardship of taxpayers’ money. Enterprise funds are sustainable economic development models that pay for themselves, achieve measurable results, build relationships that outlive the fund, and pay long-term dividends even after their liquidation. They embody the core U.S. private sector values of freedom, risk-taking, and creativity.

Enterprise Funds Can Help Address Tough Global Challenges

There are several development challenges where the private sector can play a role and enterprise funds can have a demonstrable effect. Conflict combined with exploding demographics and jobless growth are fueling migration and human rights violations around the world. The most pressing challenge today is the global forced migration crisis, in which 66 million people have been forcibly displaced from their homes in 2016 alone, fleeing conflict and...
oppression, political persecution, or seeking economic opportunity.\textsuperscript{12} Moreover, some developing regions are undergoing demographic transitions that will result in growing youth populations. Africa will be the continent with the largest youth population growth with an increase of over 100 million youths (age 15–24) between 2015–2030.\textsuperscript{13} This will put pressure on economies to create jobs and on education systems to prepare the workers of the future.

In developing countries, the private sector is responsible for 90 percent of the existing jobs.\textsuperscript{14} One of the root causes of forced migration is a lack of meaningful employment opportunities for citizens. Enterprise funds can help build the private sector, deliver better economic opportunities for poor and fragile communities, and deter citizens from migrating under dangerous conditions. Along with other development programs, enterprise funds can be instrumental in promoting stability and private-sector growth.\textsuperscript{15}

Enterprise Funds Are Catalysts for Additional Foreign Investment

Foreign assistance alone will not be able to solve the myriad challenges facing many developing countries.\textsuperscript{16} During the last 15 years, the role of foreign aid has shifted from being the sole source of finance to a “catalyst” role, mobilizing additional investments for development challenges. To achieve the United Nations' 17 Sustainable Development Goals (SDGs),\textsuperscript{17} trillions of dollars of funding will be needed, well beyond the current $171 billion that developed countries supply in the form of foreign aid.\textsuperscript{18} Additional funding sources in the form of taxes, foreign direct investment, and others need to be combined with new development instruments and approaches such as equity investments, trade finance, and blended finance.\textsuperscript{19} Foreign aid agencies, multilaterals, and other institutions can catalyze additional private finance toward developing countries.


\textsuperscript{19} The sources of finance will originate from several channels: public and private, domestic and international, and developed and developing countries. The types of financing include: grants, loans and syndicated loans, mezzanine finance, equity investments, risk mitigation instruments, shares in investment funds, trade finance, and blended finance. See: Romina Bandura, \textit{Rethinking Private Capital for Development}, (Washington: CSIS, December 2017). https://www.csis.org/analysis/rethinking-private-capital-development.
Blended finance is a modality that is gaining traction in many development institutions. This approach combines a blend of public and private funding to tackle development challenges. It has three main characteristics: i) it leverages development finance and philanthropic funds to attract private capital into deals; ii) the investments made have social, environmental, and economic impact; and iii) the investments have financial returns in-line with market expectations, based on real and perceived risks. The current “size” of surveyed blended finance funds and facilities total approximately $31 billion.\textsuperscript{20} Results from a World Economic Forum survey point out that blended finance approaches can leverage substantial additional funding: $1 of public money invested in blended finance initiatives has attracted as much as $20 of private investment.\textsuperscript{21} In this regard, enterprise funds can be instrumental in blending public funds and private capital. Impact investments are one such untapped source of private capital that have been growing in importance in recent years.\textsuperscript{22} These funds and foundations seek a social or environmental impact as well as a financial return that align to enterprise funds dual mandate of “return” and “development.”\textsuperscript{23} In 2017 alone, impact funds invested $35 billion in diverse sectors such as microfinance, energy, health, and agriculture. Impact investment is forecasted to grow 8 percent in 2018.\textsuperscript{24} This growing source of funds could potentially invest on an equal footing with future enterprise funds at the time of their launch, which would bring substantial additional capital. Leveraging U.S. government funding with private capital increases the amount of funds available for development. Attracting private-sector funds would also expand technical expertise to developing countries. This new kind of partnership could represent a paradigm shift in the world of development and to solving long-term challenges in the poorest countries.

**Enterprise Funds Can Help Counter Chinese Soft Power**

The United States needs to recognize that its development model and global commercial reach is facing strong competition from other players. China has emerged as a global actor in trade, investment, and other forms of soft power.\textsuperscript{25} Enterprise funds can be a strategic tool to counter

China’s growing influence in development finance, which is spearheaded by its Belt and Road Initiative, and strong trade links with Africa and Latin America.

China remains Africa’s biggest export market and in 2013 it became the largest origin of imports to the continent.26 Moreover, China’s new development banks—the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB)—are competing with development financing provided by the United States and the Bretton Woods institutions (i.e., World Bank and other regional development banks). The AIIB has attracted 57 countries (including close U.S. allies) with a total capital of $100 billion. It can potentially provide between $10–$15 billion per year in financing. The NDB has five members (Brazil, Russia, India, China, and South Africa) with projects in those countries, although there are other countries that could join in the future. 27

By providing equity capital to developing countries, fostering inclusive private-sector growth, and bringing U.S. private-sector expertise and standards, enterprise funds offer a promising alternative to the Chinese finance model, which encourages dependence, substandard loan practices, and indebtedness. Enterprise funds empower local actors to make their own decisions to improve their economies, create jobs, and build lasting relationships with foreign investors that can serve as the foundation for future business relationships.

Enterprise Funds Complement Other U.S. Development Programs

There is a great need for additional and transformational investments in developing countries, and the United States can be a catalyst to fill that gap. Enterprise funds should be a way to channel additional private investments, and marry U.S. expertise in private-sector development with foreign policy goals. The United States should have as many development instruments as possible, and enterprise funds would continue to be a valuable and transformational tool for development; they would also complement USAID’s technical assistance and any equity investments that the new proposed International Development Finance Corporation (IDFC) would make (Box 1).

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At the end of 2017, the Trump administration proposed a new development finance institution that would invest in private-sector projects in low- and middle-income countries. The proposed International Development Finance Corporation (IDFC) would combine OPIC and several private-sector-oriented parts of USAID, as well as expand U.S. development finance capabilities by giving it authority to make direct equity investments. If passed, the BUILD Act, which enjoys strong bipartisan support, could be the most important piece of international development legislation in more than a decade. The BUILD Act grants the IDFC authority to "establish and operate enterprise funds" by means of certain sections of the original authority, the 1991 Support for Eastern European Democracy (SEED) Act. Under the BUILD Act, enterprise fund boards will continue to be appointed by the White House.

Given that many of the global development challenges require private-sector solutions, the United States could play a significant role in supporting private-sector development worldwide. Adapting enterprise funds to fit "modern development finance" is critical to achieving this end.\(^\text{28}\) It would be in the U.S. government’s interest to treat developing countries as potential partners who prefer a deeper relationship with the United States, which involves trade, investment, and economic growth. Enterprise funds can be one important avenue for building that partnership.

04 What Should Remain in the Enterprise Fund Model?

When enterprise funds were first established 25 years ago, the world was very different. Compared to the 1990s, most countries today have some level of a functioning private sector. The private equity industry has become more sophisticated both at home and abroad. Emerging markets possess a greater number of trained investment professionals than in the 1990s, and the United States has gained significant experience in creating and managing enterprise funds.

Moreover, there is wider consensus about the power of private capital to be a force for positive innovation and development impact. More private capital is flowing into emerging markets than in the 1990s. Foreign direct investment (FDI) to developing countries increased more than tenfold since the mid-1990s and is five times the amount of foreign aid.²⁹ An impact investment industry has emerged, globally managing over $228 billion in assets in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, housing, healthcare, and education.³⁰

Technology has changed the way global citizens conduct business, with mobile banking and online payment platforms improving the way consumers purchase goods, pay for taxes and services, and access finance. The next generation of enterprise funds will be able to capitalize on these technological advances and on the lessons learned from past enterprise funds experience.

Current challenges include transnational threats, rising migration and job creation, and countering China’s growing influence in development finance. Yet, these changing trends and challenges are also an opportunity for the United States to positively utilize a third wave of enterprise funds to provide stability, help spur private-sector growth, and create jobs in countries that are key strategic partners to the United States.

While some updates are needed to reflect the changing needs of the twenty-first century, certain design components of enterprise funds should remain the same. These features include building a strong U.S. relationship with the host country, crowding in private capital, maintaining flexibility in decisionmaking, and hiring qualified local staff.

Building a Strong U.S. Relationship

Given that enterprise funds are a development and foreign policy instrument—in addition to a financial one—they should be regarded as long-term strategic vehicles to deepen relationships with target countries. While independent, enterprise funds should find ways to leverage close ties with the United States through the U.S. embassy in country or via appropriate collaboration


with the U.S. Commerce Department, OPIC, USAID, or the Millennium Challenge Corporation (MCC).

Crowding in Private Capital

Enterprise funds should be established in places where there is a liquidity gap between investment needs and access to finance or where funding can be transformational and additive to the current private equity market. Setting up enterprise funds in countries that have a strong private equity market would not be considered a significant value add, and therefore not as strategically beneficial. As mentioned, there are larger amounts of private capital now than in the 1990s and a growing need for investments and technical assistance in developing countries. In the case of Egypt, FDI to the country dropped to record lows following the Arab Spring, leading to a halt in capital investments for projects. The fund is jumpstarting private equity activity, an outcome that could be replicated in other developing countries.

Maintaining Flexibility

Enterprise funds should continue to have maximum flexibility in areas of strategic and operational decisionmaking. An independent entity with independent decisionmaking is more efficient and effective in achieving “desired results” and attracting the right private-sector talent to achieve its mission. The board of directors, especially the chairman, needs to be able to make quick and independent investment decisions without leaping through complicated bureaucratic hurdles.

Hiring Qualified Staff with Local Knowledge

There is a growing talent pool of investment professionals in developing countries. Many of them have been educated abroad and also possess strong country-specific expertise. When making hiring decisions, management should staff these funds with experienced professionals and, when possible, local talent to get greater buy in from the host country.

It is important to note that enterprise funds should not take a long time to set up and should avoid cumbersome bureaucratic processes. However, results will not happen overnight—progress will take time. Enterprise funds have to find creative, context-specific approaches to investing, and these take time to materialize. Enterprise funds are similar to building a business, and in this regard, a longer-term timeline is needed in order to see results.
An Updated Version of the Enterprise Funds Model

The lessons learned from the past waves of enterprise funds together with the changes that have taken place in the past 25 years necessitate updates to the enterprise fund model. A major innovative change to the enterprise fund model would be to allow impact investors to coinvest in enterprise funds, when launching the fund. This has the potential to both increase the amount of investments and leverage sectoral expertise in the host country.

Second, the performance of enterprise funds—and in particular what constitutes success—needs to be clearly defined beyond financial returns. It is true that enterprise funds are U.S. government money and thus accountable to the U.S. taxpayer. However, there needs to be a system in place that ensures regular reporting on the performance of enterprise funds in each host country beyond financials, which includes development impact parameters such as clients served, jobs created, and others (Box 2). The success of enterprise funds in host countries should not be an isolated event, but would spur additional investment, policy change and reform, and new economic sectors in an economy.

Enterprise funds should seek at least to return the original amount of money provided by the U.S. government and probably not expect full market returns, unlike traditional private equity. There could be two potential universes where enterprise funds can be of strategic value beyond financial returns: (1) a partial market return with social impact and foreign policy returns (e.g., building a stronger relationship with a country); and (2) zero market return but with substantial social impact and foreign policy returns.

Finally, it would be worth revisiting the sectors in which enterprise funds invest. For example, in some countries there may need to be a greater emphasis on infrastructure or energy rather than finance and education. However, the board should define the strategy of investments after a thorough review of the country’s economic needs. Also, it would be important to assess whether a regional approach would make sense for smaller countries. To achieve economies of scale, and provide peer pressure to its neighbors (e.g., a “neighborhood effect”), smaller countries could be grouped into a regional fund.

In summary, the following updates to the model are recommended:

- Allow impact investors to coinvest in enterprise funds to expand the pool of investments and bring in additional sectoral expertise to the country.
- Define success for enterprise funds (beyond financial returns) at the outset with key development performance measures such as clients served and jobs created.
- Consider critical sectors in which enterprise funds could invest and follow a regional approach for smaller countries to gain efficiencies.

Given these updates to the enterprise funds model, what set of criteria should be used to select countries? Where would the third wave of enterprise funds be launched? The next section provides an illustration of candidate countries.
Box 2: Enterprise Funds Performance: What Constitutes Success?

Under their grant agreements, enterprise funds are obligated to meet a series of reporting requirements that include a set of financial information (annual budget, annual reports, quarterly financial statements, reports on administrative expenses, and regular audits) and a performance-monitoring plan (PMP). The PMP contains a set of performance indicators (quantitative and qualitative) that measure results of an enterprise fund’s activities vis-à-vis established targets. Some proposed indicators of performance could include the following:

- **Job Creation**: Track the number of jobs created by enterprise fund investments. This metric should go beyond just the creation of direct jobs (those created directly by the enterprise fund’s support) to measure indirect jobs (jobs created as the result of support needs for direct jobs) and induced jobs (jobs created from spending by both of the above). Linking the enterprise fund’s operations to job creation could help capture more of its economic impact.

- **Foreign Investment**: Did the enterprise fund’s investment attract (or was it cited as a major reason for) additional or new foreign investments? The goal would be to create legacy and sustainability for new investments in the country.

- **Sector-Specific Indicators**: This would include clients served, houses built, and financial inclusion indicators, among others.

- **Improved Governance and Regulatory Environment**: Did the enterprise fund help improve the enabling environment for doing business? Did it create new regulations to improve the transparency of government and the private sector?
06 The Geography of the Next Wave of Enterprise Funds

CSIS conducted a country exercise to evaluate where the next generation of enterprise funds could be launched. The exercise seeks to assess which countries would be the most appropriate target markets for future enterprise funds given diverse strategies and objectives. As mentioned in the introduction, ultimately, a notional next round of enterprise funds would follow a political decisionmaking process. However, there are a series of threshold questions that any enterprise fund process should use when making these decisions. Our suggested questions are detailed in Box 3. This exercise offers U.S. policymakers a select list of possible countries to help inform their decision. This is a starting point—not an end in itself.

Box 3: Suggested Criteria for Selecting Enterprise Funds

There are certain criteria these countries had to meet in order to be selected for potential enterprise funds. First, each country is of geostrategic value to the United States or is a country in which enterprise funds can serve to broaden the reach of U.S development programs. Second, each is a country with funding gaps in terms of attracting capital for private-sector development, especially with regards to expanding small and medium-sized enterprises (SMEs). An enterprise fund can achieve a positive demonstration effect for potential investors and businesses based on a successful investment track record. Third, each is a country that does not have a sufficiently developed private sector. Finally, each country on the list possesses sufficiently developed local market conditions in which the enterprise funds would make financial returns and development impact; that is, they would have a higher likelihood of achieving the “dual mandate”. This is captured by the level of stability and degree of democracy in a country.

- **U.S. Geostrategic Interest**: Is the country mentioned in the U.S. National Security Strategy? What are the State Department’s priorities in the country, according to the U.S. Bilateral Factsheets?
- **U.S. Presence**: Does the United States have current engagement in the form of development activity from a U.S. government agency like MCC, USAID, or OPIC?
- **Financing Gaps**: Is there existing foreign investment? Is financing available for the private sector? What’s the level of banking and capital market development?
- **Private-Sector Development**: Is there a market economy? Is there a semblance of a private sector?
- **Stability**: Is the country stable or secure enough for the presence of U.S. private investors or representatives?
- **Governance**: Does the country have a democratic government?

As part of this report, CSIS identified six countries (and a region) that could be candidates for future enterprise funds based on a set of political, economic, and geostrategic criteria. The first group of candidates would be countries with geostrategic importance to the United States.
These are countries located in critical regions in terms of their political and military significance to the United States. These countries exert regional influence, are populous states transitioning to democracy, pose security risks/migration risks, or have significant U.S. military engagement. Given these criteria, in the short run, enterprise funds could be established in countries that are considered U.S. national security priorities and that have existing U.S. engagement in the form of a development program (through USAID, MCC, OPIC or Exim).

The second group of candidates would include countries that have significant migration challenges, that lack private capital and have weak private sectors. In the medium to long run, countries that would benefit from an enterprise fund would include those that are also important to the United States and where an enterprise fund could promote the private sector to create jobs in order to tackle migration challenges or serve as a counterbalance to Chinese influence.

In the short run, candidates for enterprise funds would primarily include countries in the Middle East region, including Jordan and Lebanon. These are important countries in terms of U.S. foreign policy goals, and an enterprise fund would be an added tool to further U.S. presence and relationship building. The United States has an “opportunity to catalyze greater economic and political cooperation that will expand prosperity for those who want to partner with us.” An enterprise fund, especially in conjunction with other existing U.S. development programs, could contribute to stability in the region through private-sector growth and job creation in countries that have a significant number of refugees and a large youth population.

Another geostrategic region for the United States is the Korean Peninsula. North Korea could also be a candidate country for an enterprise fund, if nonproliferation negotiations are successful. The international community and the United States have made several attempts to put an end to North Korea’s nuclear and missile proliferation. Most recently, President Kim Jong Un has signaled a willingness to begin negotiations with the signing of a joint statement between the presidents of the United States and North Korea on June 12, 2018. A successful negotiation outcome could open the door to increased U.S. engagement beyond humanitarian assistance. An enterprise fund along with other U.S. development programs could catalyze foreign investments that are so desperately needed in one of the poorest countries in the region.

In the medium run, a second category of candidates includes countries with significant youth populations and high migration rates that are important in terms of U.S. national security. In Latin America and the Caribbean, these include the Northern Triangle countries (El Salvador,

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Honduras, and Guatemala) and Haiti. In sub-Saharan Africa, Zimbabwe and Ethiopia would hold potential.

A Northern Triangle fund would help provide more stability and economic opportunity to a region riddled "with gangs and cartels that perpetuate violence and corruption." A regional fund would achieve economies of scale and attract large-scale investments. The Northern Triangle has grappled with high levels of crime, lack of jobs, and political instability. Within the Northern Triangle countries, Honduras is the most market-friendly economy and is open to U.S. engagement. Honduras could galvanize its two neighbors to enact pro-business reforms. The region needs stronger local markets, policy reforms, and more job opportunities domestically to prevent further youth migration to the United States.

In Haiti, the United States aims to spur economic growth, reduce poverty, improve healthcare and food security, and build stronger democratic institutions. Natural disasters, dire poverty, lack of infrastructure, and political volatility have propelled Haitians to leave the country via boats, mainly destined for the United States. The United States currently invests $377 million in foreign aid annually. An enterprise fund in Haiti would greatly bolster the local economy and allow Haitians to make more informed decisions that focus on real infrastructure needs like water quality, toilets, access to electricity, and roads. Every year, thousands of Haitians immigrate to the United States and an enterprise fund could be catalytic in bringing better economic opportunities for its population.

Finally, within sub-Saharan Africa, Zimbabwe and Ethiopia would also represent an opportunity for an enterprise fund. Zimbabwe holds promise, provided that there is an orderly democratic transition after the July 30, 2018 elections and significant economic reforms are undertaken. The United States is the largest provider of development and humanitarian assistance to the country. Zimbabwe is rich with natural resources and has a strong Chinese presence. Due to years of economic mismanagement, many Zimbabweans have emigrated from the country—primarily to other southern African countries, the United Kingdom, and the United States, creating a variety of challenges, including "brain drain, illegal migration, and human smuggling and trafficking." A challenge will be to entice expat Zimbabweans to come back and rebuild their country.

Ethiopia is one of the fastest growing economies in the world, with significant U.S. presence in terms of development programs and strong diplomatic ties. However, U.S. investments remain small (close to $600 million) relative to Chinese presence ($7 billion). Ethiopia also hosts a

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42 Ibid.
large share of refugees. Ethiopia’s economy is still heavily controlled by the state. However, the country’s Growth and Transformation Plan II (2015–2020) places a significant emphasis on private-sector development. The country’s banking and financial industry remains underdeveloped and an enterprise fund would help attract additional private capital to spur small and medium-sized enterprise (SME) growth.

These countries offer a starting point where enterprise funds could be set up. They provide an illustration of countries of geostrategic importance to the United States where enterprise funds could be established in the immediate future.

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43 Yayboke and Milner, Confronting the Global Forced Migration Crisis.
07 Conclusion

Enterprise funds were a U.S. foreign policy innovation when they were launched in the early 1990s. Overall, the enterprise funds program to date has been highly successful: these funds have been instrumental in creating a new investment industry in developing countries, bringing about changes in laws and regulations, and developing new economic sectors. Since their formation over 25 years ago, they have invested over $1.5 billion in strengthening the private sectors of developing countries, attracted billions in additional foreign investment, and generated significant proceeds that have been returned to the U.S. government.

Despite the success of two waves of enterprise funds, they remain an underutilized U.S. development tool. The financial and policy successes of enterprise funds deserve to be scaled and replicated. Yet, the new enterprise funds model needs some updates to reflect the changing needs of the twenty-first century. The developing world is different than it was 25 years ago: most countries have some level of a functioning private sector, the global private equity industry is more sophisticated, and there is greater private capital available for development impact. Over the years, the U.S. government and its partners have gained significant experience in creating and managing enterprise funds. Moreover, technology has impacted the way consumers purchase goods, pay for taxes and services, and access finance.

Enterprise funds complement other U.S. development efforts and should be part of a broader U.S. response to a new set of challenges that the world faces today. Rising forced migration, a youth bulge in developing countries, and China’s influence in development finance are some of the emerging global issues. These trends present an opportunity for the United States to authorize a third wave of enterprise funds to provide stability, to help spur private-sector growth, and create jobs in developing countries.

Now is an appropriate time to launch the next wave of enterprise funds. Setting up a third wave of enterprise funds could improve economic conditions in key strategic countries to the United States. Developing countries seek deeper relationships with the United States that go beyond foreign aid to include trade, investments, and innovation. Enterprise funds can be one important avenue for building that partnership.
ANNEX: A Brief History of Enterprise Funds

The First Wave of Enterprise Funds

The U.S. Congress established the first wave of enterprise funds after passing the Support for Eastern European Democracy (SEED)\(^{45}\) Act of 1989 and the Freedom for Russian and Emerging Eurasian Democracies and Open Markets (FREEDOM)\(^{46}\) Support Act\(^{47}\) of 1992. These pieces of legislation led to the establishment of enterprise funds throughout the former Soviet Union, Central and Eastern Europe, the Baltics, and Central Asia in the early 1990s. The authorized funding for enterprise funds ranged from as high as $255 million in the Polish-American Enterprise Fund (PAEF) to as low as $30 million for the Albanian-American Enterprise Fund (AAEF) (Table 1).

**Table 1: First Wave of Enterprise Funds of the 1990s**

<table>
<thead>
<tr>
<th>Name</th>
<th>Year</th>
<th>Country</th>
<th>Capital ($ in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Polish-American Enterprise Fund (PAEF)</td>
<td>1990</td>
<td>Poland</td>
<td>255</td>
</tr>
<tr>
<td>Hungarian-American Enterprise Fund (HAEF)</td>
<td>1990</td>
<td>Hungary</td>
<td>73</td>
</tr>
<tr>
<td>Czech and Slovak-American Enterprise Fund</td>
<td>1991</td>
<td>Czech Republic, Slovakia</td>
<td>65</td>
</tr>
<tr>
<td>Bulgarian-American Enterprise Fund (BAEF)</td>
<td>1991</td>
<td>Bulgaria</td>
<td>58</td>
</tr>
<tr>
<td>Baltic-American Enterprise Fund (BalAEF)</td>
<td>1994</td>
<td>Latvia, Estonia, Lithuania</td>
<td>50</td>
</tr>
<tr>
<td>Romanian-American Enterprise Fund (RAEF)</td>
<td>1994</td>
<td>Romania</td>
<td>61</td>
</tr>
<tr>
<td>Central Asian-American Enterprise Fund (CAAEF)</td>
<td>1994</td>
<td>Kazakhstan, Turkmenistan, Tajikistan, Uzbekistan, Kyrgyzstan</td>
<td>106</td>
</tr>
<tr>
<td>Western New Independent States Enterprise Fund (WNISEF)</td>
<td>1994</td>
<td>Ukraine, Moldova</td>
<td>150</td>
</tr>
<tr>
<td>The U.S. Russia Investment Fund (TUSRIF)</td>
<td>1995</td>
<td>Russia</td>
<td>329</td>
</tr>
<tr>
<td>Albanian-American Enterprise Fund (AAEF)</td>
<td>1995</td>
<td>Albania</td>
<td>30</td>
</tr>
<tr>
<td><strong>USG Authorized Funding of Enterprise Funds</strong></td>
<td></td>
<td><strong>TOTAL</strong></td>
<td><strong>1,177</strong></td>
</tr>
</tbody>
</table>


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Creating Jobs, Attracting Foreign Capital, and Returning Money to the U.S. Government

Enterprise funds create jobs, attract additional foreign capital, and return taxpayer money back to the U.S. government. During the first wave of enterprise funds in the 1990s, the U.S. government invested roughly $1.2 billion in 10 enterprise funds across 18 countries. According to USAID, by 2013 coinvestments with the private sector provided an additional $6.9 billion of capital—a significant multiplier effect on the funds appropriated to enterprise funds. Moreover, these investments resulted in the creation of an estimated 300,000 jobs in the region. Unlike any other U.S. government program, these investments generated positive returns and allowed the funds to leverage their existing funding to reinvest $1.7 billion of the net proceeds from investments. In addition, these enterprise funds returned $225.5 million to the U.S. Treasury with the remaining proceeds used to create nine separate "legacy institutions" with a cumulative endowment of $1.3 billion.48,49

A Novel Approach to Development: Getting It Right

During the first wave of enterprise funds, the U.S. government and USAID had no experience with private equity and venture capital funds in emerging markets, and did not set clear expectations about how the success of a fund should be evaluated.51 As a result, USAID did not include a set of indicators to measure performance aside from basic financial reporting requirements. In broad terms, the main objective of enterprise funds was to help fill investment gaps and spur the private sector in central and eastern European countries transitioning from centrally planned economies to market economies. Over time, these objectives evolved into a "double bottom line" (or "dual mandate"): (1) to promote economic development in host countries; and (2) to serve as an example that it is possible to invest profitably and transparently in countries in transition.52

Though the general objectives were established, there was no clear definition for development, which later proved problematic because—unlike the straightforward manner for measuring financial returns—USAID’s definition of development varied by enterprise fund agreement. This made it difficult to have an objective metric or standard for development across different enterprise funds. For example, one agreement defined successful development as the “completion of a wide array of transactions that develop and strengthen financial markets in the country” and another defined it as “conduct[ing] activities intended to further investment.”53 By not setting up a consistent definition and standard across funds, it became challenging to provide a clear explanation as to why certain funds exceeded expectations while others did poorly.

49 Ibid.
The Importance of a Strong Management Team

USAID’s inexperience with equity investments had a silver lining. USAID granted a large degree of autonomy to the boards of directors and management teams of enterprise funds, which consisted of investment professionals with extensive private-sector experience. This proved vital to the success of many of the early enterprise funds and remains one of the most important components of the enterprise fund model: allowing seasoned investment professionals to quickly direct U.S. government funding to investments that foster economic development without political or bureaucratic constraints. Indeed, this continues to be an integral component of the Egyptian- and Tunisian-American enterprise funds, which operate as autonomous organizations led by qualified individuals with deep insight and expertise into local markets.

Enterprise funds that succeeded included qualified management teams that established an understanding of the local market, pursued calculated risks with due diligence, and helped improve corporate governance standards among their investees. For example, the Albanian-American Enterprise Fund (AAEF), with only $30 million in capital, played a transformational role in the country’s economic development by helping to establish banks and start up vital services that previously did not exist. Some would argue that the biggest returns from the most successful enterprise funds were not financial but rather the legacies of the ongoing private capital investment in that countries.

In the aftermath of the Cold War, it could be argued that the former Soviet states were friendly and welcoming of a U.S. presence, and it was relatively easy to send seasoned U.S. investors to host countries to help privatize state-owned companies. Now, the countries that could most benefit from enterprise funds might not welcome an explicit U.S. presence.

The Second Wave of Enterprise Funds

The Arab Spring that began in 2010 launched the second wave of enterprise funds in Tunisia and Egypt to address the underlying economic issues that helped drive these political uprisings.

Egyptian-American Enterprise Fund

From the outset, the Egyptian-American Enterprise Fund (EAEF) faced a set of unique challenges due to delays in funding from the U.S. Congress and tense relations between the United States and Egypt, whose government was initially distrustful of a U.S.-funded, independent entity doing business in Egypt. As a result, EAEF realized that an organization managed by Egyptians and on-the-ground partners was critical to building trust and penetrating the local market. After signing its grant agreement in March 2013, the EAEF made one of its most important decisions when it seeded a local management company to serve as its investment adviser and asset manager in Egypt. This asset manager sources investment opportunities, oversees the EAEF’s portfolio companies, and will continue to do business in Egypt long after the fund is liquidated. The EAEF also put Egyptians at the forefront of its operations by appointing a board of directors and

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management team composed mainly of Egyptians and Egyptian-Americans with in-depth knowledge of Egypt’s public and private sectors.

In the beginning, the EAEF realized that in order to scale its investments and reach millions of Egyptians, it would have to overcome Egypt’s weak financial services sector in which only 1 in 3 Egyptians have access to a bank account.\(^{55}\) To expand access to finance and help grow Egypt’s economy, EAEF made the promotion of financial inclusion one of its key mandates. As a result, EAEF’s first two investments were in Sarwa Capital, a consumer finance company, and Fawry, an electronic payments platform, which have expanded access to finance to millions of Egyptians and thousands of SMEs. To multiply its impact, the EAEF also seeded two new venture capital funds. These funds invest in SMEs and entrepreneurs, which are critical to creating jobs in Egypt. As of December 2017, the EAEF has invested $130 million in Egyptian businesses and attracted an additional $130 million in FDI.\(^{56}\)

**Tunisian-American Enterprise Fund**

While the Tunisian-American Enterprise Fund (TAEF) experienced little anti-U.S. sentiment, it did face other obstacles, such as crony capitalism and bureaucratic red tape. Similar to the EAEF, TAEF’s mission is to support the Tunisian economy following the Tunisian revolution by expanding economic and employment opportunities throughout the country. To catalyze investments and promote broad economic growth, TAEF strengthens SMEs, improving prospects for sustainable growth. The TAEF is projected to inject a total of $100 million into the Tunisian economy; to date it has disbursed or committed $38 million.\(^{57}\) The main sectors that the TAEF focuses on include: small to mid-cap traditional and family-owned SMEs; high-growth start-ups; and large-cap SMEs.\(^{58}\) The TAEF is expected to be active in Tunisia through 2028 (ten years after the last $20 million investment), followed by a period of investment management and fund wind down.


\[^{58}\text{Ibid.}\]
About the Authors

Daniel F. Runde is senior vice president, director of the Project on Prosperity and Development and holds the William A. Schreyer Chair in Global Analysis at CSIS.

Romina Bandura is a senior fellow with the Project on Prosperity and Development at CSIS.