



SigmaBleyzer

Where Opportunities Emerge.

2002: A Ukrainian Odyssey

Is it time to invest?

February 21, 2002

Calgary

Michael Bleyzer

SigmaBleyzer, IPCTF and The Bleyzer Foundation

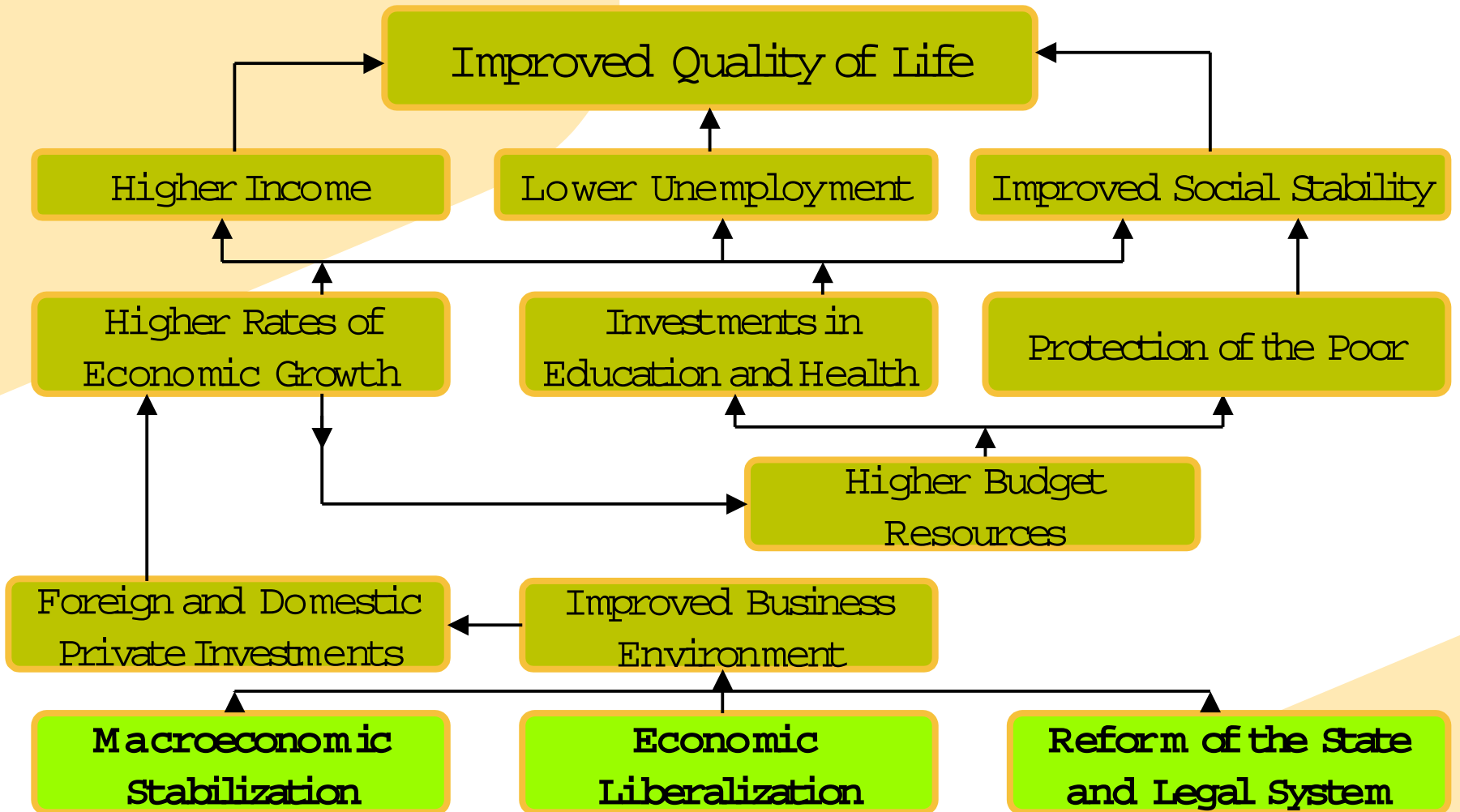
- US company managing one of the premier Ukrainian Investment Banking groups
- Three Private Equity Funds in FSU, with focus on Ukraine
- Ten years experience in Ukraine
- Investors include: International Investors, Institutions, and high net worth individuals / families
- Ukrainian Growth Funds (UGF) – over \$100 million under management
- Investments in over 70 Ukrainian companies
- Substantial experience in managing and restructuring companies
- Significant number of successful exits
- Significant Ukrainian infrastructure
- Leadership in International Private Capital Task Force (IPCTF)
- The Bleyzer Foundation – Ukrainian / International NGO

Transition to Market Economy

	Centrally Planned Economy	Transition Economy	Market Economy
Decision Making	Centralized	Chaotically Decentralized	Mainly Decentralized
Sources of Savings for Investments	The State	Initially, without domestic savings, source is principally foreign capital, and primarily debt.	Savings of Individuals and Corporations (Retained Earnings)
Coordination	Compulsory Plans, Overly Restricted	Weak State and Inefficient Markets	Primarily Market, but with some State Regulation
Ownership	The State	State, Legally Private, Semi-Private, and Shadow	Primarily Private
Incentives:	None, Collective Success	Money	Individual Success

Every Transition Economy has to start being a capital importer. With successful reforms it hopes to become a capital exporter.

Why Transition?



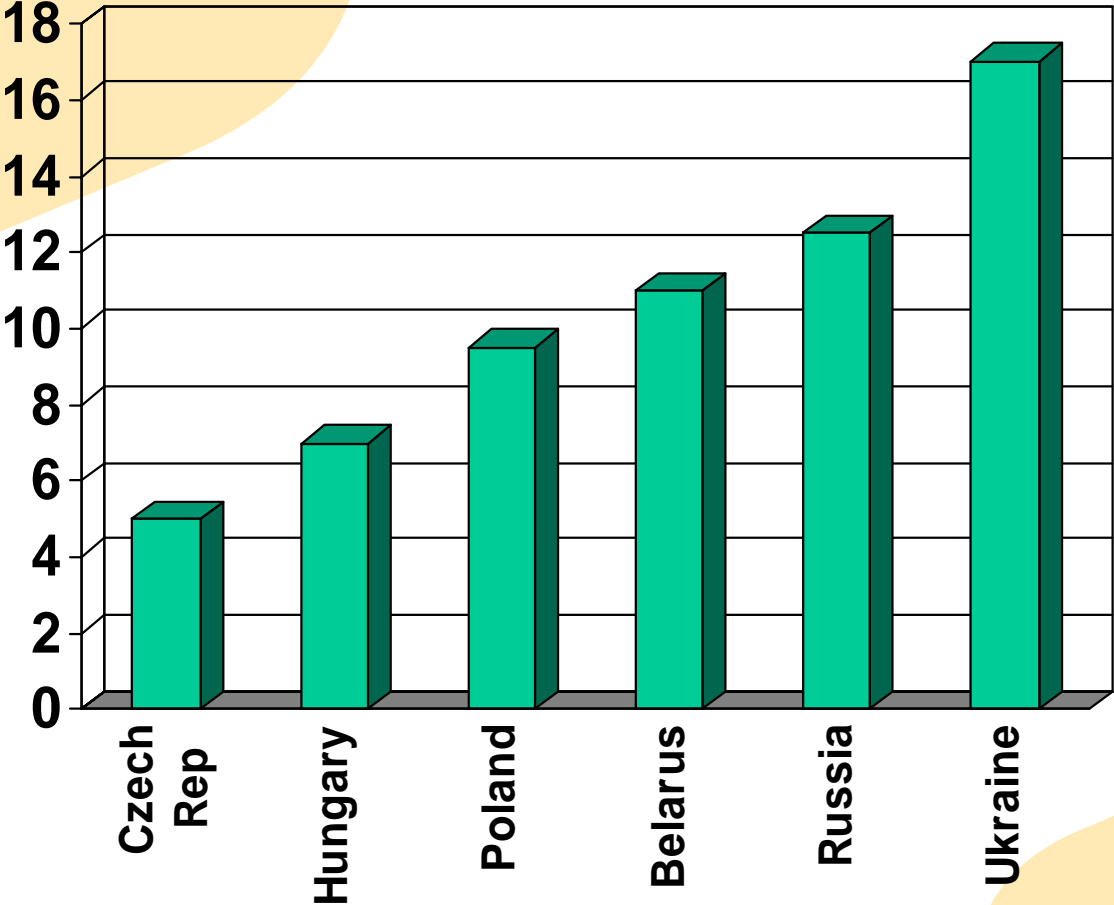
How to Finance Transition?

- Debt (foreign, public, private, domestic)
- From Debt to Equity
 - Successful Transition Economies attract private equity capital
- Effects of Private Equity Investment
 - Fundamental change in the structure of economy
 - Reduction of government's role and responsibility
 - Promotion of healthy sustainable businesses
 - Increased tax revenue base
 - Happy and prosperous taxpayers

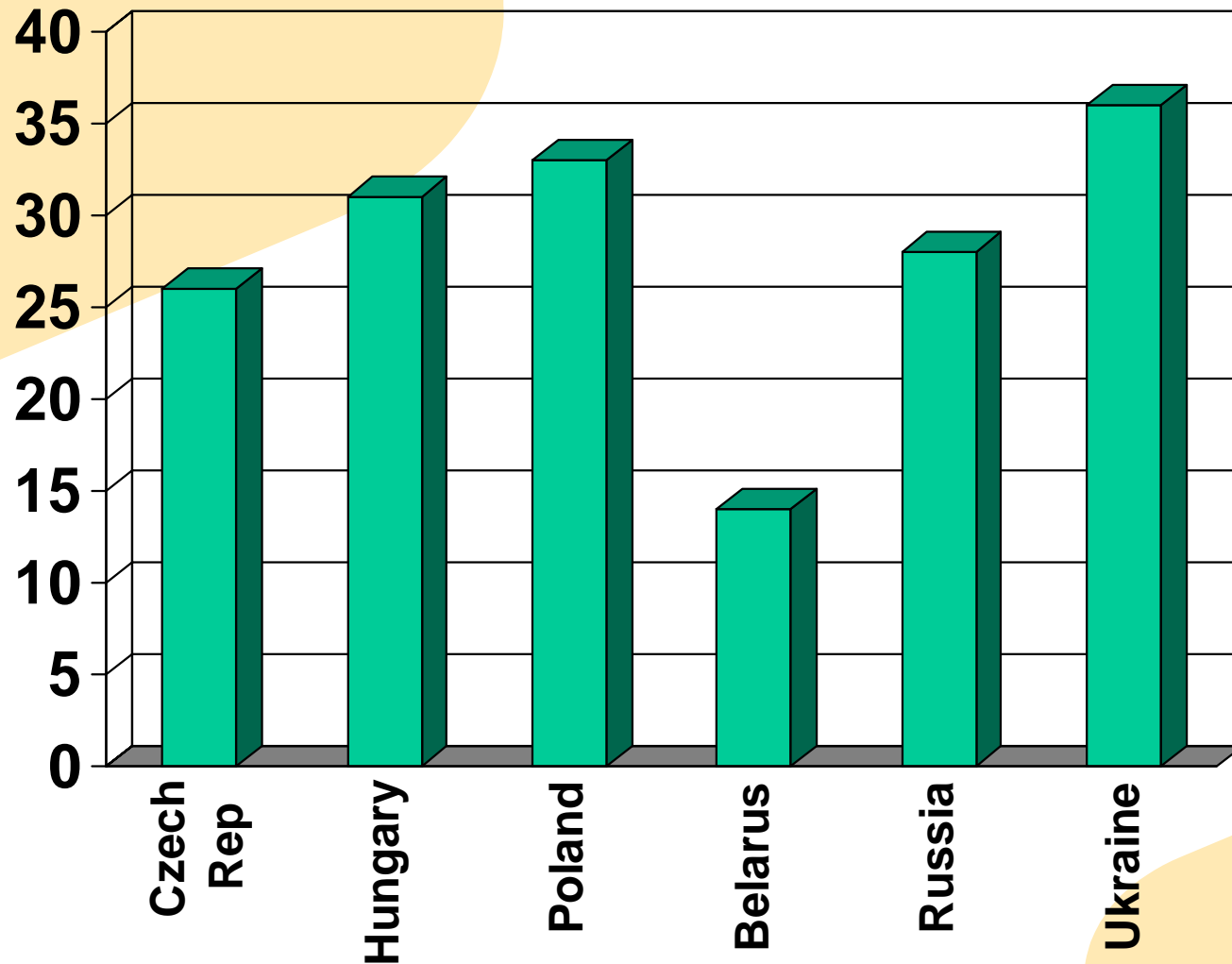
Capital Market Lessons

- **What other countries have done:**
 - Simplified investment process
 - Created legal framework and protection that is fair and uniform
 - Reduced taxes to increase tax base!
 - Created climate of transparency
 - Rules of the game made clear and stable
 - Protected and clarified shareholder rights
 - Reduced administrative barriers
- **These countries have attracted hundreds of billions of dollars in investment!**
- **Capital –friendly environment is a must for transition economies!**

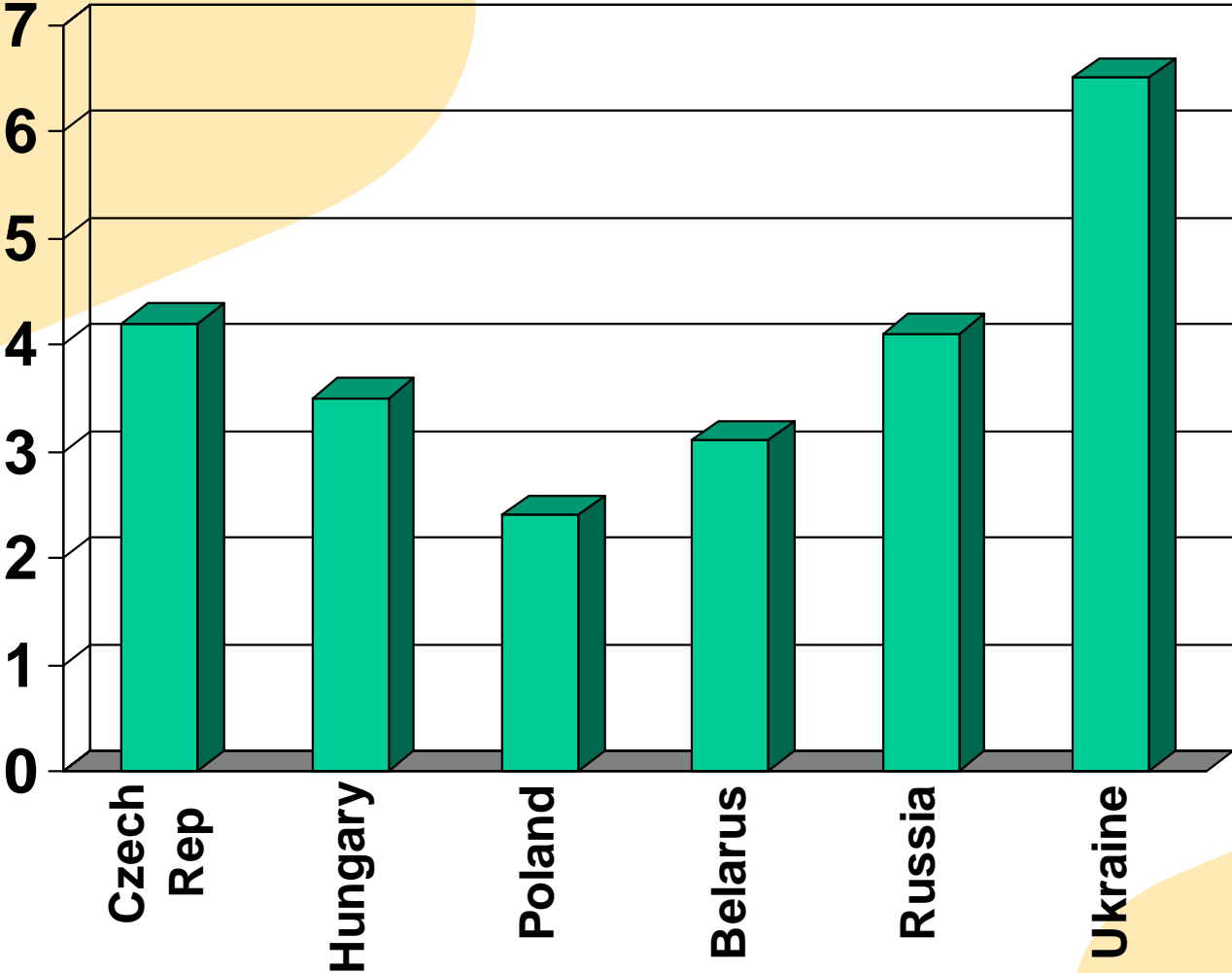
Management Time for “Regulatory” Issues (%)



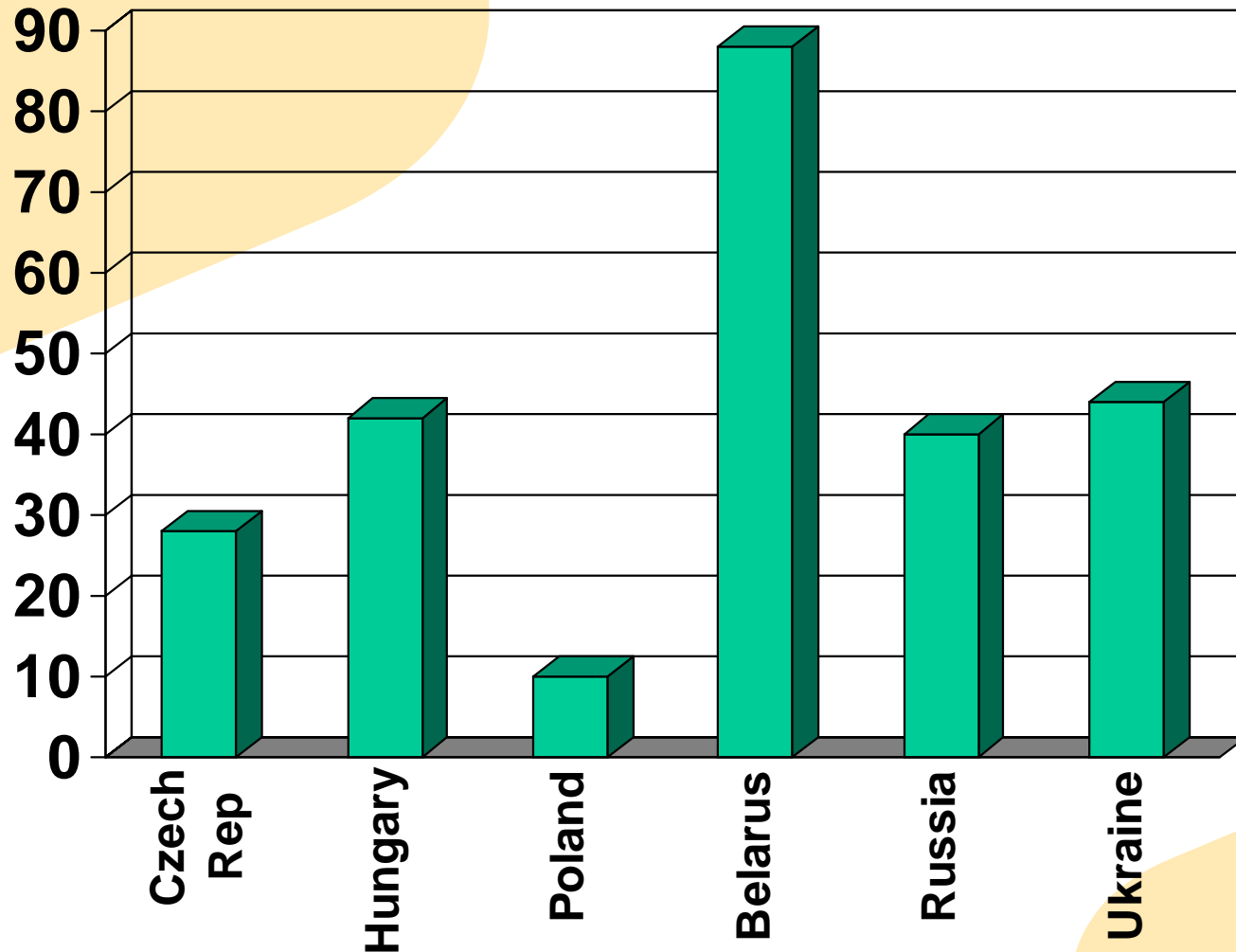
Percentage of Firms Bribing “Frequently” or More



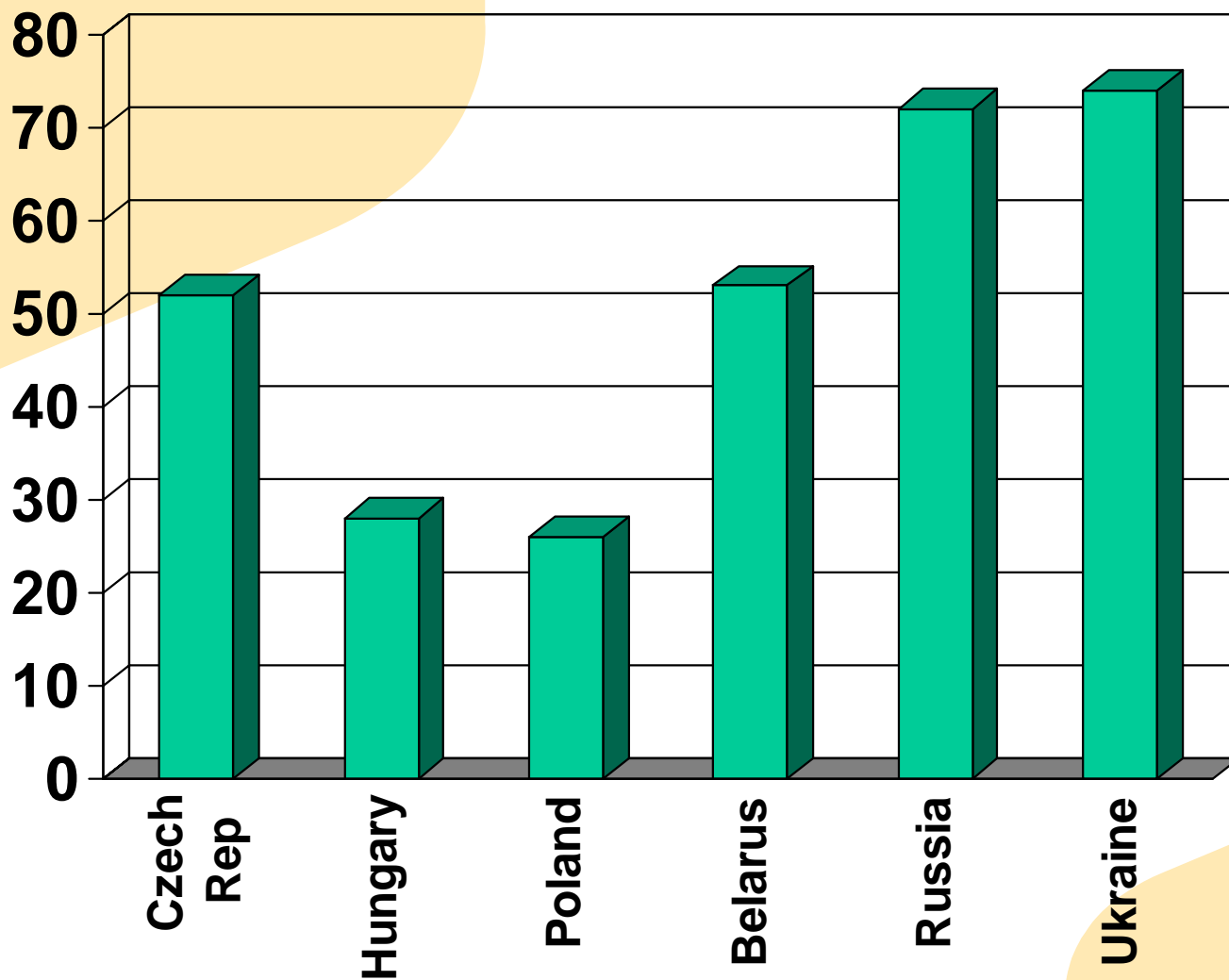
Cost of Bribes as a Percentage of Revenues



Percentage of Firms Reporting State Interventions in Enterprise Pricing Decisions



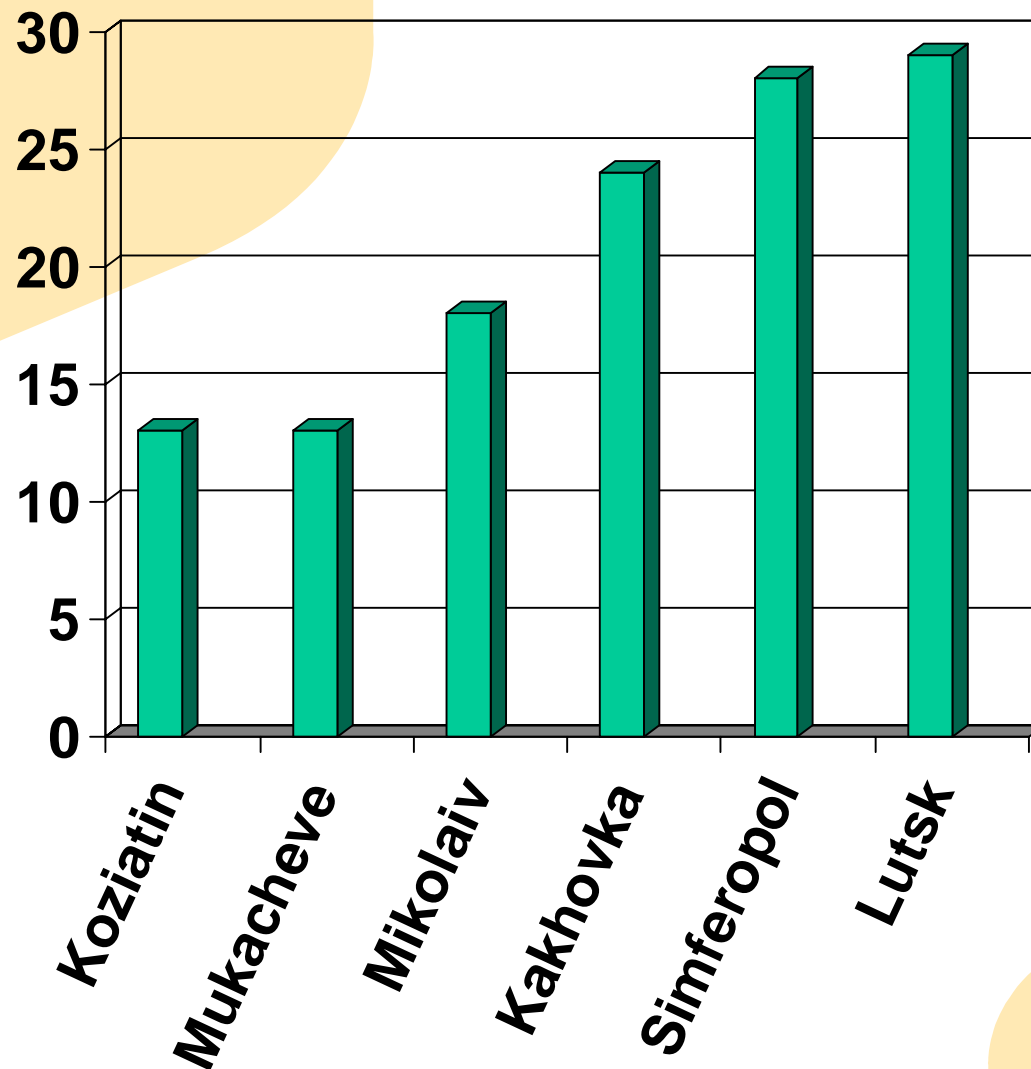
Percentage of firms insecure in their property and contract rights



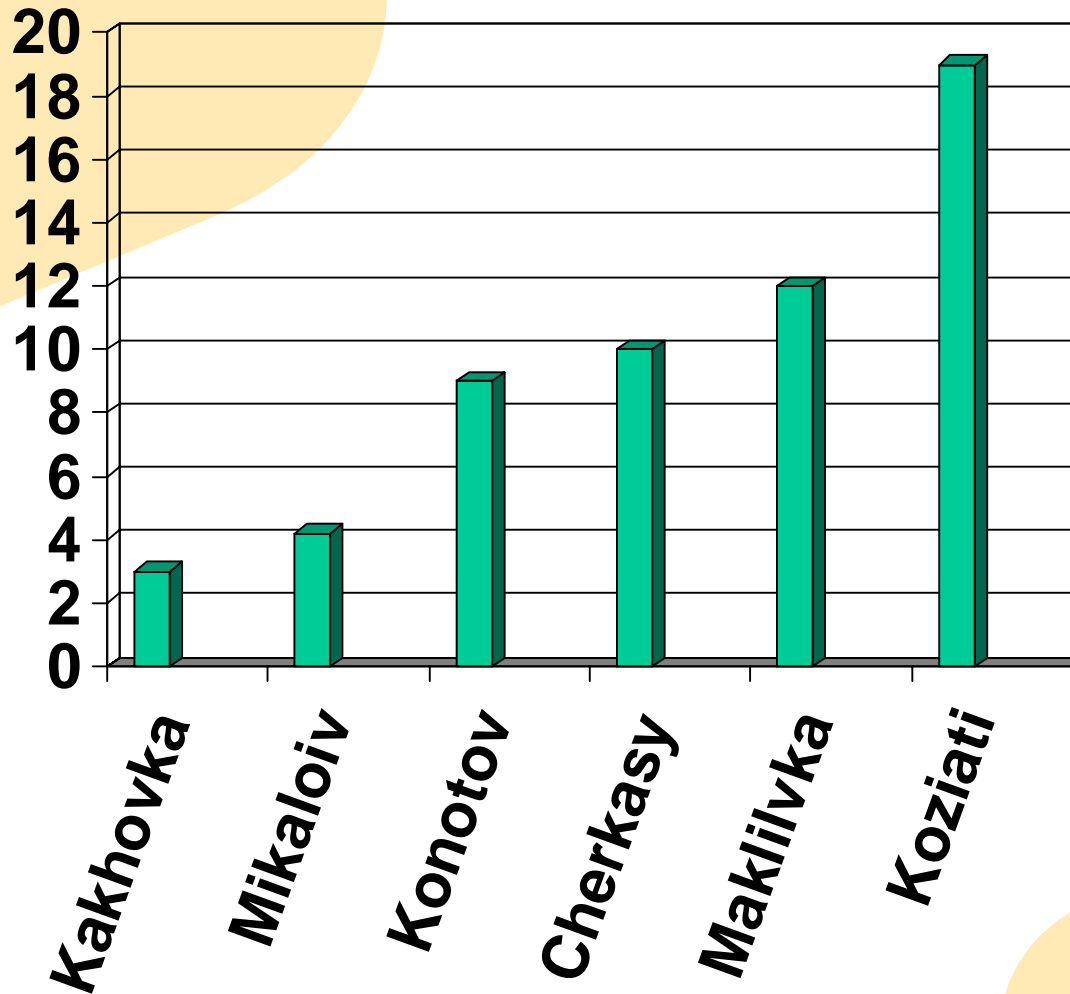
Good News!

- Significant variations in business climate among different cities, towns, regions in Ukraine
- Local governments play a major role in creating and maintaining favorable business and investment climate
- Identifying best practices, benchmarking, quantifying the consequences may help a lot

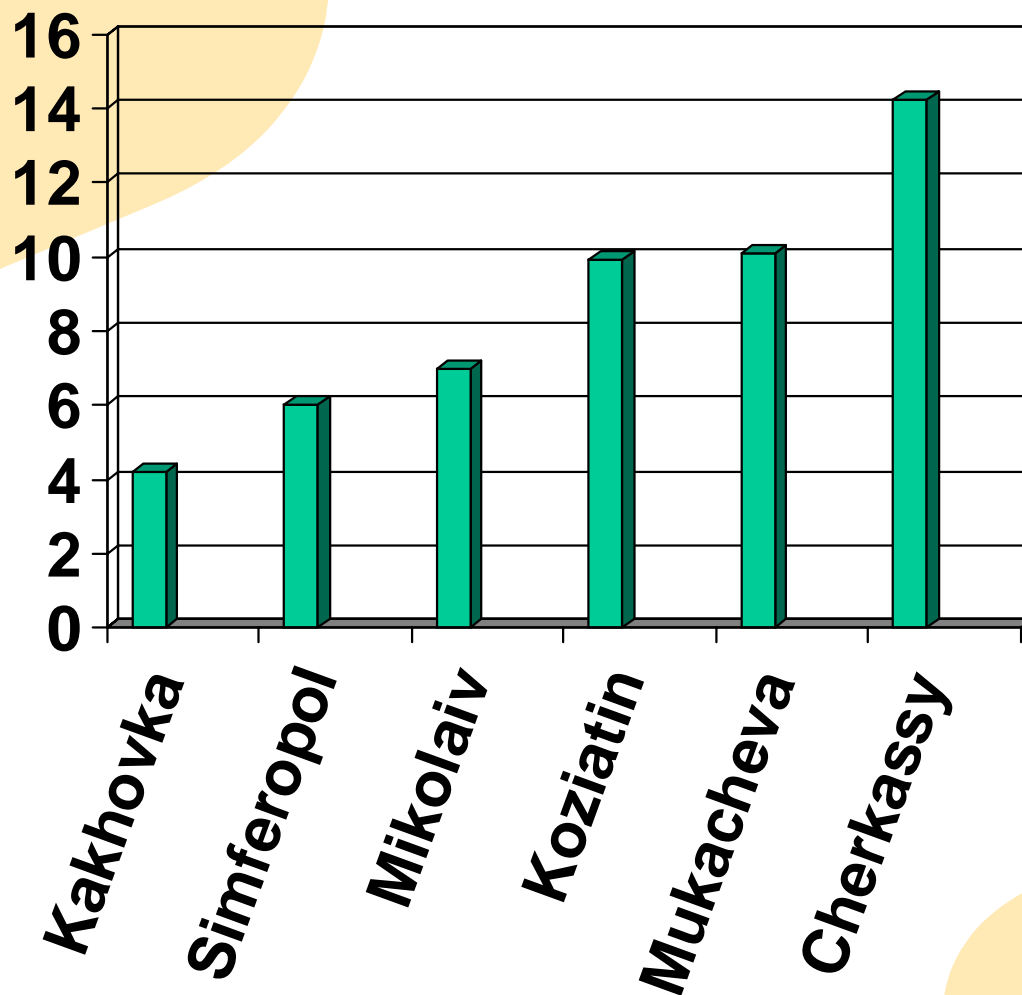
Average Time to Obtain a License (days)



Unofficial Types of Permits/Permissions



Average Number of Inspections per enterprise per year



Identifying the Best Practices

- SigmaBleyzer launched its first effort to identify best practices in government policies in transition economies in 1999
- Thunderbird Corporate Consulting Group led by Professor Krishna Kumar was retained to benchmark selected countries and build an econometric model of a transition economy based on the key drivers identified through benchmarking and statistical analysis
- The International Private Capital Task Force (IPCTF) was launched in 1999
- In 2000 SigmaBleyzer continued developing IPCTF framework and in 2001 hired a group of graduating Oxford MBAs to expand IPCTF framework to all FSU countries

International Private Capital Task Force (IPCTF) Ukraine, 2000 - 2001

- Ukrainian economy has performed very well in the last two years
- But foreign investment continues to decline
- The country remains unstable
- Major increase in investment flows is necessary to sustain long-term growth and achieve stability
- IPCTF effort objective: Benchmark transition economies to identify best practices in government policies, which improve investment climate and attract private capital

IPCTF Steering Committee

Private Companies: AGCO, SigmaBleyzer, Coca Cola, Citibank, Commerzbank, Credit Lyonnais, FMI, PricewaterhouseCoopers, Leo Burnett, DuPont.

Agencies: EBRD, IMF, IFC, USAID, European Commission, World Bank, US Embassy, American Chamber of Commerce, International Center for Strategic Studies, Harvard Institute for International Development.

Benchmarked Countries

- Argentina
- Chile
- Hungary
- Poland
- Russia
- Ukraine

Countries Included in Statistical Analysis

Angola, Argentina, Armenia, Azerbaijan, Belarus, Bolivia, Botswana, Bulgaria, Burkina Faso, Cameroon, Chile, Colombia, Costa Rica, Croatia, the Czech Republic, Ecuador, Egypt, El Salvador, Estonia, Ethiopia, Ghana, Hungary, India, Indonesia, Jordan, Kazakhstan, Kenya, Lithuania, Malawi, Moldova, Morocco, Mozambique, Nigeria, Peru, Philippines, Poland, Romania, Russia, Senegal, Slovak Republic, South Africa, Tanzania, Tunisia, Turkey, Uganda, Ukraine, Venezuela, Vietnam, Zambia, and Zimbabwe.

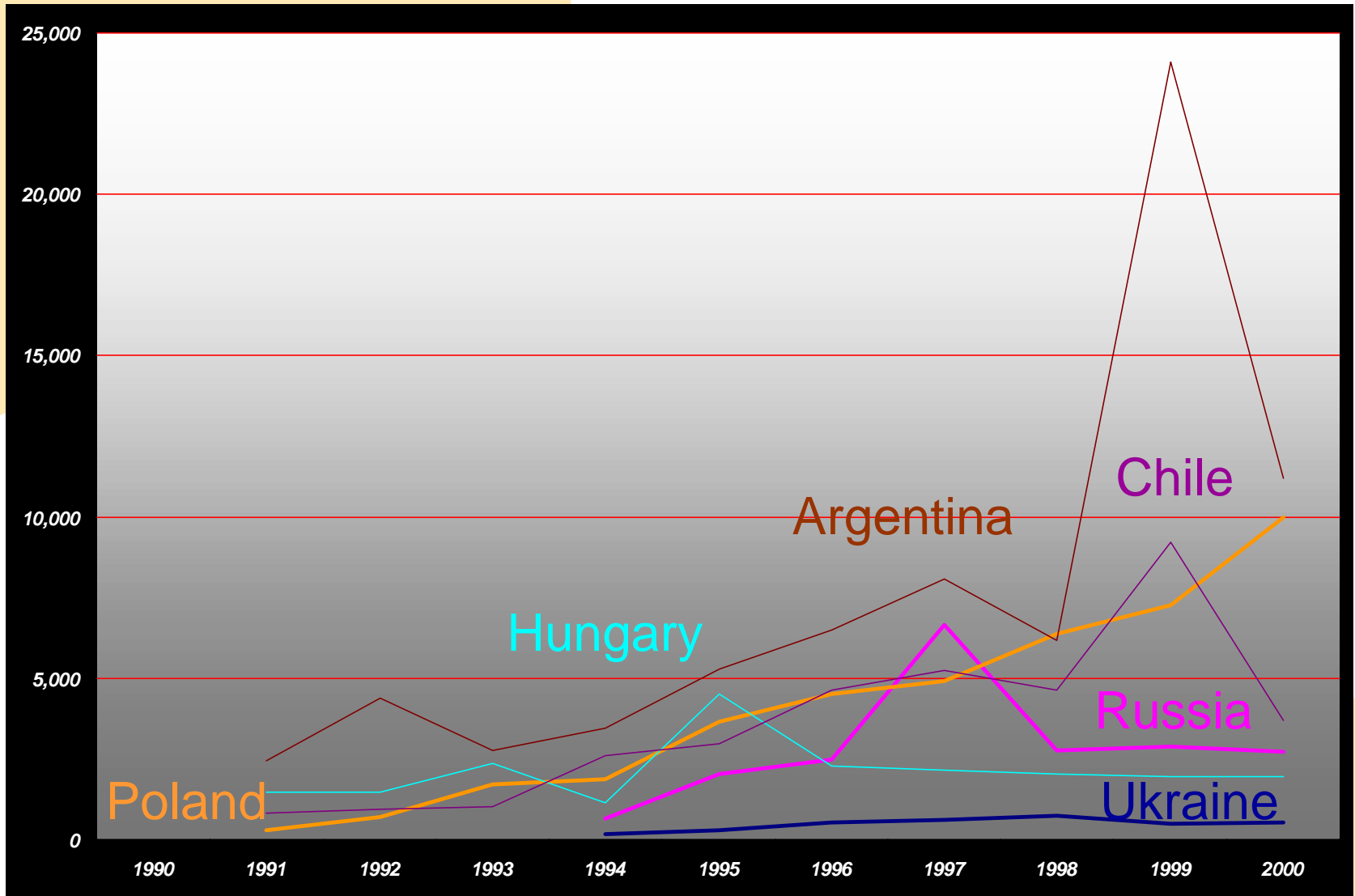
Private Equity (FDI) - the Most Stable Source of International Financing

Net Capital Flows to Emerging Markets (in US Dollar billions)

	<u>1984-89</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
Total Net Int'l Private Capital	12	141	189	224	126	45	71	32
- Foreign Direct Investment	13	81	97	120	145	149	153	146
- Portfolio Flows	4	110	43	85	43	24	54	58
- Commercial Bank Loans	-5	-50	50	19	-62	-127	-136	-172
Official Assistance	26	4	12	1	23	45	3	1

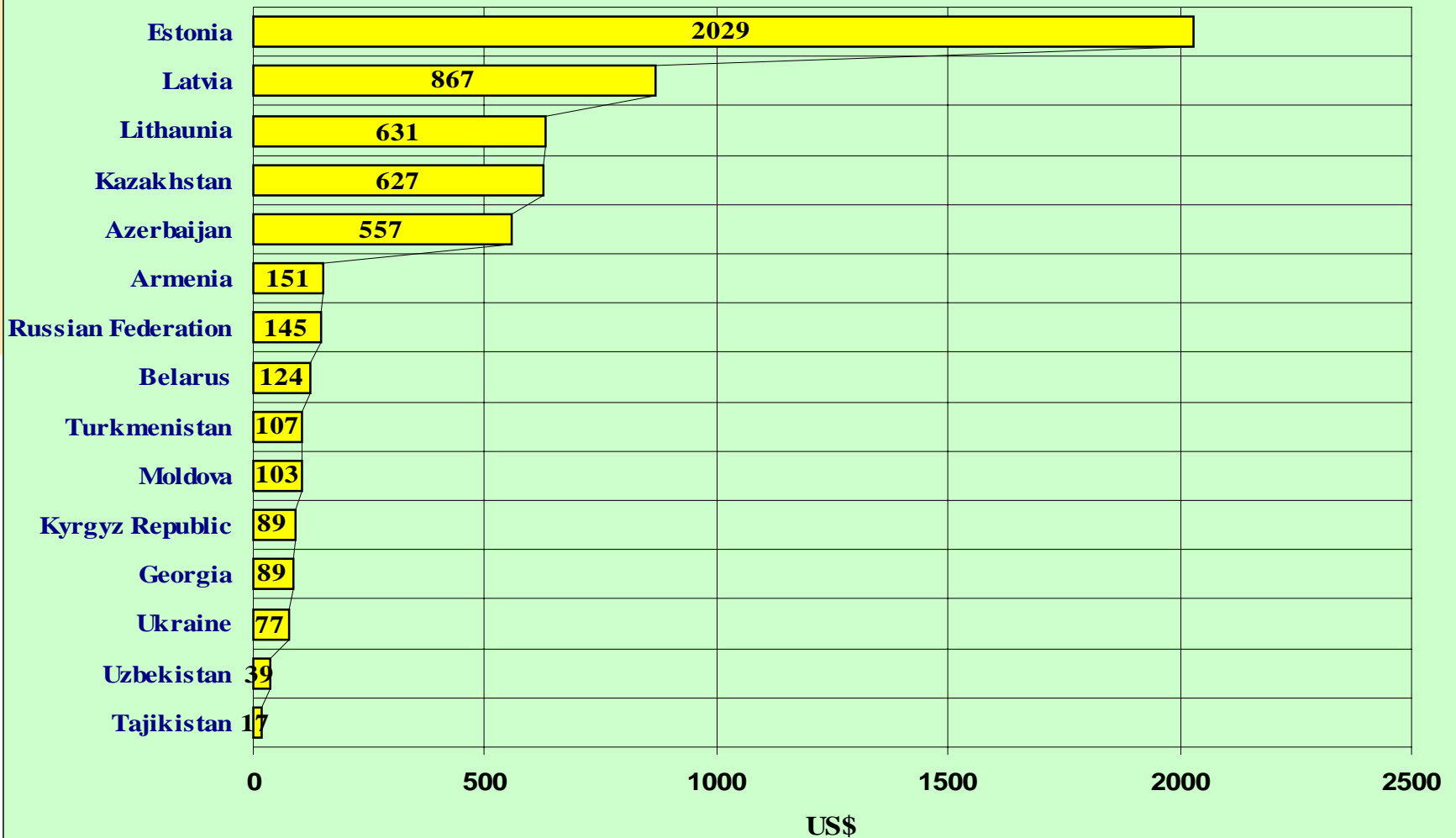
Source: IMF, August 2001

Foreign Direct Investments – Selected Countries (in millions of US Dollars)



Cumulative FDI per Capita

Cumulative FDI per Capita to FSU Countries, 2000



Key Drivers / Policy Action Groups

- ***The study pre-condition is macroeconomic stabilization, resulting from sound fiscal and monetary policies.***
- Study identified the following key government policy actions, which stimulated foreign direct investments in successful transition economies:
 - 1. Liberalize and De-Regulate Business Activities**
 - 2. Provide a Stable and Predictable Legal Environment**
 - 3. Enhance Governance & Reform Public Administration**
 - 4. Remove International Capital & Trade Restrictions**
 - 5. Facilitate Financing of Businesses**
 - 6. Eliminate Corruption**
 - 7. Reduce Political Risks (non-economic country risks)**
 - 8. Expand Country Promotion**
 - 9. Rationalize Investment Incentives**

Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
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Business Liberalization Score

18	49	87	80	89	62
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Legal Environment Score

17	62	99	93	89	65
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Financial Sector Score

10	39	62	68	74	39
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Governance and Privatization Score

29	30	89	82	80	65
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Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
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Political Risk Score

65	49	83	82	71	75
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International Capital Controls & Foreign Trade Score

63	45	78	79	84	69
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Corruption Score

15	21	41	52	74	35
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Governmental Promotional Effort Score

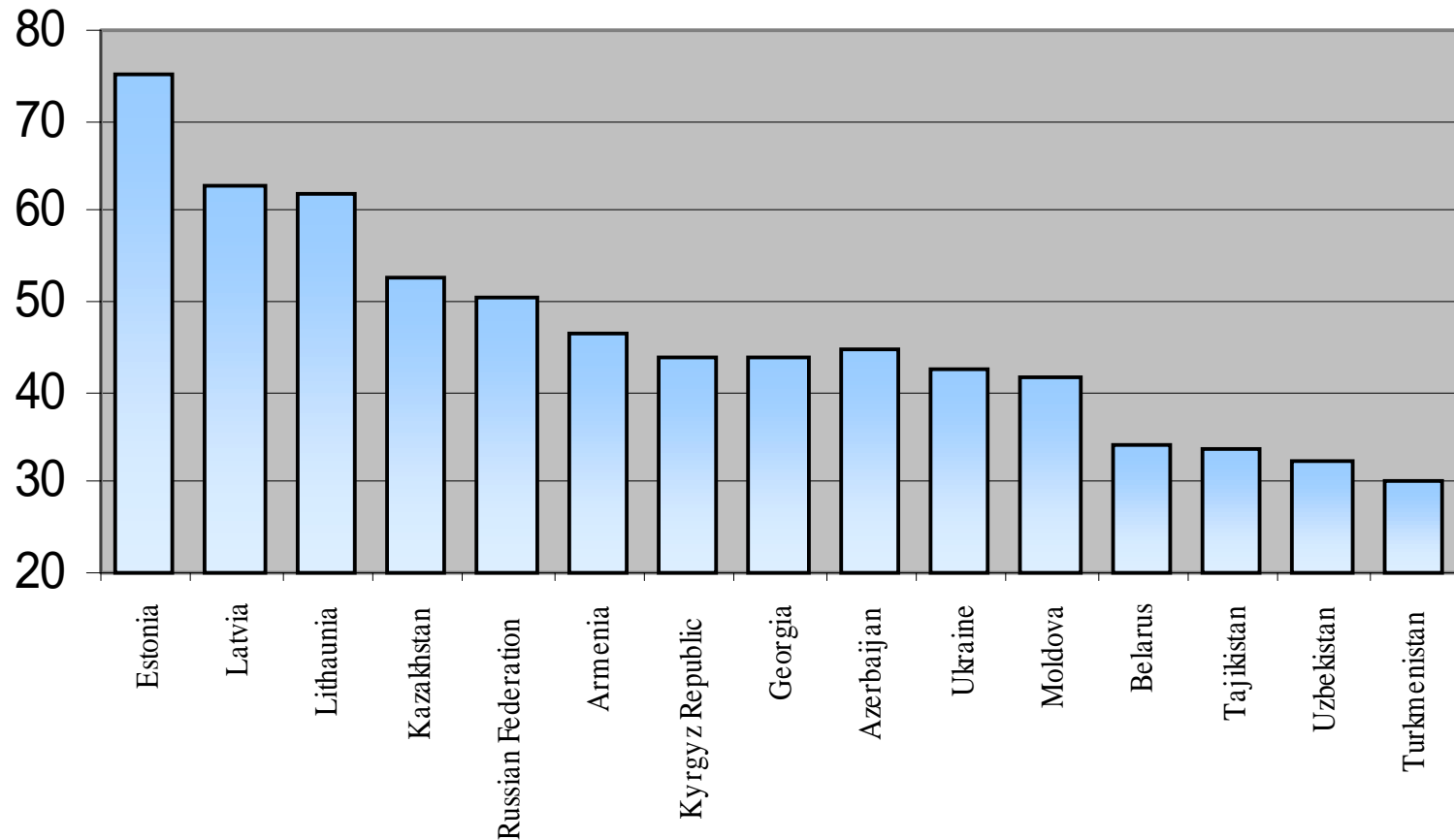
20	30	80	100	90	75
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Tax and Investment Incentives Score

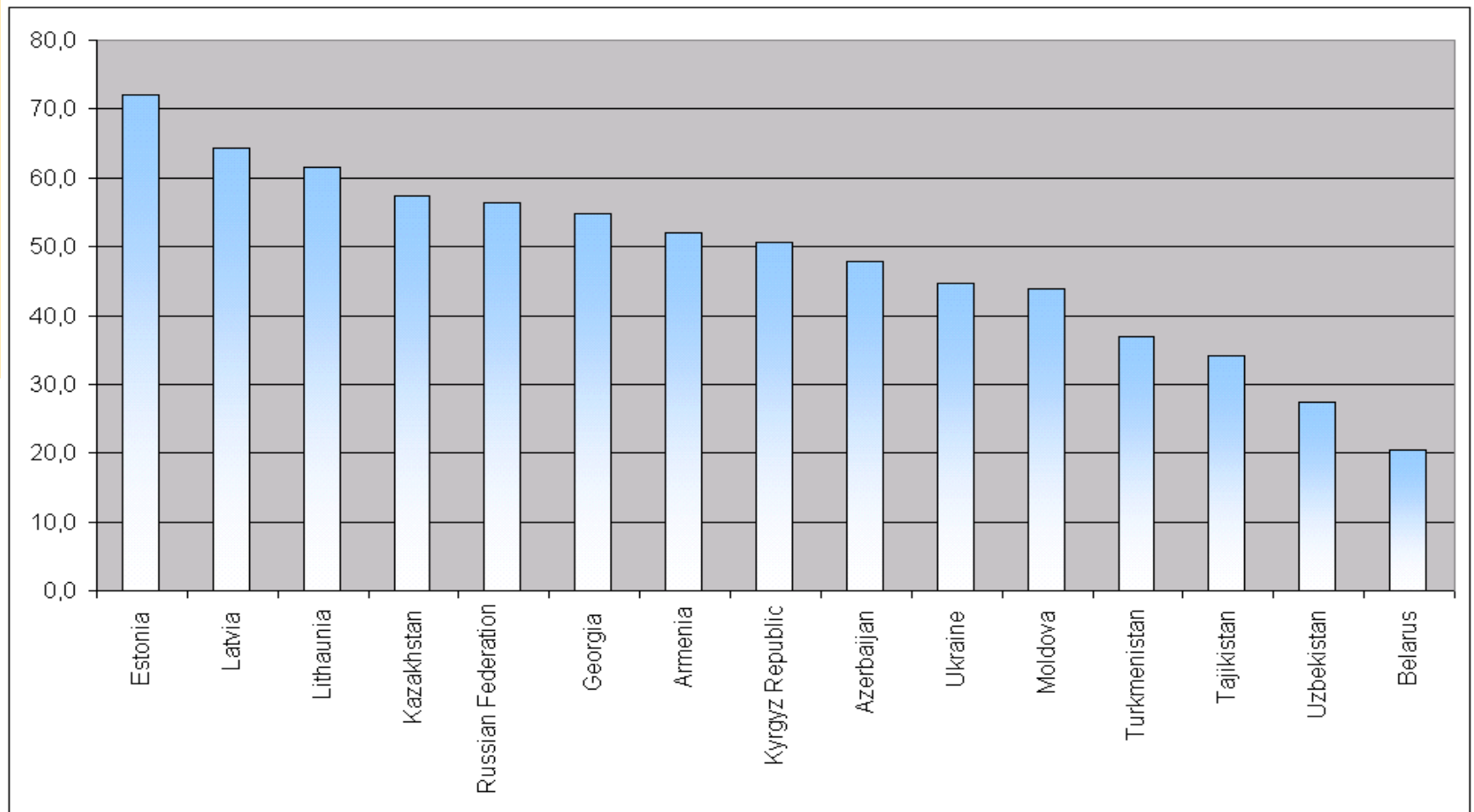
31	48	78	82	63	70
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IPCTF Ratings Reveal Major Policy Differences

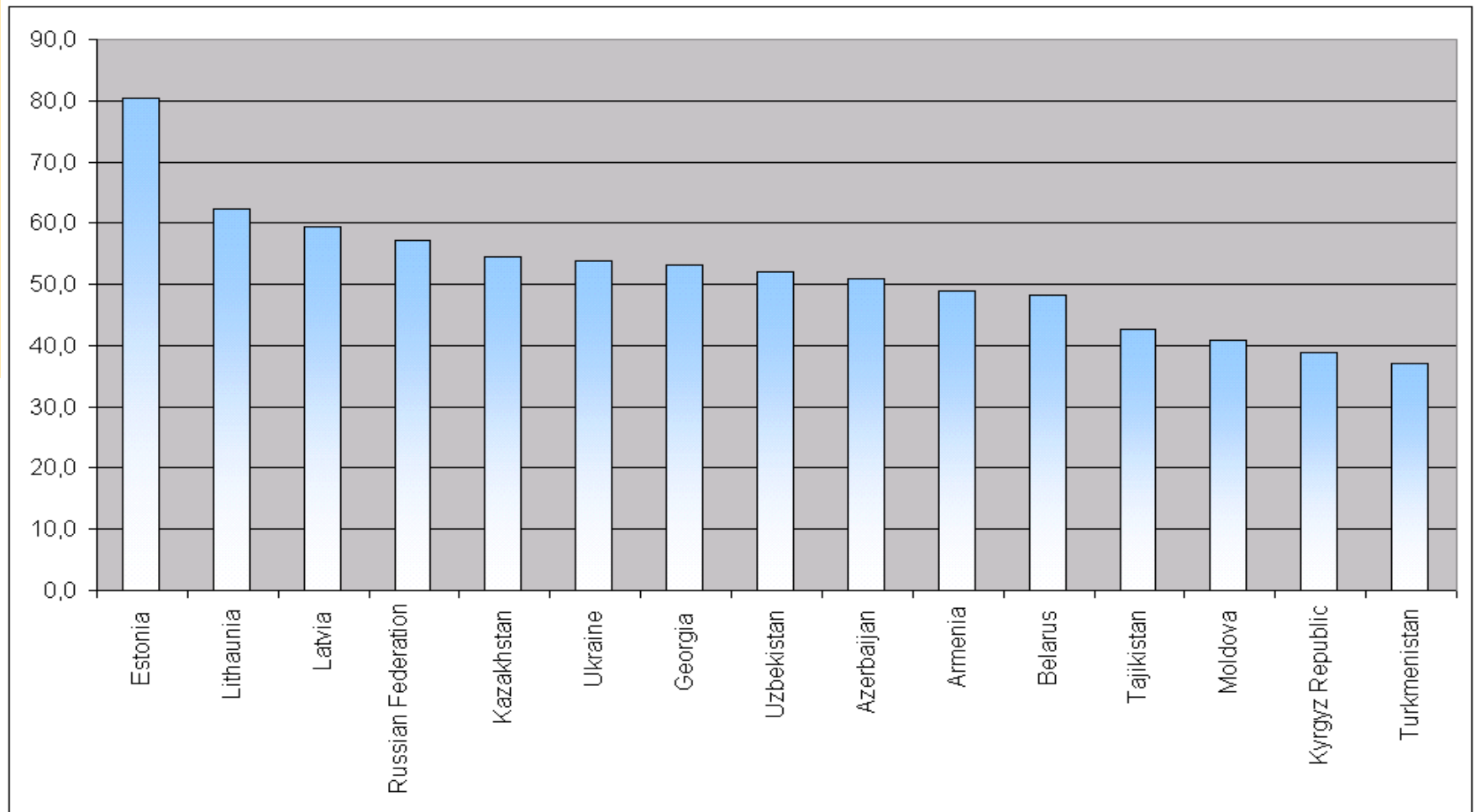
Average Ratings for FSU Countries



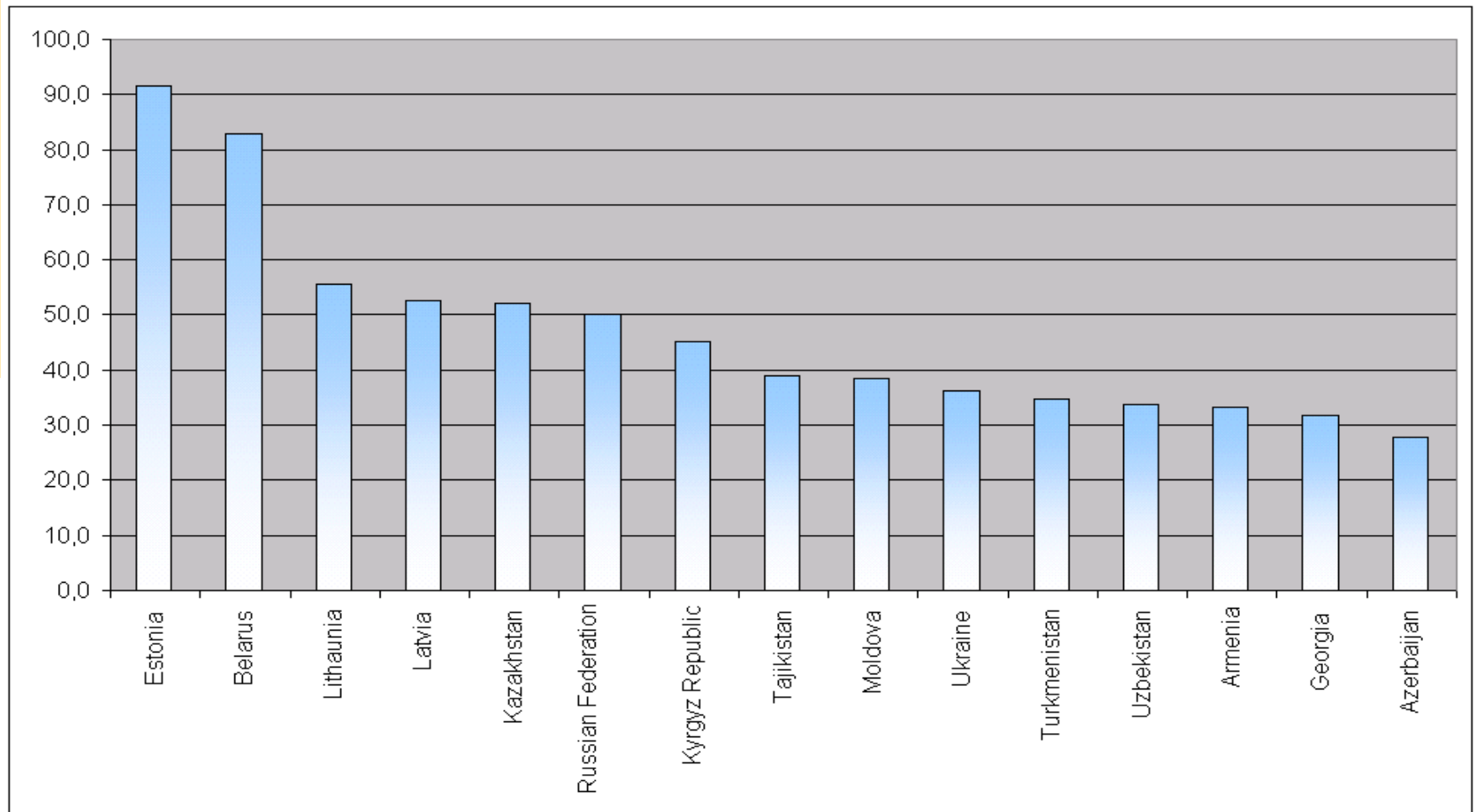
IPCTF Ratings: Business Liberalization



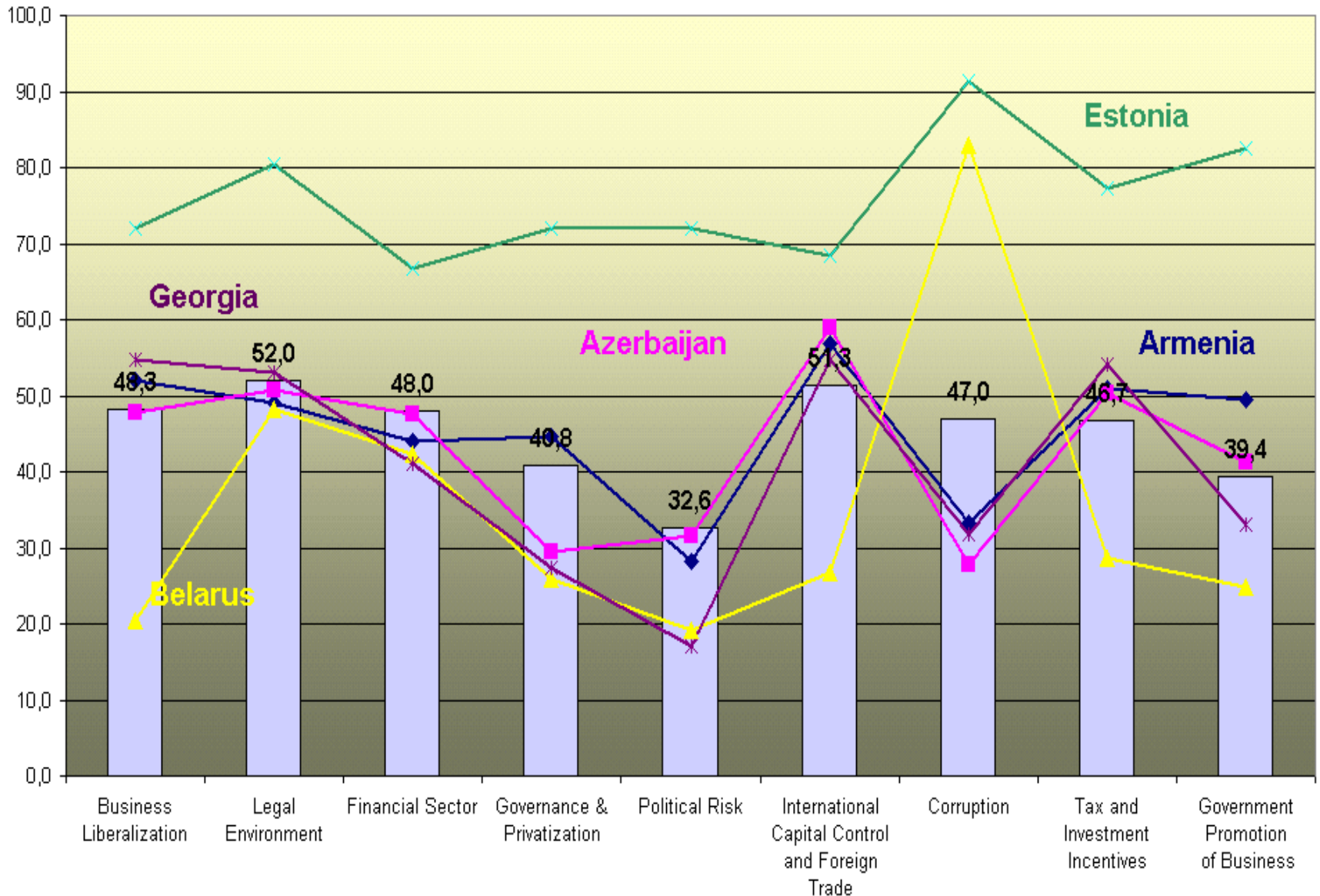
IPCTF Ratings: Legal Environment



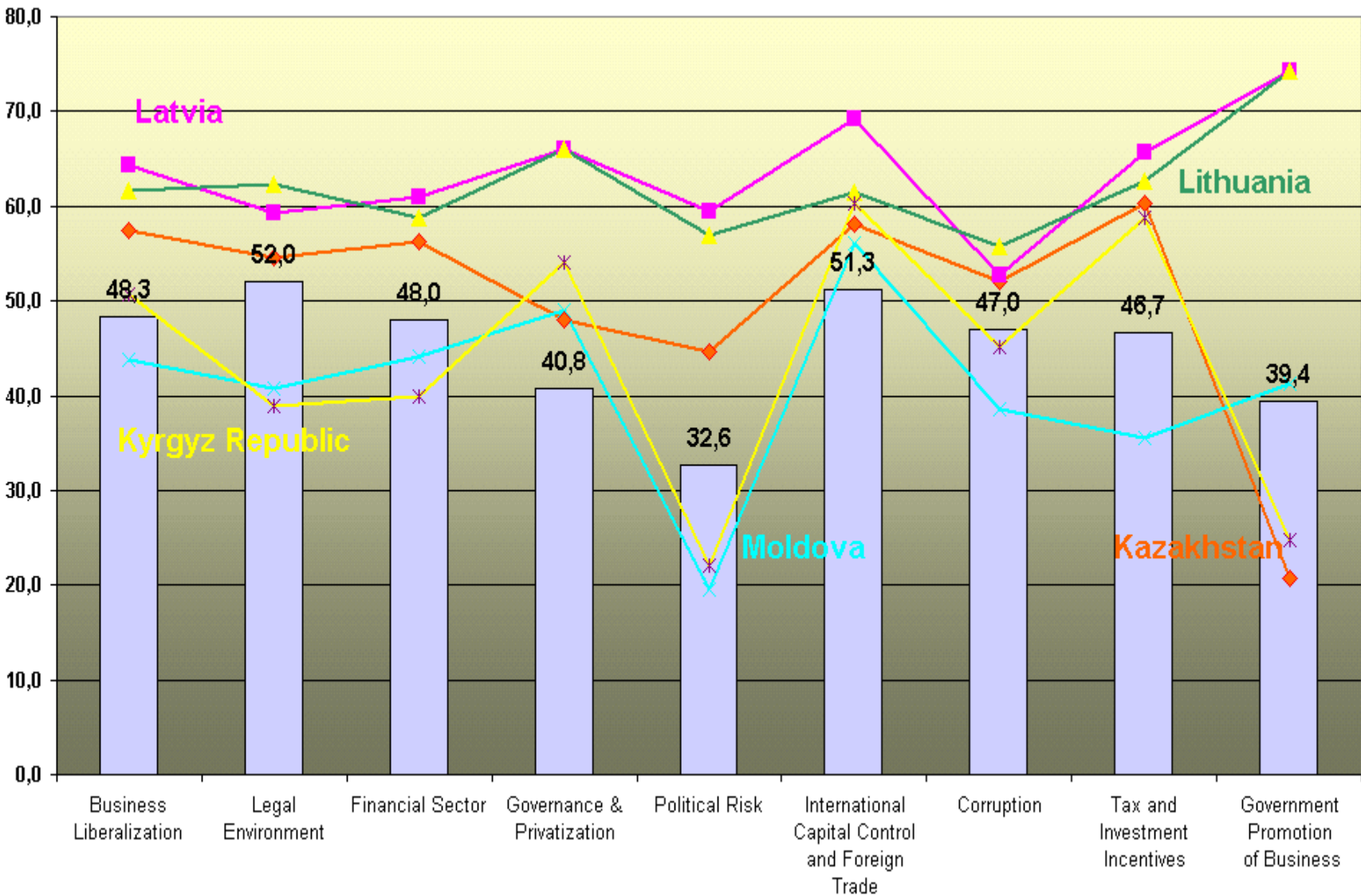
IPCTF Ratings: Corruption



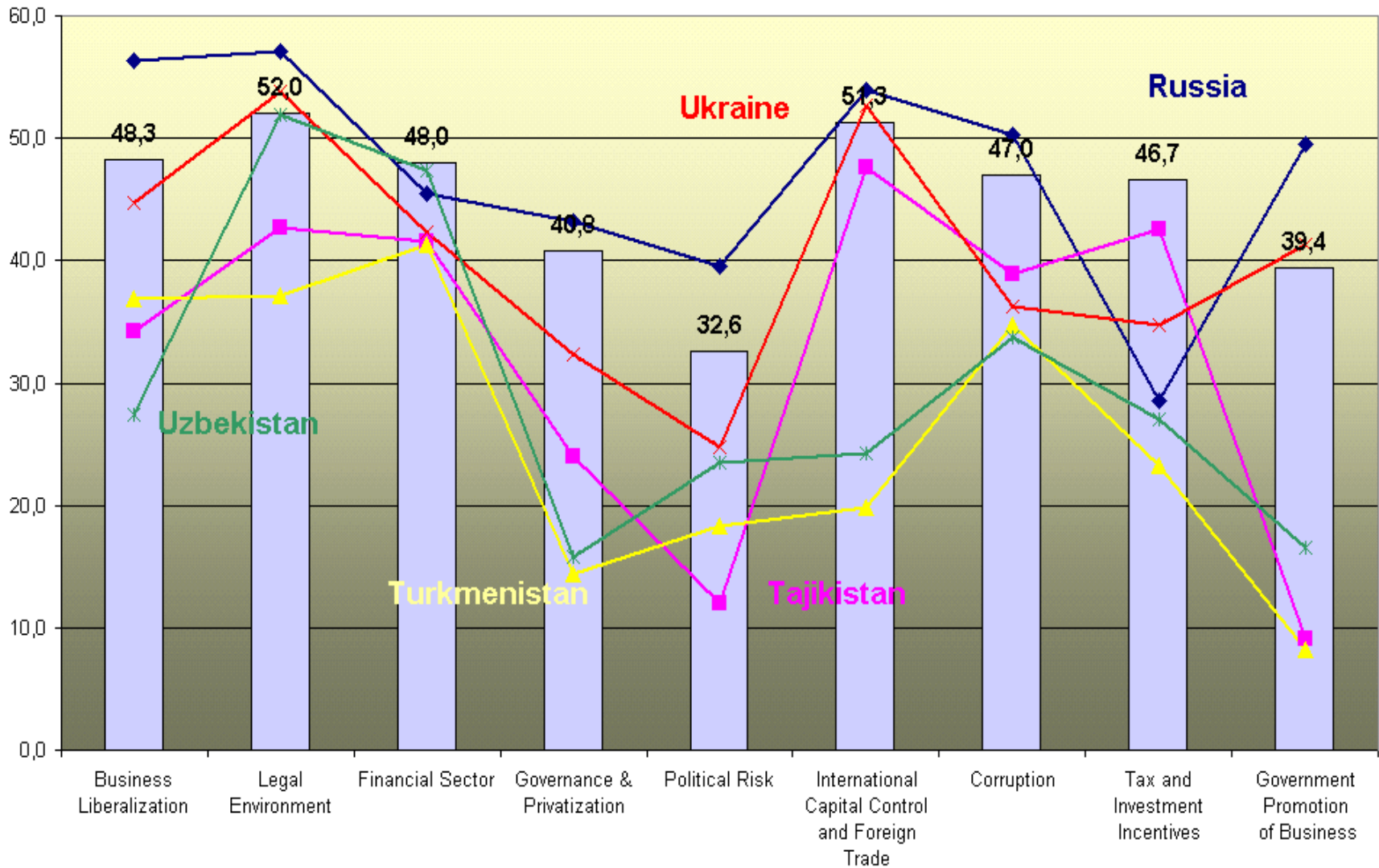
Benchmarking Analysis for FSU Countries, 2000-2001



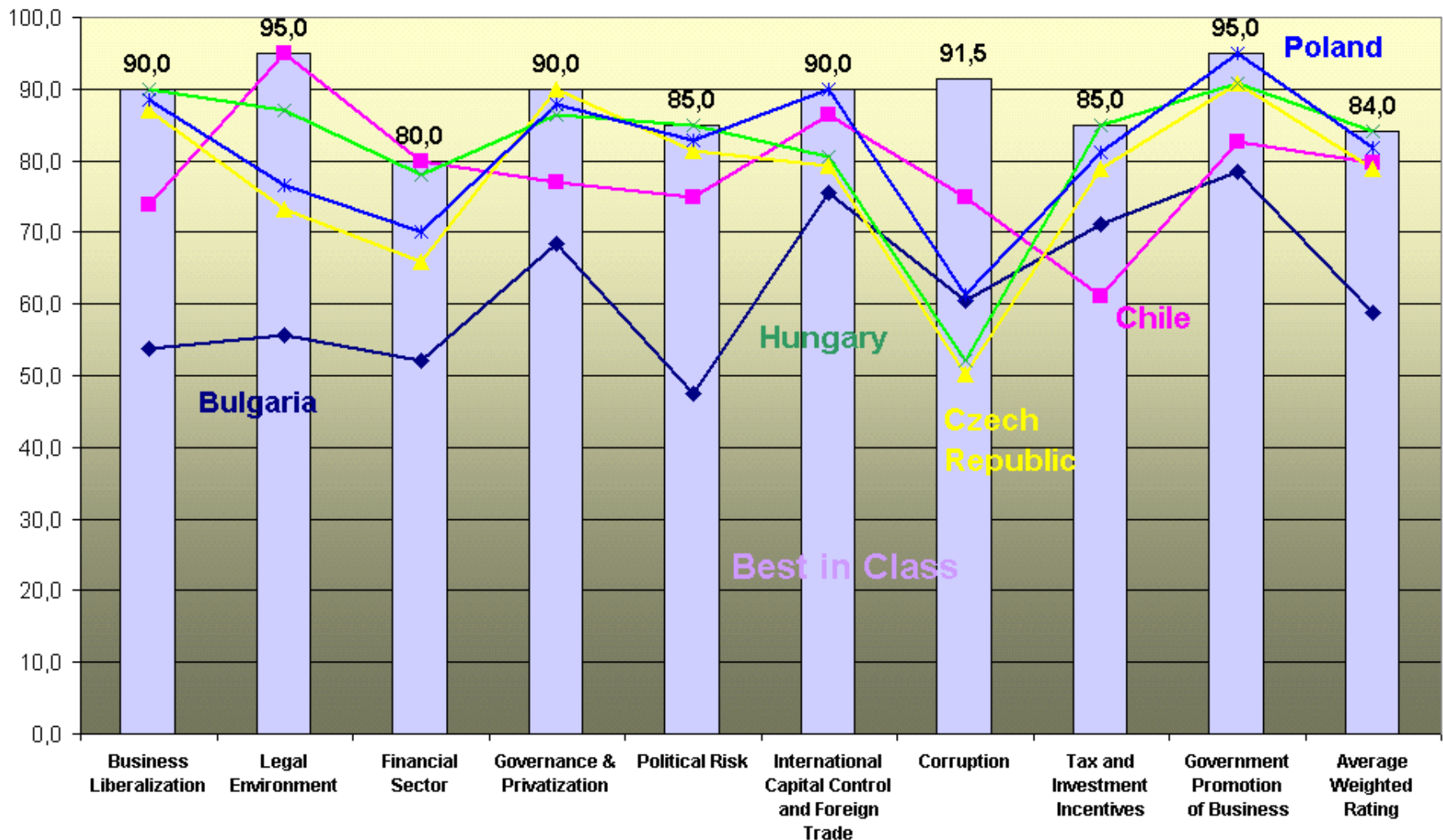
Benchmarking Analysis for FSU Countries, 2000-2001 (continued)



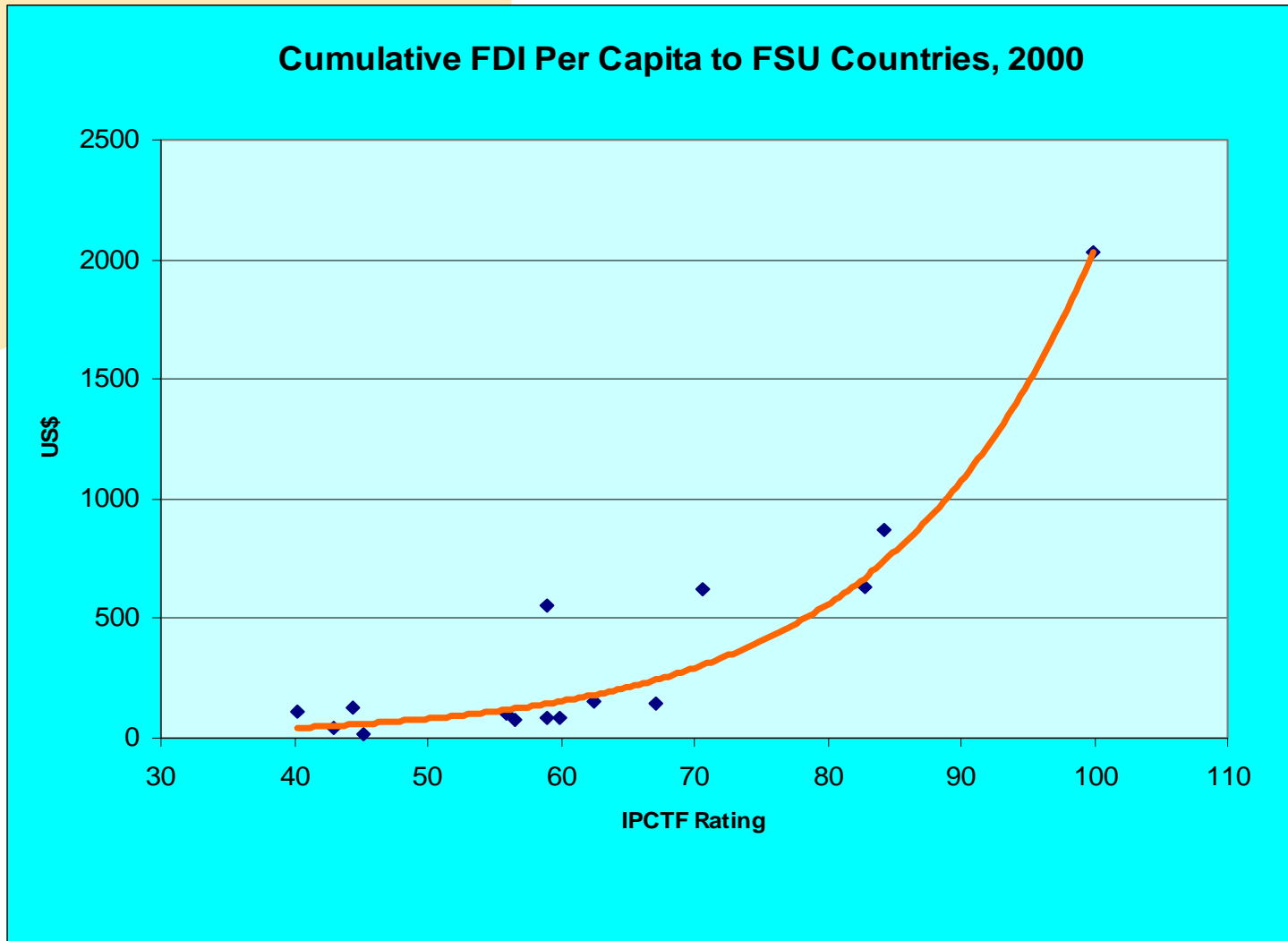
Benchmarking Analysis for FSU Countries, 2000-2001 (continued)



Benchmarking Analysis for CE Countries and Chile, 2000-2001

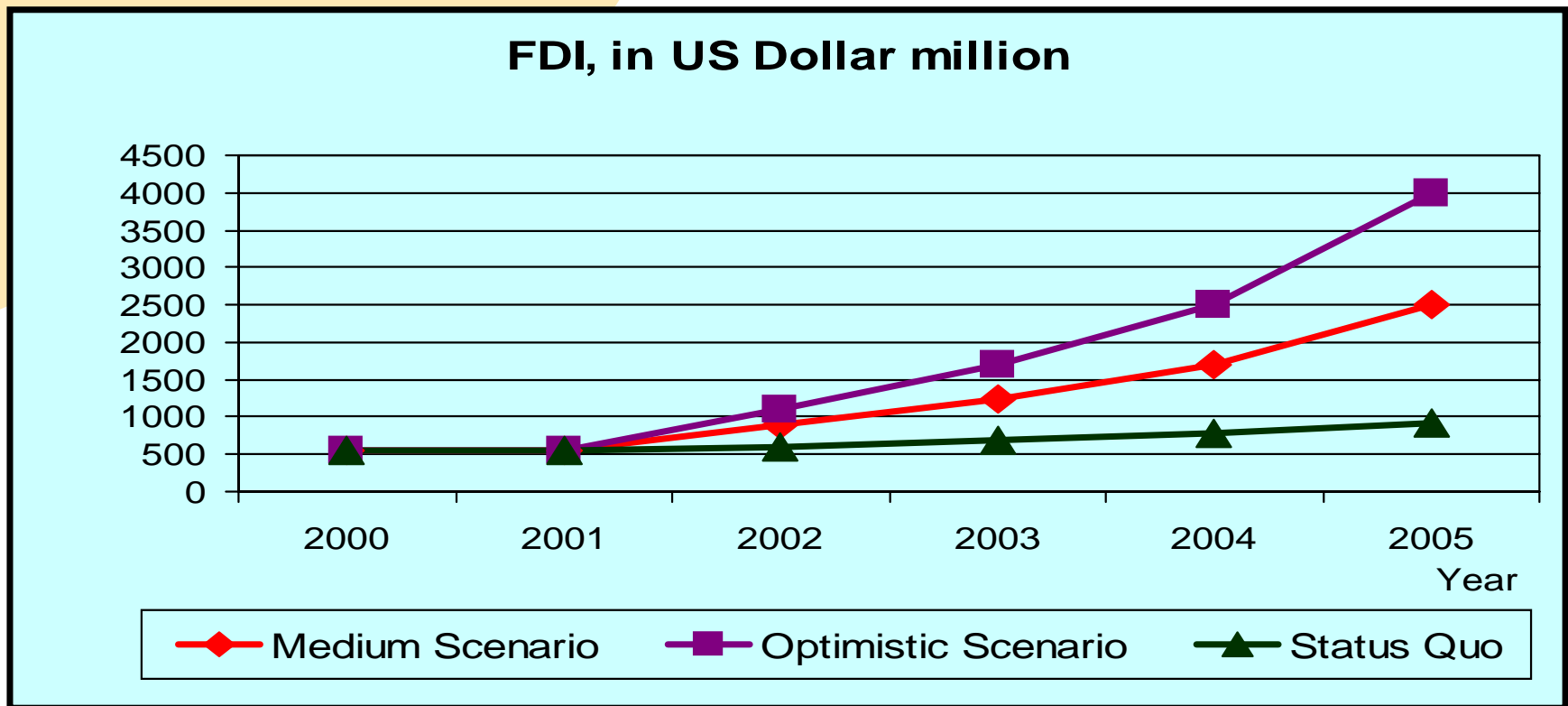


Relationship between FDI and Policy Ratings



FDI For Ukraine- Possible Scenarios

- Ukraine's government policies will determine the FDI flows over the next 15 years (5 years shown)



- The **Middle Scenario** would generate an incremental GDP growth rate of about 4% per annum.

Conclusions for Ukraine

- **With continuation of current policies**, FDI flows **will not increase** from its current level of under **US\$1.0 billion per year** (except for ad-hoc flows related to large privatizations)
- **Under a middle scenario**, with policy actions to **reduce in five years 50%** of the policy level differential with the Bests-in-Class, Ukraine could increase FDI to about **US\$3.4 billion per year by 2005, resulting in US\$75 billion over the next 15 years**
- **Under a more aggressive scenario**, with stronger policy actions to **reduce in five years 80%** of the policy level differential with the Bests-in-Class, the level of foreign direct investments could increase to **US\$6.4 billion per year by 2005, resulting in US\$100 billion over the next 15 years**

IPCTF Framework – A Tool for Action

- A generic prescription for government policies based on benchmarking and best practices definition
- Low correlation between FDI flows and “natural characteristics” (e.g., location, size, resources, etc.)
- High correlation between government policies and FDI flows
- Private Capital likes Uniformity and Business Standards
- Measuring economic impact of government policies based on the gap between a given country and the best in class in each of the nine government policy areas
- Econometric model of a transition economy predicting FDI flows based on government policies
- Priorities for 9 points may be different in different countries but all will need to be addressed to attract stable flows of FDI
- IPCTF Framework provides a **comprehensive tool** for building consensus and developing an **Action Plan** for any transition economy

New World Order

- Today, conflicts rarely stay within national boundaries
- Today, a tremor in one financial market is repeated in the markets of the world
- Today, confidence is global; it's presence or its absence
- Today, the threat is chaos, because for people with work to do and family life to balance and mortgages to pay and careers to further and pensions to provide, the yearning is for order and stability. And if it doesn't exist elsewhere, it's unlikely to exist here

I have long believed that this interdependence defines the new world we live in

Tony Blair, October 2, 2001

Developed and Developing Countries – Assured Interdependence

- A large portion of the world is in a state of transition, therefore unstable
- The main goal is to successfully complete transitions and achieve stable economic growth, based on market economy and democracy
- The developed countries hold the keys to this transition and must lead the effort
- Benchmarking and statistical analysis of the transition economies help identify the best practices, which must be used in other countries, with some adjustments for local culture

Financial Assistance to FSU Countries

- Must be focused on **Economic Growth through the development of private enterprises.**
- Minimize government-to-government money transfers and blind pools of money
- The use of proceeds is just as important as the conditionality of lending
- Reduce adjustment lending and budget deficit financing
- Maximize equity investments in place of debt
- Leverage private capital investments with financial assistance dollars
- Structure financial assistance as “private equity funds” managed by money managers from private sector

BLEYZER INITIATIVE

- Refocus multilateral and bilateral assistance to FSU countries on the creation of market economies and stronger private sector
- Use IPCTF framework to create capital-friendly environment in the FSU countries and attract private equity capital
- Focus most financial assistance on creating private businesses – SMEs and conditions for large multinationals operations in the FSU countries
- Leverage private capital with donor's money
- Implement comprehensive coordinated assistance program to the FSU countries: use donor capital to create the environment, which attracts private capital

BLEYZER INITIATIVE

Action Plan

- Convince US and EU governments at the most senior levels of the need to **actively** support the creation of market economy and democracy in the FSU countries to sustain economic growth
- Build an alliance of developed countries to promote the market-economy-focused program in FSU countries and later in Africa, Asia and other developing countries to achieve stability and improved security in the World
- Use IPCTF framework as broad conditionality for all financial assistance to the developing countries
- Work with the FSU countries' governments to create specific Action Plans for each country using IPCTF framework
- Create a series of satellite private equity funds in the FSU countries to advance Action Plans implementation (later in other countries)
- Publicize the program in the Western press to attract private capital

Ukraine Is Bound to Succeed!

"Україна приречена на успіх"



Where Opportunities Emerge.