

# EBRD EQUITY INVESTMENT

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**Abstract:** *The EBRD is the largest investor in private equity funds, mainly focusing on growth and expansion in countries of operation. The significant support to its private equity fund managers accelerates the development and institutionalisation of the private equity industry in the region. For EBRD, equity investments are made indirectly through regional and sector funds. These funds are created by groups of investors, mostly private, to which the EBRD participates with capital.*

**Key words:** *European Bank for Reconstruction and Development, EBRD, investment funds, equity investment.*

## 1. Introduction

In the transition countries of Central and Eastern Europe, the State has not participated directly in capitalization and enterprise development, leaving it under the private capital care. Existing banks themselves suffered a profound process of privatization and restructuring, were unable to provide the necessary funds and external financing was quite low. The high interest rates and increased risk of new private enterprises made it difficult the financing from credits only. In this context, the EBRD created a new opportunity to support transition by equity investment. This form is addressed to companies which prefer the maturity and interest free financing, benefiting from a transfer of management.

In practise, EBRD equity investment takes many forms: direct equity investment, investment funds, post privatisation and restructuring funds.

## 2. Investment funds

The achievement of a larger number of direct equity investments raises the question of insurance representatives in the management of companies, as the EBRD intends to hold control package together with strategic partners. This problem was solved by promoting investment funds with other partners.

Investment funds are legal entities formed by the association of several investors that manage capital for placing the purchases of shares in private companies. The main investor is usually a credible financial intermediary (commercial or development bank, capital investment company) or a strategic investor.

Its management is entrusted to a manager who is usually represented by a team of experts or a specialized firm.

Investment funds have expanded rapidly, competing with the credit system in the medium and long term.

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These forms of investment are more favourable, but more difficult to obtain because they are validated by the market. Less efficient firms have small chances to obtain investment capital or shares may be sold at prices too low, which is not to their advantage.

Investment funds diversify portfolios through investing in diverse securities on national and international markets, reducing the risk level and allowing greater expected values.

Compared to individual investors, investment funds have lower transaction costs. In actual fact, the great number of transactions allows them to use advantages from low brokers provisions and economies of scale.

Qualified managers allow investment companies to make quick and efficient investment decisions when choosing clients portfolios. This reduces the risk of wrong investment decisions and makes shares buying more attractive.

Investment funds improve the institutional structure of the banking and financial sector, increase competitiveness and acts as an incentive for developing the capital market.

Table 1 presents a comparison between the two financing instruments provided by the EBRD.

Relations between the institution and fund capital partners are very close and are done by the fund manager who makes capital investments, pursues efficiency and manages the entire portfolio approved.

*Investment funds and investment credits*

Table 1

Investment funds	Investment loans
Advantages	
Participation in decision making	Do not affect the voting power
Incomes vary according to efficiency	Long-term repayment
Free technical support - training	Free technical support – partially
No guarantees requested	Increase of capital to the amount invested.
Sale of shares	
Disadvantages	
Uncertainty selling shares	Payment of interest costs
Uncertainty regarding obtaining income	Guarantees

*Source: EBRD Working Paper*

In loans for investment, creditors are entitled to receive interest at maturity regardless of the economic results obtained, while the benefits of the investment funds depend on the profitability.

The executive management is provided by a manager or specialist agency for large value funds, a management and administration team of experts in capital markets, financial analysis and portfolio risk management. The relational schema to

organize an investment fund with EBRD participation is shown in Figure 1. The investment fund management is always provided by the manager. He has two main responsibilities: making investments and monitoring the portfolio. For this purpose, the fund management prospects the market, identifies investment opportunities and the capital investment proposed for approval. After that, the aim is represented by making the enterprises profitable.

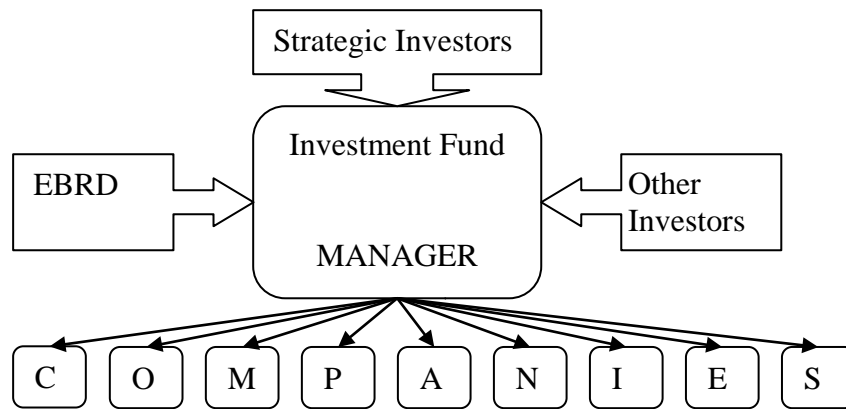


Fig. 1.

For EBRD, equity investments are made indirectly through regional and sectoral funds. These funds can be created by groups of investors, mostly private, to which the EBRD participates with capital (eg. AIG New Europe Fund) or special funds established by the EBRD under Article 14 of the Agreement Establishing the Bank.

In 2009, for example, EBRD managed 14 special investment funds, out of which 11 special investment funds (Balkan Region Investment Special Fund, the EBRD's Special Fund for SMEs, particularly the investment fund for small businesses in Russia, the Financial Intermediary Investment Special Fund, particularly the investment fund of Italy, special funds for financing facilities for small and medium enterprises, the investment fund for the Baltic states, Central Asia Fund venture capital, the Special Fund for financing facilities infrastructure, particularly the investment fund for Central Asia, the Special Fund for micro credit facility for Romania) and three special funds for technical cooperation (Technical Cooperation Special Fund for SMEs in Russia, EBRD Technical Cooperation Special Fund, the Technical Assistance Special Fund for the Balkans).

To participate as sponsors to such funds, the European Bank for Reconstruction and Development focuses on certain criteria that would ensure fulfilment of its purposes as follows:

- experienced management, based on successfully completed investments on similar markets and paid depending on fund performance;
- experienced local partners with local market access;
- commitment of partners to provide the subscribed capital;
- mobilization of resources by the EBRD;
- presence of the representatives of the EBRD in the management of the fund to ensure adoption of appropriate policies and prudential rules;
- rate of return based on the degree of investment risk.

### 3. Regional and sectoral funds

Investment funds that have received only administration or funding from the EBRD:

**Advent Fund** - This fund finances and assists in the management of private companies. The funding level is between 1 and 8 million and addresses companies in Hungary, Czech Republic, Poland and Slovakia

**AIG New Europe Fund** - invests directly under the form of shares or

subscriptions in companies operating mainly in Poland, Romania, Poland, Croatia, Macedonia, Moldova. Its investments fall 10 to \$ 30 million U.S.

**AIG Silk Road Fund** - has features similar to the previous fund range action, lies in Asia: Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan, Azerbaijan and Kirghistan.

**ScanEast Alliance Fund** - this fund buys stakes in cases where partner companies with a broad range of coverage are involved: telecommunications, building materials, petrochemicals, paper, oil, etc.

**Investment Fund for the Baltic states** – together with the EBRD, it invests in domestic or small business joint ventures in Estonia, Latvia, Lithuania. Amounts between 1 and \$ 2 million can extend funding under certain conditions. Assets of the fund in 2001 were 41.4 million euros. The main sponsors were the European Union, Sweden, Norway, Denmark, Finland. The post-privatization fund for the Baltic states - mainly aims to help post-privatization restructuring and development of enterprises in Estonia, Latvia and Lithuania, offering money and assistance to management. Amounts are invested on a short 7 years, on average, and are between 0.5 and 3.5 million.

**Baring Emerging Europe Communication Equity** - aims to acquire holdings in private enterprises in media and communications, particularly in companies whose activity extends to other countries in the activity circle of the EBRD. Outlays are between 1 and \$5 million.

**Danube Fund LDT.** – invests by taking stakes in private enterprises undergoing privatization, at least 75% of the amount goes to Romania and Moldova, and the rest on specific projects in Bulgaria, Albania and Macedonia.

**DBG Osteuropa Holding GmbH** - invests sums amounting to \$5-10 million in local companies from Acceding Visegrad.

**Emerging Europe Capital Investors, LDC** - is an investment fund that will acquire equity and equity-related securities of companies operating in countries that are expected to join the EU. The Fund's objective is to achieve substantial long-term capital appreciation through the purchase and active management of such investments. The investment size range is typically US\$ 10 million to US\$ 20 million. The fund is managed by Royalton Partners, a joint venture between State Street Corporation, a bank holding company listed on the New York Stock Exchange, and EEAM Limited, an investment firm of the management team.

#### **Environmental Investment Partners**

This fund invests in profit-making environmental businesses in central and Eastern Europe. The Fund invests between US\$ 0.5 million and US\$ 5 million in the equity capital of environmental companies. The fund is a passive financial investor and thus usually takes a share ownership of between 5 to 45 per cent of a company.

#### **Argus Capital Partners**

This is a US\$ 172 million private equity fund, sponsored by the Prudential Insurance of America, targeting the advanced countries of central and eastern Europe. The average investment size ranges from US\$ 8 million to US\$ 15 million with no sector specialisation. The Fund has offices in Prague, Budapest and Warsaw and will consider deals outside its priority target countries (Czech Republic, Hungary, Poland and Slovenia).

**East European Food Fund** - invests amounts of between 2 and \$ 7 million in food and drink industry, although it can interfere in any other country in the scope of the EBRD, its investments focus more on Russia, Bulgaria, Romania, Poland, Belarus, Hungary and Ukraine.

**First NIS Regional Fund** - (the first regional fund for the CIS) invests in various forms in the former Soviet Union countries.

**Innova / 98 LP** - is a fund active in Central Europe and its investments are between 3 and 12 million USD.

**Renaissance Fund** - invests in private companies with high growth potential, but also in the companies purchased by employees or small businesses in Slovakia and Poland.

**Special Fund for the Balkans** - helps reconstruction in Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Macedonia, Yugoslavia and Romania. With an asset of 15 million, it has Germany Netherlands Switzerland as main sponsors.

**Investment Special Fund for micro-enterprises in Moldova** - promotes development of micro-enterprises, supporting SMEs in this country, along with EBRD; the fund has Switzerland as a sponsor.

**Investment Special Fund of Italy** - facilitates modernization, restructuring and development of SMEs in several countries in the action area of the European Bank for Reconstruction and Development. With 16 million euros, Italy is the only sponsor with the EBRD.

A more special investment fund is represented by the regional venture capital funds. They were created in a program implemented in 1997 and focus on the Russian Federation area of activity only. The primary objective was to create the infrastructure for making private equity investment in medium – sized private companies in the Russian regions with the ultimate aim of attracting further capital from private investors, to demonstrate the viability of private equity in Russia. There

are eleven such funds and they were created territorially, with official entities as sponsors (Table 2).

#### 4. Conclusions

These funds, which receive funding or financing and management from the EBRD, geographically cover much of the action range of the bank. However, less represented is the area outside the Asian region of Russia. Also, there is coverage in terms of the economic sectors concerned. In this case, a lack of interest can be registered only at large industrial enterprises, which require huge investment both for purchase, but especially for making them profitable, and in agriculture at the production level. Nevertheless, the primary agricultural issue raises no particular interest in the world, for any investment fund. Instead, food industry, drawing on agricultural products is often subject to such investments. If the geographical coverage or structural level are well represented investment funds, the same thing cannot be said about their volume. In this field of European credit institutions, one can say that equity investment exercises an active role on the economic structures of the concerned countries. Positive influences are induced in the capital markets which are often insufficiently developed, aiming at liquidity, confidence, encouragement and transactions. It also stimulates market acquisitions operations and boosts the restructuring process of distressed companies. Finally, the transfer of management is done to these companies.

By investing in its countries of operation, EBRD has become the largest private equity fund with commitments of over 2.7 billion to funds with capital of over 13.5 billion.

*Regional venture capital funds - Russian Federation*

Table 2

<b>Fund</b>	<b>Sponsor</b>
Black Earth	European Union
Central Russia	Germany
Far East and Eastern Siberia	Japan
Lower Volga	USA
Northwest	Finland, Norway, Sweden
St. Petersburg	Germany
Smolensk	European Union
Ural	European Union
Western Russia	Italy
South Russia	France
Western Siberia	European Union

*The Russian Working Class in Times of Transition, Staff Paper, 2008.*

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