



SMITH SCHOOL OF ENTERPRISE
AND THE ENVIRONMENT



“SOVEREIGN DEVELOPMENT FUNDS”

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OVERVIEW

- SOVEREIGN WEALTH FUNDS ARE MATURING (SOPHISTICATION)
- THEY FACE NEW CHALLENGES COMPARED TO 10–20 YEARS AGO
- MORE IS EXPECTED FROM SOVEREIGN FUNDS (EMERGING REALITIES)
- EQUALLY, THERE ARE NEW OPPORTUNITIES ON THE HORIZON.

SOVEREIGN WEALTH FUNDS (OVER THE PAST DECADE)

- HAVE BECOME MORE IMPORTANT IN THE GLOBAL ECONOMY
- HAVE STRENGTHENED THEIR GOVERNANCE AND MANAGEMENT
- HAVE EXTENDED THEIR REACH, DEEPENING SKILLS AND EXPERTISE
- HAVE DEMONSTRATED THEIR VALUE TO NATION-STATE SPONSORS.



MY PRESENTATION

- SITUATES SOVEREIGN FUNDS IN A CHANGING WORLD
- INDICATES HOW AND WHY SOVEREIGN DEVELOPMENT FUNDS ARE EMERGING
- IDENTIFIES THE ADVANTAGES ENJOYED BY SDFs, AND
- CLOSSES ON THE IMPORTANCE OF HIGH QUALITY GOVERNANCE AND MANAGEMENT.

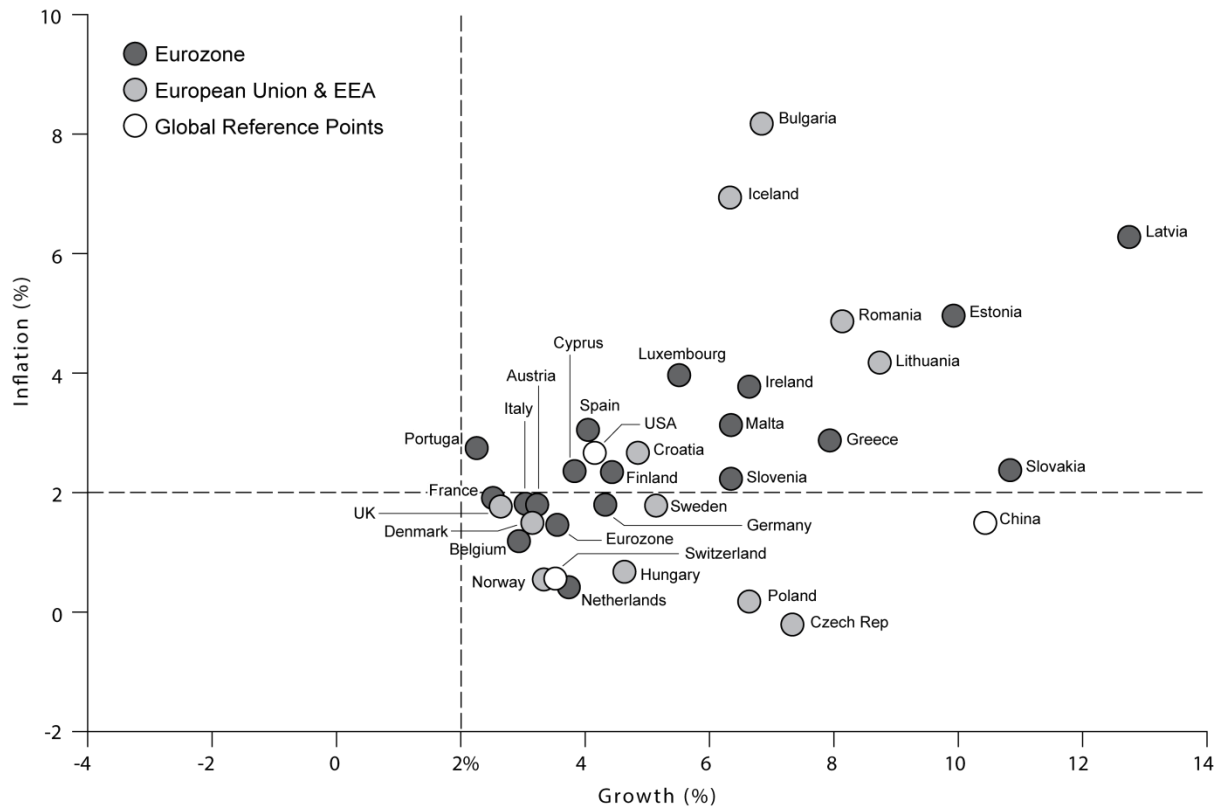
EMERGING REALITIES I

- A SLOWING RATE OF GLOBAL ECONOMIC GROWTH
- THE RESOURCES SUPER-CYCLE APPEARS TO BE OVER
- EMERGING MARKETS ARE INCREASINGLY VOLATILE AND VULNERABLE
- FINANCIAL CRISES 'LOOM' IN CERTAIN COUNTRIES AND REGIONS.

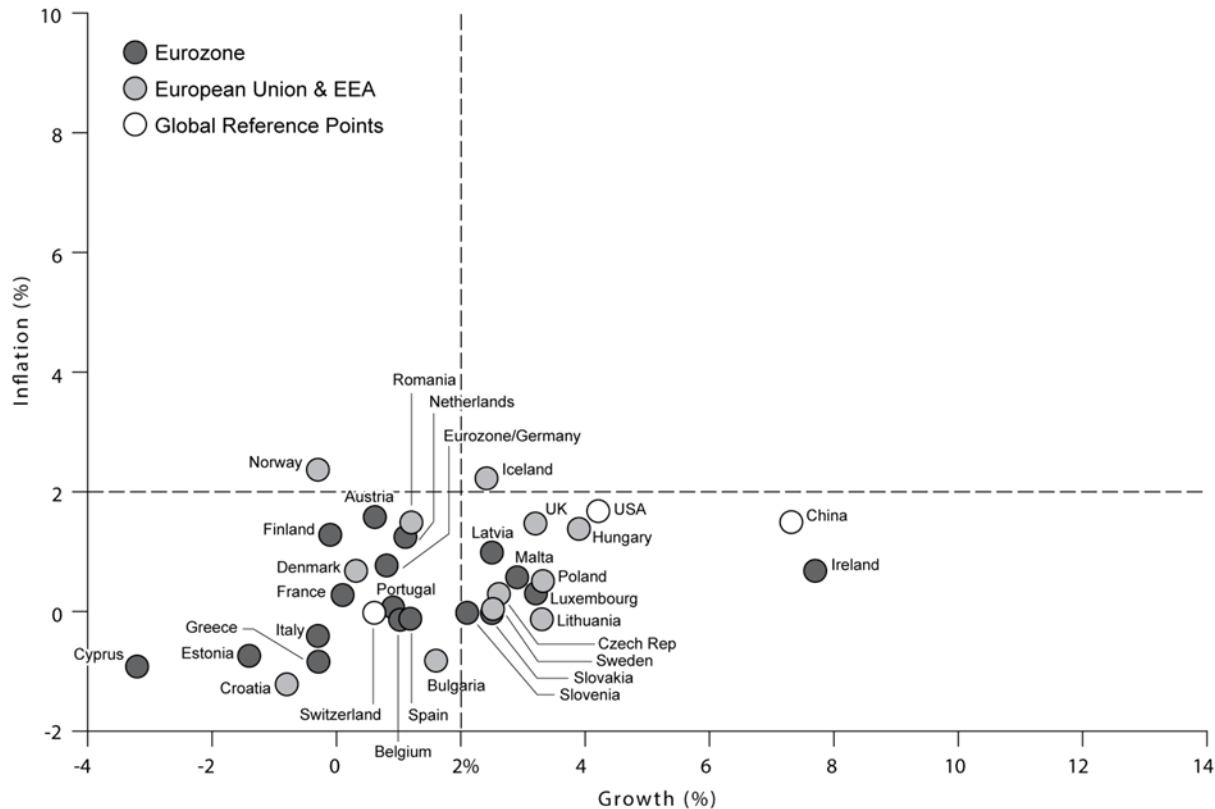
EMERGING REALITIES II

- EUROPEAN ECONOMIC GROWTH IS FALTERING (DEFLATION)
- ATTENUATED BY US AND UK GROWTH (IN THE SHORT TERM)
- AMPLIFIED BY GEOPOLITICAL RISK AND UNCERTAINTY
- COMPARE FIGURE 1 WITH FIGURE 2.

GLOBAL PROSPECT Q2 2006



GLOBAL PROSPECT Q2 2014





EMERGING REALITIES III

- BANKING SYSTEMS REMAIN FRAGILE
- FOCUS IS UPON SOLVENCY WITH RESPECT TO ANOTHER POTENTIAL FINANCIAL CRISIS
- THERE IS INCREASING SCRUTINY OF LENDING PRACTICES BY REGULATORS
- RESULTING IN A CREDIT SQUEEZE, EVEN CREDIT CRISES IN SOME REGIONS AND COUNTRIES.

EMERGING REALITIES IV

- MATCHED BY NATION-STATE INDEBTEDNESS
- REDUCED THE FISCAL CAPACITY AND POLICY FLEXIBILITY
- OVER-RELIANCE UPON MONETARY POLICY (QE1, QE2, ETC.)
- NOTWITHSTANDING THE URGENT NEED TO INVEST IN THE FUTURE, E.G. INFRASTRUCTURE, INNOVATION, EDUCATION, AND DEVELOPMENT.

SWF INVESTMENT STRATEGIES I

- BY CONVENTION, SWFs ARE GLOBAL PORTFOLIO MANAGERS
- OUTSOURCING INVESTMENT MANAGEMENT AND EXECUTION TO SERVICE PROVIDERS
- RELIANT UPON GLOBAL FINANCIAL MARKETS
- OFTEN INVESTING IN OFFSHORE OPPORTUNITIES VIA TRADED AND UN-TRADED INVESTMENT PRODUCTS.

SWF INVESTMENT STRATEGIES II

- THE GLOBAL FINANCIAL CRISIS PROFOUNDLY DISRUPTED CONFIDENCE IN THIS MODEL
- PROMPTING GREATER CONTROL AND OVERSIGHT OF THE INVESTMENT VALUE-CHAIN
- ACCELERATING COMMITMENT TO THE IN-SOURCING OF INVESTMENT MANAGEMENT (BY ASSET CLASS, GEOGRAPHY, ETC.) AND
- THE DEEPENING OF IN-HOUSE SKILLS AND EXPERTISE.

SWF INVESTMENT STRATEGIES III

- HENCE, THE SEARCH FOR DIFFERENT TYPES OF INVESTMENT OPPORTUNITIES (E.G. UNTRADED PRODUCTS AND PROJECTS)
- AND THE SEARCH FOR DIFFERENT WAYS OF INVESTING (E.G. THROUGH PEER-BASED COOPERATION AND COLLABORATION)
- WHILE REWRITING CONTRACTS WITH EXTERNAL PROVIDERS
- MADE POSSIBLE BY THE SIZE AND SCOPE OF THE LARGER SWFs.

SWF INVESTMENT STRATEGIES IV

- THERE WERE (AND ARE) EXCEPTIONS
- SOME SOVEREIGN FUNDS HAVE FOCUSED ON PROJECT-BASED INVESTMENT
- BEING RELIANT UPON INTERNAL EXPERTISE, LONGER-TERM PARTNERSHIPS ETC.
- BENCHMARKED AGAINST LONG-TERM INVESTMENT RETURN TARGETS, OUTSIDE OF FINANCIAL MARKETS.

SOVEREIGN DEVELOPMENT FUNDS I

- IT IS OBVIOUS THAT MANY NATION-STATE GOVERNMENTS ARE FISCALLY CONSTRAINED (AND WILL REMAIN SO)
- BUT ECONOMIC GROWTH IS AT A PREMIUM (E.G. EMPLOYMENT, INCOME, AND INNOVATION)
- E.G.: THE UK GOVERNMENT HAS SOUGHT TO ENCOURAGE PRIVATE INVESTMENT IN INFRASTRUCTURE.

SOVEREIGN DEVELOPMENT FUNDS II

- PROJECT FINANCE VIA BANKS AND RELATED GLOBAL FINANCIAL INSTITUTIONS IS DECLINING (IN RELATIVE TERMS) AND COMES AT A HIGHER PRICE
- IN ANY EVENT, NATION-STATES HAVE BECOME WARY OF BANKS THAT ARE “TOO BIG TO FAIL”
- INEVITABLY, NATIONAL GOVERNMENTS HAVE TURNED THEIR ATTENTION TO SOVEREIGN FUNDS AND OTHER RELATED INSTITUTIONS TO FILL THE GAP
- CAN THEY HELP?

SOVEREIGN DEVELOPMENT FUNDS III

- MANY SOVEREIGN FUNDS ARE CENTRES OF (SCARCE) NATIONAL FINANCIAL EXPERTISE
- HAVE RISK AND RETURN CULTURES VERY DIFFERENT FROM NATIONAL CENTRAL BANKS
- HAVE SKILLS AND EXPERTISE WITH GLOBAL CREDIBILITY CONSISTENT WITH BUILDING AND MAINTAINING INVESTMENT PARTNERSHIPS
- STAFFED BY 'NATIONALS' RETURNING FROM OVERSEAS WITH RELEVANT EDUCATION AND PROFESSIONAL EXPERIENCE.

SOVEREIGN DEVELOPMENT FUNDS IV

- LIKE SWFs, SDFs ARE STOREHOUSES OF NATIONAL WEALTH
- LIKE SWFs, SDFs HAVE INVESTMENT GOALS AND OBJECTIVES
- UNLIKE SWFs, SDFs TEND TO INVEST LOCALLY AND REGIONALLY RATHER THAN GLOBALLY
- UNLIKE SWFs, SDFs VIEW INVESTMENT AND DEVELOPMENT AS SYNONYMOUS.

ADVANTAGES OF SDFs I

- THERE CAN BE A PREMIUM ON LOCAL KNOWLEDGE (RECOGNISED IN THE ACADEMIC LITERATURE)
- WHICH IS ESPECIALLY IMPORTANT WHEN INVESTING OVER THE LONG TERM
- WHERE LOCKING-IN A LOCAL ADVANTAGE CAN PROVIDE PREDICTABLE LONG-TERM RETURNS
- ESPECIALLY WHEN THE SOVEREIGN FUND IS A PATIENT INVESTOR RATHER THAN A PORTFOLIO INVESTOR.

ADVANTAGES OF SDFs II

- THERE CAN BE A PREMIUM ON LOCAL CONTROL OVER THE INVESTMENT PROCESS
- REORDERING RELATIONSHIPS BETWEEN SOVEREIGN FUNDS AND SERVICE PROVIDERS AND CO-INVESTORS
- SETTING THE TERMS FOR THE FLOW OF COMMITMENTS AND THE FLOW RETURNS OVER THE SHORT TERM AND LONG TERM
- FACILITATING CLOSE TIES BETWEEN SOVEREIGN FUNDS AND GLOBAL INVESTMENT INSTITUTIONS WITH SIMILAR GOALS AND OBJECTIVES.

ADVANTAGES OF SDFs III

- LOCAL INVESTING, PATIENT INVESTING, AND CONTROL OVER THE INVESTMENT PROCESS CAN ENABLE COLLATERAL RETURNS (E.G. PROPERTY DEVELOPMENT AROUND A KEY INFRASTRUCTURE PROJECT)
- ESPECIALLY IMPORTANT IN CIRCUMSTANCES WHERE DEVELOPMENT IS CLUSTERED IN NODES OF INNOVATION AND HUMAN CAPITAL
- SUSTAINING SUPERIOR INVESTMENT RATES OF RETURN THROUGH THE POSITIVE EXTERNALITIES OF DEVELOPMENT
- THEREBY UNDERWRITING THE LEGITIMACY OF SOVEREIGN FUNDS IN CIVIL SOCIETY.

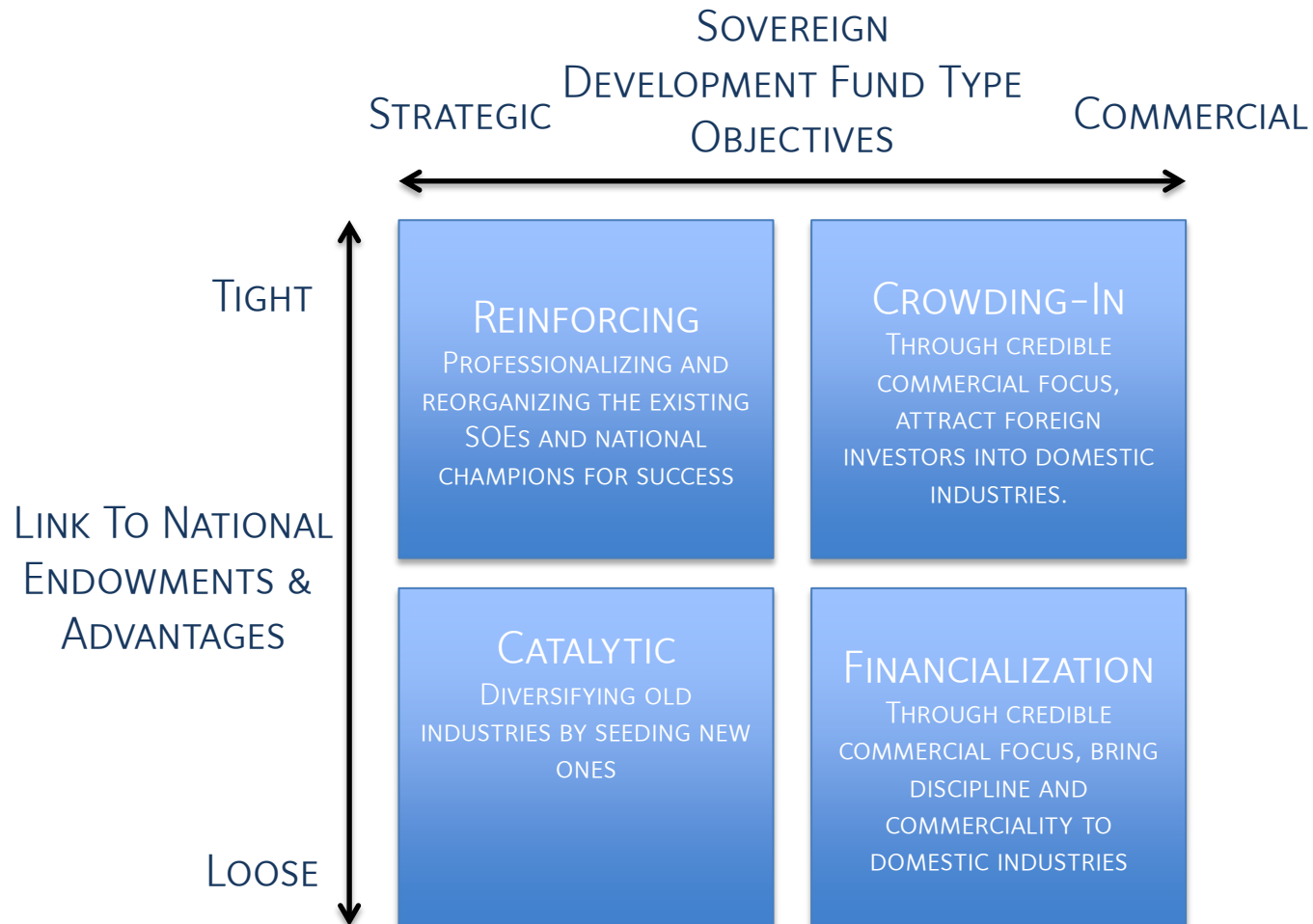


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THE SDF PROJECT

SDF CATEGORIES



CLARK AND MONK 2014, BASED ON CHESBROUGH'S (2002)
ANALYSIS OF CORPORATE VENTURE CAPITAL.



SDF SUCCESS FACTORS I

BASED ON OUR RESEARCH, WE'VE FOUND THE FOLLOWING CRITERIA ARE IMPORTANT IN SDF SUCCESS:

- **COMMERCIAL ORIENTATION:** THE NEW VEHICLE SHOULD HAVE A CLEAR, COMMERCIAL MANDATE THAT WILL GUIDE THE MANAGEMENT TEAM'S DECISION-MAKING AND HELP OTHER INVESTORS UNDERSTAND AND RELATE TO ITS MISSION.
- **GOVERNANCE:** THE SDF MUST HAVE ROBUST GOVERNANCE THAT CAN STAND UP TO FOREIGN DUE DILIGENCE. IF THIS FUND IS GOING TO ORIGINATE DEALS AND BRING CO-INVESTORS ALONGSIDE, IT WILL HAVE TO!
- **LOCAL ACCESS:** THE SDF MUST BE ABLE TO SOURCE, ASSESS, STRUCTURE, AND DE-RISK (AS APPROPRIATE) THE INVESTMENT OPPORTUNITIES IN A CREDIBLE WAY.

SDF SUCCESS FACTORS II

- **TOP TALENT:** IT'S CRUCIAL THAT THE INDIVIDUALS RUNNING SDFs BE OF THE HIGHEST STANDING AND, IDEALLY, THAT THEY HAVE A INVESTMENT TRACK RECORD TO BACK IT UP.
- **LOCAL VOICE:** SDF SHOULD PROVIDE A POINT OF CONTACT FOR INTERNATIONAL INVESTORS TO MAKE THEIR VOICES HEARD AMONG THE LOCAL AGENTS AND ACTORS.
- **DE-RISKING:** IN CERTAIN CIRCUMSTANCES, IT MAY BE NECESSARY FOR THE SDF TO BE IN A 'FIRST LOSS' POSITION WITH CERTAIN GUARANTEES AROUND LOCAL RISKS.
- **CLARITY OF MISSION:** THE "FINANCIAL" COMPONENT OF THE SDF CAN GENERALLY HANDLE DEVELOPMENTAL CONSTRAINTS SO LONG AS THEY ARE VERY WELL DEFINED.



SOME THINGS SDFs SHOULD AVOID ...

- **DEADWEIGHT LOSS:** SDFs SHOULD AVOID DOING THINGS THAT EITHER THE GOVERNMENT OR THE FREE MARKET WOULD DO ON THEIR OWN. IF IMPACT DOLLARS ARE THERE TO BE CATALYSTS, THERE'S REALLY NO SOCIAL OR ENVIRONMENTAL VALUE IN CATALYZING SOMETHING THAT WOULD HAVE HAPPENED ANYWAY.
- **UNINTENDED CONSEQUENCES:** SDFs SHOULD LEARN FROM THE FAILURES OF GOVERNMENT AND CAPITALISM AND TRY NOT TO MAKE SHORT-TERM DECISIONS THAT LEAD TO LONG-TERM PROBLEMS. IT'S A RELATIVELY SIMPLE CONCEPT THAT WARRANTS LOTS OF SCENARIO PLANNING.
- **'BRIDGES TO NOWHERE':** DEVELOPMENT-ORIENTATION IS NOT AN EXCUSE FOR A LACK OF RIGOR IN INVESTMENTS. IN FACT, IF YOU'RE GOING TO TRY TO USE FINANCIAL MARKETS TO DRIVE EXTRA-FINANCIAL BENEFITS... YOU NEED TO BE MORE RIGOROUS AND SAVVY THAN THE AVERAGE INVESTOR. OR, AT THE VERY LEAST, YOU BETTER UNDERSTAND YOUR STRENGTHS AND WEAKNESSES VERY WELL.

LOOKING FORWARD I

- SWFs ARE LIKELY TO BECOME HYBRID ORGANISATIONS
- COMBINING PORTFOLIO INVESTMENT WITH PROJECT FINANCE
- LEADING CONSORTIUMS OF LIKE-MINDED INSTITUTIONS (LOCAL AND GLOBAL)
- STEPPING INTO THE GAP LEFT BY BANKS AND GOVERNMENTS.

LOOKING FORWARD II

- SDFs ARE GROWING IN NUMBER AND IN SIGNIFICANCE
- PERHAPS THE NEXT GENERATION OF SOVEREIGN FUNDS
- WITH SIMILAR FUNCTIONS, IF NOT THE SAME INSTITUTION FORM
- BEING A STOREHOUSE OF NATIONAL WEALTH, AND A MEANS OF ENHANCING LONG-TERM WELL-BEING.

LOOKING FORWARD III

- SOME SDFs WILL SUCCEED, REINFORCING THE STRENGTH AND COHERENCE OF CIVIL SOCIETY
- SOME SDFs WILL FAIL BECAUSE OF THE MISMATCH BETWEEN THE INTERESTS OF POLITICAL ELITES AND THE EXPERTISE OF SOVEREIGN FINANCIAL INSTITUTIONS
- SOME SDFs WILL SUSTAIN THEIR INTEGRITY BY A PUBLIC ROLE IN THEIR SOCIETIES
- SOME SDFs WILL ALIGN WITH THE “NATIONAL INTEREST”, THEREBY INSULATING THEMSELVES FROM THE SHORT-TERMISM APPARENT IN PARTISAN POLITICS.



RELATED ACADEMIC PUBLICATIONS

- CLARK, G.L. 2014. INFORMATION, KNOWLEDGE, AND INVESTING IN OFFSHORE FINANCIAL MARKETS. JOURNAL OF SUSTAINABLE FINANCE & INVESTMENT (FORTHCOMING).
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- CLARK, G.L. AND MONK, A.H.B. 2013. THE SCOPE OF FINANCIAL INSTITUTIONS: IN-SOURCING, OUTSOURCING AND OFF-SHORING. JOURNAL OF ECONOMIC GEOGRAPHY, 13(2): 279-298.
- DIXON, A.D. AND MONK A.H.B. 2014. FINANCIALIZING DEVELOPMENT: TOWARD A SYMPATHETIC CRITIQUE OF SOVEREIGN DEVELOPMENT FUNDS JOURNAL OF SUSTAINABLE FINANCE & INVESTMENT (FORTHCOMING).