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New Roles that Key Developing Countries Will Have in the Provision of Finance for Europe

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New Roles that Key Developing Countries Will Have in the Provision of Finance for Europe

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Abstract: The following paper aims at discussing the first of the three main objectives under the sixth Work Package entitled Finance, Development and Global Governance, which is the changing global financial and monetary system, including the rising influence of major emerging economies, such as those of Brazil Russia, India, and China (BRICs), as well as the role of Sovereign Wealth Funds (SWF) in these countries and the ways in which the aforementioned developments and countries can be leveraged so as to help finance investments in Europe. In this paper we focus on Foreign Direct Investment (FDI), Sovereign Wealth Funds, Hedge Funds, Private Equity and Venture Capital. Besides noting the possibilities provided through emerging and emergent countries and sources of funds, we also provide proposals as to what can Europe do and how, so that to leverage available sources of funding in a way that fosters sustainable development.

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1. Introduction

The history of the current international monetary and financial system (IMFS) has been viewed under two different lenses. The first one focuses on current accounts and dates back to as early as 1898, to David Hume's gold specie standard. Over the years, a systematic contractionary mechanism has been identified, pertaining to an asymmetric adjustment problems, that is the observation that, deficit countries are forced to retrench, while developed countries are under no pressure to expand. The second view is that of capital accounts where the role of the mobility of financial capital (in the gold standard) is highlighted. As with current accounts, capital accounts are said to give rise to biases and asymmetries arising from the role some countries have as bankers of the world (Borio, James, & Shin, 2014).

The current financial system is gradually being replaced to a system in which government agencies (such as central banks), multilateral agencies (such as the International Monetary Fund), and multilateral government bodies (such as the G20) are gradually wielding more influence through currency swap arrangements between central banks, the refinancing of cross-border credit, and some increase in the regulation of the practices of private banks. The process of switching between the aforementioned systems, involves a division of labour in which a *new regionalism* emerges. Defined as *the increasing co-operation between governments in particular regions, (most notably in Africa, Europe and East Asia), in resolving critical economic, social and political difficulties that affect more than one country in a region*, this new regionalism gives bodies (such as the EU) the authority to coordinate policies, reforming governance and maintaining financial and monetary stability in the affected region while participating in institutions of supra-national governance (Toporowski, 2014).

In order for the new regionalism to materialise, this should include re-structuring of the New International Financial Architecture (NIFA), established at the turn of the century and embodied by the new coordinating role of the G20. Contrary to what happened at the end of the last century, when the terms of engagement of the IMF and the World Bank were merely redefined, the aforementioned restructuring refers to the entire international financial system. In this emerging regionalism, the EU will have an different part in line with the diverse obligations it has had vis-à-vis its members and states on its periphery as well as the developing countries and major emerging economies including BRICs, and South Africa (Toporowski, 2014).

An important pre-condition for an enlarged or at least non-diminished role for Europe in the NIFA, is for it to maintain and indeed improve upon a cohesive, sustainable growth/development path. The recent crisis and intra-EU divisions prejudice this. In this context it is very important to identify ways

in which win-win situations can emerge for Europe to both benefit from, and provide profitable outlets/benefits to, emergent players and global fund surpluses.

Accordingly, the aim of this paper is to examine the potential financing role of Europe by major emerging economies and funds. We focus in particular on four types of potential funding/investment sources, namely Foreign Direct Investments (FDI), Sovereign Wealth Funds (SWFs), Hedge Funds, Private Equity and Venture Capital. The paper will be divided in four main sections, the introduction, the section on sources of funds from the four categories we focus on in this paper, the section on ways in which Europe can take advantage of, and offer benefits to these funds and countries and the final section which will summarise our main findings, limitations and discuss opportunities for future work.

2. Sources of and Vehicles for Global Surpluses

Emerging and emergent countries such as the BRICs have generated huge surpluses of funds which are seeking profitable investment opportunities. It is arguable that Europe has not been proactive enough in offering such opportunities, and thereby also helping itself address its own liquidity needs. Below we focus on four ways and vehicles through which these countries have sought to use their surpluses, FDI, SWFs, Hedge Funds, Private equity/Venture Capital. Below, we focus sequentially on each of these.

2.1 Foreign Direct Investment (FDI)

The role of the FDI on a country's economic growth and development has been a controversial topic since the 1960s - referred to as the UN's development decade. Those in favour argue that FDI leads to economic growth and productivity increases, which in return results in boosting the economy as a whole and therefore, may explain some of the differences in economic growth across countries. Those in opposition to FDI argue that there is a risk of destroying local capabilities and extracting natural resources without compensating poor countries. However, over approximately the last forty years most governments are in favour of inward FDI, including it as a key policy in their developmental strategies.

The impact of the FDI on growth and development depends on three main factors: the type of FDI, the investing firm's characteristics and the investee country's economic conditions and policies.

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Therefore, in order to understand the impact of FDI, one should understand what attracts FDI, how it can change over time and how these changes in determinants and types can influence different growth prospects (Willem te Velde, 2006). Determinants of FDI can relate to:

- General policy factors: Overall, the more politically stable a country is, the more it will benefit from long term investments, since stability reduces risks. The main exception to this is countries with abundant natural resources. The creation of market friendly environments also favours the attraction of FDI as well as countries open to investments. It has been shown that heavy regulation on new firm's market entry is associated with higher corruption and weaker governance.
- Specific FDI policies: The liberalisation of investments as well as the provision of incentives, performance requirements, investment promotions, international trades and investment treaties, has been shown to increase FDI.
- Macro-economic factors: When FDI policies are not restrictive, other macro-economic factors become more important. Such factors include human resources, infrastructure, and market size and growth; these differ in importance depending on the sector, type and motivation of the FDI.
- Firm specific factors: Technology, for instance, impacts the way companies structure their international activities. Most importantly, it has facilitated a specialized production centre in locations that can offer the most competitive environment for any given activity.

Those factors have experienced various changes over the past decades which may explain why some countries receive more FDI than others, whilst additional weight in their significance has changed over the years. (Willem te Velde, 2006; Dunning & Lundan, 2008). Since 2010, developing and transition economies have received approximately half of the global FDI inflows, while in 2012 FDI flows towards developing economies, exceeded those to developed countries. BRICs and South Africa have played an important role in the current pattern of global investment (UNCTAD, 2013). Outward FDI flows from BRICs and South Africa have increased considerably over the last decade, from less than USD 8000 million in 2002, to approximately USD 200000 million in 2013. As shown in Table 1 below, a steady and increasing outward FDI for all BRICs and South Africa is evident. An exception to this trend can be seen in 2009 as a result of the financial crisis during which BRICs and especially Brazil suffered from a prolonged recession. In addition to the trends however, the share of FDI for each country differs significantly. For example, over the examined 13 year span, S. Africa accounts for the rather negligible 1.23%, Brazil and India account for 15.13% (5.38% and 9.75% respectively), while the remaining

83.64% is attributed to China and Russia (43.3% and 40.34% respectively). Overall, Russia has the largest outflow equal to USD 523312 million, with China being second with USD 487565 million. BRICs and South Africa accounted for 9% of the global outflows in 2012, 8% more than ten years before (2002) (UNCTAD, 2013).

Table 1: Outward FDI flows in million USD 2000-2013 at current prices and exchange rates

Year	2000	2001	2002	2003	2004	2005	2006	2007
Brazil	2281.59	-2257.59	2482.11	249.30	9806.99	2516.70	28202.49	7066.66
China	915.78	6885.40	2518.41	2854.65	5497.99	12261.17	21160.00	26510.00
India	514.45	1397.44	1678.04	1875.78	2175.37	2985.49	14284.99	17233.76
Russian Federation	3176.78	2532.58	3532.65	9727.13	13782.03	17879.65	29993.15	44801.21
South Africa	270.61	-3177.89	-397.98	565.12	1350.06	930.29	6063.31	2965.92
Total	7159.20	5379.94	9813.22	15271.98	32612.44	36573.30	99703.94	98577.55

Year	2008	2009	2010	2011	2012	2013	Total	Percentage Total
Brazil	20457.1	-10084.226	11588	-1029	-2821.4	-3495.83	64962.4	5.38
China	55910	56530	68811	74654	87804	101000	523312	43.3
India	21147.4	16031.302	15933	12456.1	8485.7	1678.74	117877	9.75
Russian Federation	55662.6	43280.522	52616	66850.8	48822.4	94907	487565	40.34
South Africa	-3133.7	1151.4491	-75.67	-256.847	2987.59	5619.85	14862.1	1.23
Total	150043	106909.05	148872	152675	145278	199710	1208579	100

Source: Authors after UNCTAD Statistics

Regarding the destinations of this outward FDI, a significant share – 42% - goes towards the developed countries, with circa 34% going to the EU (see Figure 1). Most of these investments are driven by market-seeking motives with cross-border mergers and acquisitions (M&As) being the key for entry; M&A purchases in developed countries accounted for USD 105 billion during 2010-2012 (UNCTAD, 2013).

As expected, and in accordance with the outflows, China established the most companies in the EU-15 between 2003 and 2009. Despite its relatively low percentage in total outflows (circa 10%), India ranked second by establishing 254 projects – 17% less than China, followed by Russia with 95 projects - however, it should be noted that, India invested more capital than the other mentioned countries - whilst Brazil ranks last from the BRICs with 48 projects. Of that period's total 697 projects, 35.5% were in the UK (248 projects), 17% in Germany (118 projects) and 11% in France (75 projects) (see *Table 2*). The UK had the highest share because of its business and language links and serves as distribution centre to the rest of the EU (Hunya & Stöllinger, 2009).

Figure 1: Outward FDI stock from BRICs and South Africa, by destination region in 2011 (USD millions) (UNCTAD, 2013)

Partner region/economy	Value	Share
World	1 130 238	100.0
Developed countries	470 625	41.6
European Union	385 746	34.1
United States	31 729	2.8
Japan	1 769	0.2
Developing economies	557 055	49.3
Africa	49 165	4.3
Latin America and the Caribbean	175 410	15.5
Asia	331 677	29.3
Transition economies	31 891	2.8
Memorandum		
BRICS	28 599	2.5

Table 2: FDI in the EU-15 from the BRICs (number of projects) (Source: Author after as indicated)

	Source	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
India	Hunya & Stöllinger, 2009	24	33	40	48	36	64	9					**254**
China		22	37	52	37	69	77	6					**300**
Russia		8	17	18	15	18	17	2		Data not available			**95**
Brazil		5	9	5	7	5	14	3		from this source			**48**
Total		59	96	115	107	128	172	20					**697**
BRICs (Total)	EYGL, 2014					156	218	217	257	266	245	313	**1672**

As seen above in *Table 2* however, depending on the source, the number of projects may differ. According to Ernst & Young 2014 *Attractiveness Survey – Europe 2014*, a total of 591 projects were established in the EU from the BRICs, as opposed to 320 projects identified in Hunya and Stöllinger's (2009) report. Nonetheless, the number of projects established by the BRICs kept rising, creating 16,900 jobs in 2013 alone. As a result, the investment-promotion agencies in many European countries have made additional efforts to attract investments from BRICs companies. For 2013, China invested 153 FDI projects (49%) creating 7,135 jobs. India ranked second, with 103 projects (33%) creating approximately 7,000 jobs, followed by Russia with 44 projects and Brazil with 13 projects. However, the increase in BRIC investments in Europe has not been spread unevenly. Investments remain highly concentrated in the UK and Germany, with 62% of the total investments (EYGL, 2014).

In terms of FDI inflows, a breakthrough can be observed after 2004 and until 2008; growing from USD 76661 million to USD 284500 million (see Table 3). In 2009, and as a result of the global crisis, a decrease of 34.5% (compared to 40% for developed countries (UNCTAD, 2013)) can be observed,

which nevertheless, did not last long. BRICs and S. Africa quickly recovered, with 20011 exceeding the 2008 inflow by 0.6%. Out of the total inflows between 2000 and 2013, almost half (47%) went in China, followed by Brazil and Russia with 19% each.

Table 3: Inward FDI flows in million USD 2000-2013 at current prices and exchange rates (Source: Authors after UNCTAD Statistics)

	2000	2001	2002	2003	2004	2005	2006	2007
Brazil	32779.24	22457.35	16590.20	10143.52	18145.88	15066.29	18822.21	34584.90
China	40714.81	46877.59	52742.86	53504.70	60630.00	72406.00	72715.00	83521.00
India	3587.99	5477.64	5629.67	4321.08	5777.81	7621.77	20327.76	25349.89
Russian Federation	2714.23	2748.29	3461.13	7958.12	15444.37	15508.06	37594.76	55873.68
South Africa	887.34	6783.92	1569.16	733.67	798.03	6646.93	-526.76	5694.53
Total	80683.61	84344.79	79993.02	76661.09	100796.09	117249.05	148932.97	205024.00

	2008	2009	2010	2011	2012	2013	Total	Percentage Total
Brazil	45058.16	25948.58	48506.49	66660.14	65271.85	64045.33	484080.15	19.58
China	108312.00	95000.00	114734.00	123985.00	121080.00	123911.00	1170133.96	47.34
India	47138.73	35657.25	27431.23	36190.40	24195.77	28199.45	276906.43	11.20
Russian Federation	74782.91	36583.10	43167.77	55083.63	50587.56	79262.00	480769.61	19.45
South Africa	9209.17	7502.06	3635.60	4242.87	4558.85	8187.93	59923.28	2.42
Total	284500.97	200690.99	237475.09	286162.04	265694.02	303605.71	2471813.44	100.00

In more detail, Brazil between January 2003 and December 2008, received a total of 539 investment projects from 306 EU-15 companies as recorded by the FDI markets, with the Chemicals sector receiving a significant share of the projects (8%). Manufacturing was the business activity with the highest share (46%), while 18% of all investment projects came from the top-ten leading companies, including Sonae (Portugal), Fiat (Italy) and Akzo Nobel (Netherlands). Similarly, in Russia between January 2003 and January 2009, a total of 1446 investment projects from 696 EU15 companies were recorded, with the leading sector being Food & Tobacco with 10% of projects. As with Brazil, the leading business activity was manufacturing, totalling 33% of projects, while 17% of all investment projects came from the top ten companies including Metro (Germany), IKEA (Sweden) and Raiffeisen Zentrabank (Austria). The main factors impacting the decision on the location of the project investments were Domestic Market Growth Potential and Proximity to markets or customers, as cited by 76% and 20% of companies respectively. In India, between January 2003 and January 2009 a total of 1497 investment projects from 709 EU15 companies were recorded, with the leading sector being Software & IT services, with 11% of projects. Again, the leading business activity was manufacturing, which accounted for 33% of projects, while 11% of all investment projects coming from the top-ten companies including Deutsche Post (Germany), cargo-partner (Austria) and Volkswagen (Germany).

As with India, the main influencing factors were Domestic Market Growth Potential (61%) and Proximity to markets or customers (20%). Finally, in China between January 2003 and January 2009, a total of 2398 investment projects came from 1108 EU15 companies, with the leading sector being the Financial Services (9% of projects). As with all previous countries, the leading business activity was manufacturing with 40% of projects, and the top-ten companies accounting for 13% of all investment projects, including HSBC (UK), Siemens (Germany) and Carrefour (France). The main factors influencing the allocation of the investment projects were Domestic Market Growth Potential with 65% and Proximity to markets or customers with 24% (Hunya & Stöllinger, 2009).

Based on the data, and in accordance with the existing literature, it is evident that the EU invests more in China, but in terms of total FDI inflows, China lags behind both Russia and Brazil. This can be explained by the lower frequency but higher in total capital investment projects in Russia's natural resource sector and the higher frequency number of finance and trade related but smaller in terms of capital investments in China (Hunya & Stöllinger, 2009). While Europe is the largest source of FDI to the BRICS, investments are not evenly spread; the UK has been investing more in Russia and China (especially Hong Kong), Spain in Brazil, and Germany in India, while South Africa has benefited from circa 80% of FDI inflows originating from the EU (SAIIA, 2013; Hunya & Stöllinger, 2009). Such discrepancies can be attributed to the size and industry structure of investors in the countries. For similar reasons, Portugal emerges, by the number of projects, as the top investor in Brazil from mainly real estate projects, while it is not present in the top five in terms of invested capital (Hunya & Stöllinger, 2009). In terms of FDI originating from BRICs towards the EU, investments remain at relatively low levels. One major explanation for this is that most of the BRICs' FDI is resource-seeking, particularly that of China and India that focus on Asia and Africa, while Brazil's focus is on a regional basis. For Russia, the EU is a major outward FDI target region, and judging by the amount of invested capital it is the most important BRIC investor (Hunya & Stöllinger, 2009). In addition, the countries that receive BRICs' FDI is not broad enough, with Germany and the United Kingdom capturing more than half of the investment; in 2013, for example, this amounted to 62% of all projects (EYGL, 2014). In recent years, concerns regarding sovereign wealth funds (SWF) have caused FDI policies to be accelerated (Marchick & Slaughter, 2008)

2.2 Sovereign Wealth Funds (SWF)

SWFs are defined by the European Commission (EC) as *state-owned investment vehicles, which manage a diversified portfolio of domestic and international financial assets* (Commission of the European Communities, 2008).

SWFs originate back in the 1950s, when some oil-rich countries, strong in exporting commodities, were seeking alternative ways to invest funds that came from foreign exchange earnings and reserves (Commission of the European Communities, 2008) in order to avoid *boom and bust cycles* as well as to *sterilize foreign currency inflows, smooth long term consumption and investment, and improve reserve returns* (Balding, 2008). Over the last few years however, SWF have received significant attention as they can offer a source of investment and market liquidity in time of economic downturn (Commission of the European Communities, 2008). This highlights the changing nature of the economy worldwide, and a development which is linked to the appearance of BRICs and their increasing financial wealth (Goldman Sachs, 2007). As a result of increased oil revenues and trade surplus, setting up SWFs has increased dramatically, and they are expected to increase even more. Their significance is highlighted by the sizes they have achieved; currently, global assets under the control of SWFs have increased from 500bn USD in 1990 to circa 6.6tr USD in 2014. In 2008 alone, their net worth exceeded 3tr USD – more than the value of all private equity or hedge funds and were responsible for 35% of the total M&A activity in 2007. Between March 2007 and June 2008, these actors injected 59bn USD into western financial institutions, including Barclays and Citigroup during the financial meltdown (Drenzer, 2008).

SWFs are mostly concentrated in Arab oil-producing countries (Abu Dhabi, Algeria, Dubai, Kuwait, Libya, Qatar and Saudi Arabia), non-Arab oil-producing countries (Norway and Russia) and emerging East Asian economies (China, Hong Kong and Singapore). China has one of the biggest SWFs and its operations attract special attention from host countries due to the financial and political implications of its investments (Sun, Li, Wang, & Clark, 2014). When the top twenty SWFs are measured by asset size, seven are found in the greater Middle East and nine in the Pacific Rim region and in total, the advanced industrialized states hold more than 40% of all SWF international assets (Drenzer, 2008). Table 4 shows the ten largest SWFs where it is evident that the total assets managed by these funds contribute to about a total of 5bn USD, equivalent to 75% of the total estimated SWFs assets under management (AUM). While the most of countries with SWFs are resource-rich countries (with mainly oil as their natural resource), it can also be seen that the source of capital for some of these SWFs is not necessarily commodity related. China, for example has three funds managing 1.3tn USD. As mentioned earlier, these countries have established these funds in order to manage their foreign reserves as well as to improve the return they achieve on traditional exchange reserves (Alhashel, 2015).

Table 4: Top 10 SWF by Assets (Source: Alhashel, 2015)

Country	Fund	Assets US$ billion	Inception	Origin
Norway	Government Pension Fund – Global	878	1990	Oil
United Arab Emirates (UAE)	Abu Dhabi Investment Authority	773	1976	Oil
Saudi Arabia	SAMA Foreign Holdings	737.6	N/A	Oil
China	China Investment Corporation	575.2	2007	Non-commodity
China	SAFE Investment Company	567.9	1997	Non-commodity
Kuwait	Kuwait Investment Authority	410	1953	Oil
Hong Kong	Hong Kong Monetary Authority Investment Portfolio	326.7	1993	Non-commodity
Singapore	Government of Singapore Investment Corporation	320	1981	Non-commodity
China	National Social Security Fund	201.6	2000	Non-commodity
Singapore	Temasek Holdings	177	1974	Non-commodity

There are currently two kinds of nations with SWFs: commodity exporters and countries running fiscal and trade surpluses. The first hold approximately two-thirds of the total SWF assets and specifically for the oil exporters, the incentive to create an SWF is three-fold: first, these economies want to create assets that ensure a long-term stream of returns to protect themselves from the commodity booms and busts. These countries are mainly converting assets extracted from the earth into a more liquid form. Second, a lot of these governments are trying to build up reserve funds for the day when all of the oil is used and third, by focusing on foreign investments, these governments are attempting to prevent the Dutch disease of rapidly appreciating currencies. Overseas investment in SWF can mitigate all of these tasks (Drenzer, 2008).

However, as SWFs are state-owned entities, a series of concerns arise regarding the risk that in which these investments may have against functioning of market economies (Commission of the European Communities, 2008). This is especially true after the current global financial crisis (2008–2013), where a number of SWFs incurred large losses (Sun, Li, Wang, & Clark, 2014). Market analysts and regulators are concerned about the transparency of such funds and argue that the unexpected actions of SWFs could roil financial markets (Drenzer, 2008), whilst free market supporters worry about the political incentives of SWF and the potential protectionist backlash that could arise in host countries. Prominent leaders such as Germany's Angela Merkel and France's Nikolas Sarkozy also worry that SWFs may possess bargaining leverage over the economic and political futures of major economies (Drenzer, 2008). Some have argued that the controversy regarding SWFs is due to the friction of two concepts, state capitalism and market capitalism. Market capitalism is defined by minimal government

intervention in the economy as well as by individual firms whose objective function is to maximize their value. Contrary, state capitalism is concerned with maximizing the value of a country's economy as a whole and is characterized by a government that has a significant role in the economy (Alhashel, 2015).

Regarding the opaque nature of SWFs, supporters of these funds argue that other financial entities such as hedge funds and private equity, also lack transparency and have faced requests for greater openness. In response to this criticism, hedge funds and private equity funds have begun to move towards more public disclosure. In the aftermath of the global financial crisis, both hedge funds and private equity firms faced calls to open up their operations to the public leading to additional demands to adhere to voluntary codes of conduct. Regarding the strategic nature of SWF investments, they have been accused of favouring maximisation of their country's strategic interests instead of profit maximisation incentives. Some have even classified several of the large SWF as strategic-driven investment vehicles. A recent survey of global financial institutions revealed that private actors viewed SWFS being more likely to seek strategic interests than maximizing their financial returns – even though SWF respondents stressed the latter over the former (Drenzer, 2008).

Critics have argued that without the proper global regulation of SWF, access may be gained to crucial national industry sectors, which may influence domestic politics, destabilise the domestic and international financial system (Balding, 2008). As a result, certain governments have already begun to introduce tighter controls on acquisitions by state-owned companies, despite the fact that a SWF investment has never culminated as a national security threat in any country in the last five decades. In Russia, for example, which hosts some of the largest state-owned entities in the world, is set to introduce new restrictions on acquisitions by foreign government-owned. In response several well-respected SWFs, Isthimar and the Kuwait Investment Authority for example, have declared they feel unwelcome in both the United States and Europe and will seek to decrease their asset allocations to these continents (Marchick & Slaughter, 2008).

For the overall well-being of citizens and the efficient functioning of the market economy in Europe, and also to the benefit of SWFs, a step towards increased transparency, predictability and coherence has to be taken. The EU has both the capacity and the incentive to promote a common response to the challenges posed by SWFs, and to utilise its role in this ongoing debate. This common approach should be seen as a complement to the prerogatives of Member States regarding the use of national legislation in conformity with the Treaty (Commission of the European Communities, 2008). This becomes even more important as some policy analysts have argued that the rise of SWF are

symptomatic of shifts in the global distribution of power away from the OECD economies, towards the BRICSAM (BRICs including S. Africa and Mexico) countries and energy exporters (Drezner, 2008).

In order to assess the last claim, one needs to examine the relation of SWF and BRICs. Overall, the BRIC pension funds are not evenly distributed in domestic economies. The weight of pension funds in 2007 corresponded to 15% of the GDP in Brazil, to 5.6% of the GDP in India, to 1.5% of the GDP in Russia, and was negligible in China. The total investment in pension funds of BRICs accounts for too little compared to investments in other regions, like the OECD countries, Euro area countries, and Asian and Latin American countries (Peaucelle, 2010).

In 2008, the International Working Group (IWG) of Sovereign Wealth Funds published a report entitled, *Principles and Practices for SWF - Santiago Principles,* in which China participated with its China Investment Corporation (CIC), and Russia participated with the Reserve Fund and the National Wealth fund while India and Brazil participated at the meeting as recipient countries. According to the report, the proposed principals can be implemented on a voluntary basis subject to home country laws, regulations and obligations. They treat commercial and property rights aspects of SWF management, and are subject to the influence of neo-liberal economic thought (IWG, 2008).

Following this report, Brazil created a new non-commodity fund in 2009, the sovereign Fund of Brazil. This SWF utilises a mechanism for anti-cyclical development and for the promotion of investment projects of strategic interest to Brazil, abroad and within the country. It is also required to support national companies in their export activities. The advisory board that manages the fund's investments is composed of government officials in the planning and finance sector, and the president of the central bank. The fund uses financial instruments, such as corporate bonds, rather than diffusing the capital of firms. At the beginning of 2010 the government formalized the rules of its operation; the federal treasury would not be allowed to sell domestic government securities held in the Fund to make new investments. Rather, the fund's investments must be made in assets that have good investment grade ratings from no less than two rating agencies. In addition, the PREVI Pension Fund was established for employees of the Bank of Brazil - the largest pension fund. It aims at providing its employees and their dependents with social security benefits. In 2007, the fund had profits equal to 37.08%, bringing together 31% of the total assets of the Brazilian pension funds and guaranteed an average payment of more than twice the average secured by all Brazilian funds. In 2008, the fund lost 5.29bn USD as a result of the crisis, and had a negative rate of return (-11.4%), but in 2009 its profits equalled 28.25%, while the profitability of the investments reached 27.16% (Peaucelle, 2010).

Following the global financial crisis, the Brazilian economy started to stabilize with its biggest bank, Banco do Brasil, in accordance to the government's guidelines, acting as a lever for recovery. This, in return, stabilised the inflation rate whilst maintaining low interest rates. As a result, the income profitability was kept fixed at low levels, but was essential for credit and investment returns for firms. In addition, the Stock Exchange recovered, marking a strong sign of trust for foreigner investors. The low interest rates also facilitated long term financing, resulting in an increase of the real estate values, and hence further increasing attractiveness to foreign investors. These factors, helped to improve PREVI, resulting in excess profitability, both in terms of surplus recovery and better retirement conditions. In 2009, PREVI merged with two Brazilian companies, Petros and Funcef, in order to form a Brazilian infrastructure company, INVEPAR. INVEPAR gained the right to operate highways in Sao Paulo and acquired complete control of the Rio de Janeiro's underground system. In the case of Metro Rio, PREVI was among the partners that helped finance the project by purchasing 19 trains (Peaucelle, 2010).

In regards to the negative role of derivatives during the spread of the financial crisis, Brazilian regulators restricted the allowed exposure of financial institutions to this instrument to 20%, minimising their detrimental effect. Other constraining measures included (Peaucelle, 2010):

I. Prior risk assessment;
II. Appropriate internal control systems;
III. Record of transactions in the stock exchange;
IV. Performance of clearinghouse and settlements as transaction counterparts; and
V. Strict rules forbidding transactions left uncovered by buying operations.

Despite the liberalisation of the Russian economy in 1992, its government failed to develop a modern industrial structure, mainly because of its insufficient capital allocation, and difficulties in accessing long term credit. Western countries provided Russia with short term financing; however, this was only beneficial for maintaining stable levels of household consumption, while the domestic industrial and agricultural sector remained idle. This was followed by a period of high oil and gas prices, during which Russia could have accumulated large sums of foreign currency reserves, but as its financial system was inefficient, capital flowed abroad. It was evident that Russia needed funds that could be used as collateral for the obligations of domestic and foreign investors. Therefore, the first stabilization fund was created for these purposes and was divided later into two specialised funds (Peaucelle, 2010).

Aiming at saving the fiscal windfall gains from high oil prices, the Oil Stabilisation Fund was introduced in 2004 by the Russian government, and was financed from the oil export custom duties and the mineral extraction tax. In the case of a year that ended with a fiscal surplus, this was also added to the fund and the total funds were then used to finance the federal budget deficit in case the oil price fell below the reference price. In the case the fund's balance exceeds RUB 500 billion (circa 8.12bn USD), the excess could be used towards the prepayment of external debt. In 2008 the fund was split into a *Reserve Fund* and a *Future Generations Fund* (Beck & Fidora, 2008)

The Reserve Fund of the Russian Federation, established on February 1st 2008, has managed to use its capital in the event of insufficient oil and gas revenues in order to financially support the country's economic programme. The normative value of the Reserve Fund in absolute term sis valued as 10% of projected GDP for the relevant planning period. The fund is financed by revenues from oil and gas as well as the federal budget in excess of the amount authorized by the oil and gas transfer, and through income from the management of the funds. It also covers insurance functions, covering deficits of budget and pension funds. In 2008 alone, 13 different instances of capital inflow transactions to the Reserve Fund took place. The only outflow in 2008 took place in November from the US dollars account, which corresponded to the purchase of RF currency for the correction of the RF reserve position for the International Monetary Fund; this correction was necessary due to the sudden erosion of the budget revenue because of the oil price drop in 2008. In 2009, dollar outflows took place four times in order to purchase Russian currency, again for the correction of its reserve position in the International Monetary Fund. Another six outflow transactions in US dollars took place in order to purchase RF currency for oil and gas transfer accumulations. Seven cases of Dollar inflows were also observed, four of which took place at the end of November and beginning of December 2009. Inflows in Euro and GB pounds were more frequent, totalling eleven different cases. In 2010 all flows were outflows for financing the federal budget deficit, resulting in the exhaustion of the fund's capital (Peaucelle, 2010).

The second Russian SWF, the Stabilisation fund, is also part of the federal budget and its main objective is to co-finance voluntary pension savings of citizens and to cover the deficit of the Pension Fund of Russia. The Fund is formed partly by transfers from the Reserve Fund, if this exceeds 10% of the GDP. The assets of the fund are placed in the accounts of the Central Bank of Russia (CBR) in foreign currency (U.S. dollars, Euros and GB pounds).The Central Bank of Russia is the main agent managing and paying interest for the use of this accumulated capital. The Russian government has set a list of requirements regarding the financial assets in use, where a virtual portfolio of financial instruments is estimated and

the value of the potential average yield is projected. For example, financial assets with a high level of risk are excluded from the list. The Fund is financed only in sovereign debt obligations, with debt securities of foreign agencies and in cooperation with the central banks of Austria, Belgium, Britain, Germany, Denmark, Ireland, Luxembourg, Netherlands, USA, Finland, France and Sweden, as well as in debts with international financial organizations, such as the Asian Development Bank, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the International Financial Corporation and the International Bank for Reconstruction and Development. To allow a debt issue, a foreign bank or credit organisation must have a rating of long term credit not below "AA-", using the classification of rating agencies. If a bought liability no longer meets the requirements set by the government, they must be sold within one month after the date of this discrepancy (Peaucelle, 2010). As of April 2008, the fund exceeded 150bn USD, holding by law only fixed income securities of AAA credit quality issuers from low risk countries. Pressure exists to diversify the Russian fund into both domestic and international equities, but currently the Russian Stabilization Fund holds a clear low risk mandate with respect to its investment policy. Estimates of Russian SWF holdings only include the debt holdings, excluding the state holdings of Gazprom and Rosneft, which would result in an additional 200bn USD to the total holdings (Balding, 2008).

In 2009, Russia entered a recession that resulted in a 7.9% decrease in the GDP, a 10.8% contraction in industrial production and a 16.2% decrease in investment in fixed capital compared to the previous year. The Russian government chose to subsidise this by using its SWFs to balance its domestic demand and to improve its domestic financial system. In the mid-2009, outflows from the National Wealth Fund began, and by the late 2009, 15 more capital outflows were observed, against only 4 capital inflows. However, by August 2010, the outflows were reduced to two, one of them being a transaction to co-finance the voluntary pension savings of Russian citizens (Peaucelle, 2010). In early 2010, it was decided that the VEB infrastructure projects would be financed from the National Welfare Fund. Two billion USD were also deposited in the same year from the National Wealth fund at a rate of 2.75% above the London interbank rate. The National Wealth Fund would be used in the future to cover the federal budget deficit if adverse conditions of economic development emerged, such as a reduction of the price of oil below 75 USD per barrel or a growth rate of the economy below 5%. In this case the Reserve Fund would be depleted, and the National Wealth Fund would be used for resolving political issues, mainly state commitments towards pensions (Peaucelle, 2010).

A short historical overview of the Russian SWFs illustrates a safe strategy regarding its investment management (Balding, 2008).The Funds were useful in periods of crisis in terms of sustaining the Russian economy and its financial sector. The share of household consumption increased significantly, and was the biggest since 1992, at 63.8% GDP. In 2009, due to its SWFSs, Russian capital incomes increased by 102% compared to 2008, and real fixed pension wages grew significantly at 111%. Overall, Russia appears to have allocated its debt portfolio towards low risk offerings, however with the recent sanctions against Russia resulting from the EU and the US due to its involvement in Ukraine, coupled with the drop in oil prices in 2015, it remains to be seen how its SWFs can balance its deteriorating fiscal position. Nevertheless, Russia would be in a much worse position if it had not used mechanisms associated with SWFs to augment its oil and gas revenues.

Since the beginning of the century, the foreign exchange reserves in India have increased. The GDP annual growth rate prior to the crisis was approximately 9.5% as a result of the export oriented policy. Exports increased, while FDI inflows were high – especially between 2005 and 2007. However, according to its official mandate, the Reserve Bank of India had no right to use funds in foreign currency for investing abroad except for treasury instruments. The Indian government began by establishing a public Indian Infrastructure Finance Company in 2006, owned and controlled by the government, aiming at financing major infrastructure projects that require large investment sums. The Company offers financial assistance by lending directly to infrastructure projects that met certain pre-agreed upon conditions, and refinancing to banks and financial organizations for long term loans. In this case long term debt refers to a debt provided to a project company in which the average maturity for repayment in more than 10 years and the loans are guaranteed by the government (Peaucelle, 2010).

In 2008, the Indian government debated the possibility of establishing a SWF, which would support economic growth. The arguments in favour of such a fund indicated the necessity of further diversification, which would not be run only by the Central Bank. Against this view, opponents suggested possible inflationary consequences would arise and also, argued that the timing was not right because of the country's economic depression. In fact, India's current account balance since the start of the crisis declined and it was not clear if an SWF could be fully funded. In addition, the actual increases in Indian reserves were accumulated by *speculative* capital inflows on the capital accounts side, and are exposed to sudden outflows by foreign investors. The most likely investment strategies of the SWF could be to increase returns on reserves, and to guarantee energy resources and other natural materials, such as metal, iron and services (Peaucelle, 2010).

China has four SWFs, three of which have identifiable objectives (Peaucelle, 2010). However, according to the definition of SWFs provided by the IMF and used in the Santiago Principles (IWG, 2008), China only has one entity fulfilling all these criteria: the Chinese Investment Corporation (Sun, Li, Wang, & Clark, 2014). Table 5 shows China's SWFs list published by SWF Institute.

Table 5: Chinas SWFs as listed by the SWF Institute (Source: Sun, Li, Wang, & Clark, 2014)

Sovereign Wealth Fund Name	Assets ($Billion)	Year Created
SAFE Investment Company	$567.9	1997
China Investment Corporation	$482	2007
National Social Security Fund	$134.50	2000
China-Africa Development Fund	$5.00	2007

Nonetheless, the first Chinese SWF to be created was the Investment Company of State foreign exchange management (SAFE), introduced in 1997 and manages the foreign reserves of China, ranking fourth in the list of the world's largest sovereign funds in 2010. During the first period of its existence, investments were placed in safe financial instruments. Later, with the introduction of a competing state-owned company, the China Investment Corporation (CIC), in the spring of 2007, SAFE began to buy shares and high-risk bonds and to make direct investments, particularly in companies in the oil industry of West European countries. The CIC in 2010 ranked fifth largest amongst sovereign funds globally. Its sources of capital are special issue treasury bonds and as a result, CIC has to pay extra to the State Council of China. The objective of the CIC's is to improve the governance of key state-owned financial institutions, as well as to help Chinese enterprises to expand abroad. On the on start of the 2007/08 financial crisis , CIC made important investments in the US financial sector by purchasing equity stakes in US financial institutions, such as the investment bank Morgan Stanley (5.6 million dollars US), funds of private equities in Blackstone (3 million dollars) and JC Flowers (3.2 million dollars). However, the bankruptcy the Lehman Brothers and the systemic financial disaster in America resulted in a radical modification in the investment strategy of these SWFs. For example, in August 2010 CIC sold off shares of the investment bank Morgan Stanley (70.4mn USD) to cut its ownership to less than 10% (Peaucelle, 2010)

At the start of its conception, the CIC had to borrow in appreciating currencies in order to buy assets nominated in depreciated currencies. In connection with the lowering of prices of shares of leading companies of energy and mining industries in the world, CIC started investing directly in their securities. Of the USD 200billion in registered capital, 50% was allocated to global investment (Sun, Li, Wang, & Clark, 2014). It also introduced management principles similar to the Singapore's SWF,

Temasek. Similar to the Singaporean Fund, the CIC started to develop many active investment patterns. Compared to the average of a Temasek project, the value of the average CIC investment project was much larger; there were only 12 projects to finance in 2008, whilst two years later the amount of an average transaction of CIC declined considerably and did not exceed 8bn USD. Now, CIC manages more domestic investment projects, some of which are quoted on the Hong-Kong stock exchange. Moreover, the SWF continues to diversify its investments in varying industries(mining, construction, agriculture, equipment construction) and locations (Australia, Central and South Asia). CIC has plans to be an active shareholder in companies of countries such as Brazil (iron export sector) and Mexico, by increasing direct investments. China has increased investments in resource-related companies by purchasing a 45% stake in the Russian Nobel oil group and in environmental treatment firms, for example in the largest French water treatment company, Veolia. In addition, CIC acquired, in February 2010, more than 2% of the UK's private euro equity fund, Apax Partners. It also plans to work together with Intel Capital to invest in next generation technology, by combining China's assets with the technology expertise of Intel Corporation. Its investments in the financial sector are now with Asian companies, such as Hong-Kong Group CITIC (at the level of 40% of capital stock). During the financial crisis of 2008-2009, CIC deployed circa 21bn USD of its investible capital into the financial market however, due to the financial downturn, the return on its global portfolio in 2008 was -2.1%, while a year later this increased to 11.7% (Sun, Li, Wang, & Clark, 2014). Therefore, it is evident that the CIC shifted its investments away from the financial sector and away from unpredictable sectors in the American and European continents and, into the economies of the Middle East, Asia, Russia, and Brazil (Peaucelle, 2010).

There is a clear separation in the domestic and international investment activities of the CIC. CIC International was established with a permission to manage overseas investments; in December 2011, 30bn USD was injected into CIC International in an attempt to improve its role as a vehicle to diversify China's foreign exchange holdings. CIC International (Hong Kong) Co., Ltd. opened in November 2010 and the CIC Representative Office in Toronto opened in January 2011. The CIC has also increased positions in direct investments and private equity investments in industry sectors, such as energy, natural resources, real estate and infrastructure. In addition, the CIC establishment has indicated that China intends to expand its capital accumulation strategies as part of a broader policy to go global. In this sense, the CIC can undertake both commercial operations directly, as well as indirectly, supporting the 'going global' policies of other Chinese firms, and especially the State-Owned Enterprises (SOEs). Since the CIC is still accountable to the State Council of the People's Republic of China, the state can affect the temporalities and geographies of SWFs' operations extensively, by exercising its sovereign

right to control the flows and creation of financial capital through its central bank (Sun, Li, Wang, & Clark, 2014).

Over time, the CIC has to hold on to the principle of pursuing long-term investments based on commercial considerations. Despite this, there are disputes as to whether the CIC is a commercial or strategic investor and there is no agreement for the domestic sector in China (until 2014). Foreign researchers, however, see the CIC as a strategic investor because of its governmental background and the industries it chooses for its investments. Still, despite its orientation, it is of great importance for the CIC to attain high returns through effective risk management and active adjustment of portfolio structure. While the overseas investments of the CIC are entirely based on commercial principles, its energy investments have raised concerns regarding the possibility that the SWFs have been used as a means for realising its national strategy. On occasions, the host country might take actions toward limiting the SWFs' investments in its strategic assets due to concerns the motives behind the SWFs investment. These can result in negatively affecting the CIC's portfolio construction (Sun, Li, Wang, & Clark, 2014).

In 2000, the National Social Security Fund (NSSF) pension fund was introduced by the Central Committee of the Communist Party and State Council of China. As a strategic reserve fund, the NSSF aims at resolving the problem of the ageing population of China. It is funded by capital derived from the reduction or transfer of state-owned shares, investment proceeds and equity assets, and allocations from the lottery public welfare fund. However, due to ethical principles, the later has been heavily criticised by some socially responsible financial institutions who perceive gambling a forbidden economic activity (such as the Islamic finance) (Peaucelle, 2010). Since its introduction, the NSSF made domestic investments (such as bank deposits, treasury bonds, financial bonds, corporate bonds, securitised products and stocks) and showed an important increase in allocation to shares (1.3% of its portfolio in 2001, and 24.2% in 2006). During the same period, the percentage of bonds in the total investments of NSSF also increased, from 46.8% in 2001 to 53.7% in 2006. However, in 2007 the market share fell, resulting in the Social Security Fund (NSSF's administrator) to report NSSF's first annual loss (6.8% on its investments) in 2008, and in 2010,globalinvestments were made through external money managers instead of direct investments (Peaucelle, 2010).

In 2007, the China-Africa Development Fund was established by the China Development Bank. The funds of this special investment vehicle can be invested in stocks, convertible bonds, and other types of investments, as quasi-equity investments and fund of funds. In total, this fund has made equity

investments in 27 projects in Africa with a total value of USD 540 million. This fund can potentially increase its investments up to USD 3.6 billion (Peaucelle, 2010).

Following the global financial crisis, the focus of international SWFs switched from finance and real estate to transportation and energy. As such, CIC's investments on energy vary from its own global industry portfolio to achieving overall energy security. In 2011, each of CIC's five major sectors (i.e. financial, energy, information technology, consumer discretionary and consumer staples) accounted for more than 10%, but the percentage of energy investment increased to 14%, ranking second only to the financial sector. Since investing in energy is a form of a long-term investment that helps mitigate the short-term fluctuation of energy prices, it deems the energy field profitable and attractive, not only for the CIC's portfolio construction, but also for China's energy security. Hence, in 2014, China's energy security depended mostly on energy trade and investment in resource-rich countries. However, some leaders view energy security as an obstacle for China's economic and social sustainable development; nonetheless, overseas investments in energy have been increasing and in 2010, 2011 and 2012 almost all investment projects were related to energy (Sun, Li, Wang, & Clark, 2014).

Overall, SWFs for China are a tool to be used in investments by SOEs as well as in the energy field, but it is difficult to decouple them from political influence (Sun, Li, Wang, & Clark, 2014). Despite this, the use of SWFs has helped China maintain its currency fixed to the dollar at a low par value. As of 2007, China had accumulated approximately $1.8 trillion in foreign assets, of which 80% are in the form of foreign exchange reserves, i.e. secure investments with very low rates of return (Drenzer, 2008). In addition SWFs are a tool for China to be used in the energy field, in addition to investments by SOEs, and it should play a more active role in the future. However, there are some debates and even fears expressed due to the rising investments by Chinese SWFs (Sun, Li, Wang, & Clark, 2014).

2.3 Hedge Funds

The history of hedge funds dates back to 1949 when Alfred Winslow Jones started an investment partnership, the ideas behind of it still remain fundamentals to today's hedge fund's structure and investment strategies. Jones' fund was structured in attempt to be exempt from the SEC regulations, as these were described in the 1940's Investment Company Act. By doing so, Jones was able to use his fund in a broader variety of investment techniques, including short selling, leverage, and concentration (instead of diversification) of his portfolio. He was also the first to combine the *shorting* and *leverage* techniques, in order to hedge against market movements and reduce exposure to risk (Connor & Woo, 2004). A number of definitions have been provided in order to define what a hedge

fund is, but a universal definition still remains debateable (Kumar, 2007; Connor & Woo, 2004). On the whole, they are unregulated pools of capital that are being managed by an investment advisor (hedge fund manager), who is motivated by perfomance based fees. Hedge funds have similar operations to financial institutions and banks,such as borrowing from markets and taking short positions on stocks, but with the difference being that hedge funds do not have any restrictions on the type of instruments or strategies they can employ (Kumar, 2007).

Funds of hedge funds[1] underwent a major decline following the global financial crisis in 2008, in addition to the Madoff scandal in the same year. The industry's assets under management declined

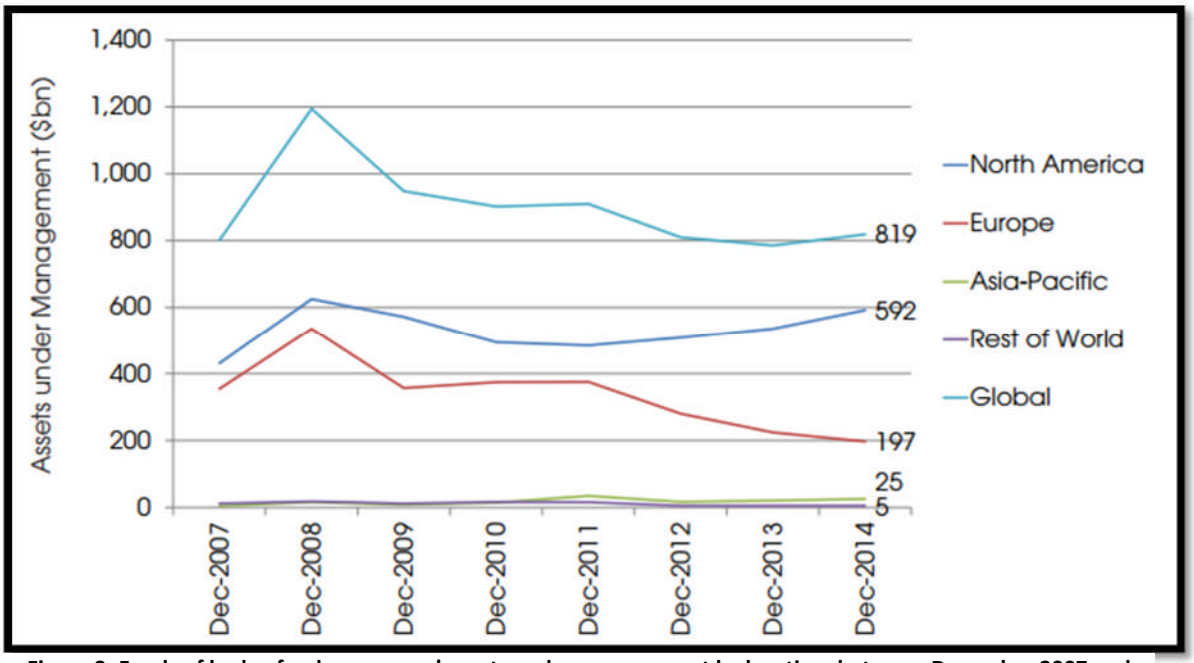

Figure 2: Funds of hedge funds managers' assets under management by location, between December 2007 and December 2014 (Preqin, 2015)

from 1.2tn USD in December 2008 to 948bn USD by the end of 2009 (as illustrated above in Figure *2*), reaching its lowest level in 2013, with 786bn USD in assets under management. Currently however, the industry has managed to recover some of the lost assets, reaching its highest level since 2011, with total assets equal to 819bn USD. There are now more than 4,800 institutional investors worldwide that are using hedge funds in order to diversify their portfolios and to add a source of risk-adjusted returns to their holdings, signalising a mainstream trend towards the use of hedge funds. This came as a result of new regulations being adopted worldwide and a constant review of existing ones, giving investors confidence in the wealth creation and protection that these asset classes may offer (Preqin, 2015). In 2014 alone, the hedge fund industry accounted for 355bn USD in assets

[1] A fund of hedge funds is an investment fund that invests in a portfolio of other investment funds, rather than investing directly, in an attempt to provide a broad exposure to the hedge fund industry.

globally, which came despite the challenges to fund managers due to the volatile global macroeconomic environment. A 2015 Preqin report found that 70% of fund management groups noted positive inflows and only 9% witnessed outflows. In addition, 44% of the fund managers witnessed an increase in the amount of capital they received from institutional investors in the same year. At a glance, in 2014, a total of 586 hedge funds managers utilised an event driven strategy, with 1304 active event driven funds present in the market. A total of 2138 institutions invested in event driven strategy hedge funds, of which 29% witnessed losses. Overall, event driven strategies funds witnessed their lowest annualized return in 2014, at 1.54%, since 2011 (-2.24%) (Preqin, 2015).

In Europe, the European Union's incoming Alternative Investment Fund Managers Directive (AIFMD) regulations (that came into effect on July 22, 2013), as well as the ongoing sovereign debt crisis, have affected negatively both the European based fund managers and global hedge funds that seek to make returns from the European continent. Nonetheless, some growth was evident in 2013, with single manager hedge fund assets increasing to USD 582billion. Still, only 8% of the new hedge fund managers that entered the market in 2013 were based in Europe, as compared to 18% in 2012 and 22% in 2011, as a result of the AIFMD. Overall, in 2013, 76% of the European based hedge funds totalled over USD 1bn in size, with 75% of these managed by firms located in the UK. In addition, a total of 552 hedge funds operating in Europe are structured under the UCITS regime and have a mean size of 431mn USD. In terms of hedge fund management by number of managers, the top five countries are the UK with 696 hedge fund managers, followed by Switzerland with 251, France with 81, Sweden with 53 and the Netherlands with 44 (Preqin, 2013). The following table shows Europe's top ten largest single managers ranked by AUM (HFJ, 2013). In 2014, European hedge funds lost USD 27billion in AUM (Preqin, 2015).

Table 6: Europe's top ten largest single managers ranked by AUM (Source: Author after HFJ, 2013)

Name	Total AUM ($bn USD)	Number of Hedge Funds	Dedicated Managed Accounts AUM ($bn USD)	UCITS-compliant Hedge Fund AUM ($bn USD)
Brevan Howard	40.00	5	0.04	2.00
Man	35.60	5	8.20	2.60
BlueCrest Capital Management	34.22	3	n/a	n/a
Blackrock	28.70	5	n/a	4.70

Winton Capital Management	24.80	4	14.60	0.28
GAM Holding	24.10	4	n/a	n/a
Brummer and Partners	16.20	5	2.30	n/a
Amundi	12.45	3	7.18	6.97
Lansdowne Partners	12.32	5	1.24	n/a
Marshall Wace	10.74	5	n/a	1.63

Prior to 2008, a study conducted by Becht, Franks and Grant (2010) analyzed 362 European activist interventions by hedge funds and other activist investors, and concluded that for public interventions, the disclosure of acquired stakes was associated with large positive abnormal returns across a number of countries. While private activism was extensively profitable, the same could not be said for public activism, mainly because of the higher frequency of takeovers in the public activism sphere. The returns from hostile activist interventions were more profitable than co-operative ones, and the returns for specialist activist funds were larger than for other investors (Becht, Franks, & Grant, 2010).

In Brazil, the funds that implemented the main strategies in the hedge fund industry are known as multimarket funds (fundos multimercado). Such funds do not require the participation of the manager's capital and do not restrict access to customers with little capital (some funds allow for the participation of small-capital investors). In September 2009, these funds registered a net worth of 160bn USD, accounting for circa 8% of the total net worth of all Brazilian funds and just below the percentage that were made up by: fixed income funds (circa 30%), the Brazilian interbank deposit interest rate (DI) referenced funds (circa 17%) and fixed income pension securities (circa 9%). Studies have shown that this industry provides favourable returns when compared to mutual funds, including those mentioned above (fixed income funds, Brazilian DI referenced funds and fixed income pension funds) (Jordao & De Moura, 2012). In 2011, the Brazilian multimarket funds represented approximately 232bn USD, when in 2005, this value totalled USD 60.04bn. This increase is due to internal factors relating to the sector itself, such as a decline in the real interest rate in Brazil during this period and an increase in investors' interest (Joaquim & De Moura, 2011). However, the total assets under management were 56bn USD in 2010 from over 400 funds. Nonetheless, the Brazilian onshore funds AUM increased by 50.8% in 2009 and the Brazilian hedge fund index [BBOEMSBZ] returned to 37.51% (J.P.Morgan, 2010).Moreover, in 2013, two hedge funds from Brazil were featured in the top 100 hedge fund list, Gávea Investimentos and BTG Pactual. Both firms manage single-manager funds and multi-manager vehicles. Brazil is also the host country for all top 100 funds

managed by South America-based firms. Sao Paulo-based managers, Credit Suisse Hedging-Griffo and Brasil Capital, have several representative funds, of which, 53% of the strategies were attributed to long/short strategies. This was followed by a macro strategy with 32%, multi-strategies with 9%, relative value with 4% and a final 2% to other strategies (Preqin, 2013).

In 2011, Joaquim and De Moura analyzed performance and persistence of the Brazilian hedge fund market using daily data from September 2007 until February 2011. They found evidence of joint persistence, but results were limited to a select group of individual funds, especially when considering a 3-month time horizon, which highlights the importance of diversification from an investor's perspective, both in terms of risk as well as to respect to performance persistence. The researchers also analyzed the relationship between the aforementioned factors and discovered a statistically insignificant relationship. However, they did find positive and statistically significant coefficients for the mean-accumulated returns when examining the relationship between performance and management fees, which may indicate higher mean-accumulated returns, allowing fund managers to charge higher management fees (Joaquim & De Moura, 2011). Following this, in 2012, Jordao and De Moura published a paper, the objective of which was to analyze the performance of Brazilian hedge funds between 2000 and 2009. They concluded that when they analyzed the ability of managers to obtain returns excluding overall systematic risk, only 3.7% to 7.8% of the funds presented positive and significant alpha coefficients (a coefficient of reliability (or consistency)). Moreover, they showed that when examining the performance in market timing ability, only 3.7% of hedge fund managers could successfully predict the market in order to aggregate greater returns and 33% of the funds showed zero systematic risk (Jordao & De Moura, 2012).Overall, the Brazilian hedge fund market shows a dynamic industry segment within the Brazilian fund industry especially given that more than 39% of the funds analyzed in Joaquim and De Moura's study presented a significant and positive alpha for all of the specifications and estimation methods (Joaquim & De Moura, 2011).

The Asian-Pacific region, including India and China, are currently undergoing one of the most significant periods for their hedge fund industry, with new developments and specifically with the introduction of the new Securities Investment Funds Law in China (Preqin, 2013) and the recent authorisation of India's first domestic hedge fund (Shamdasani, 2012). Currently, Asian-Pacific based hedge fund managers account for less than 4% of the total hedge fund industry capital despite the fact that the region is home to a considerable number of managers (Preqin, 2013). As seen, in *Figure 3* (Shah, 2013), Asian hedge funds have increased significantly since 2000, reaching their pick in 2007. A decline is observed followed by a slow and fluctuated recovery, with 2013 being the best year in

terms of total AUM (as compared to the years after 2007). Specifically, the number of funds in Asia increased from 259 in 2002 to 768 in 2013 and the AUM increased to $159 billion from $21 billion during the same period (Shah, 2013).

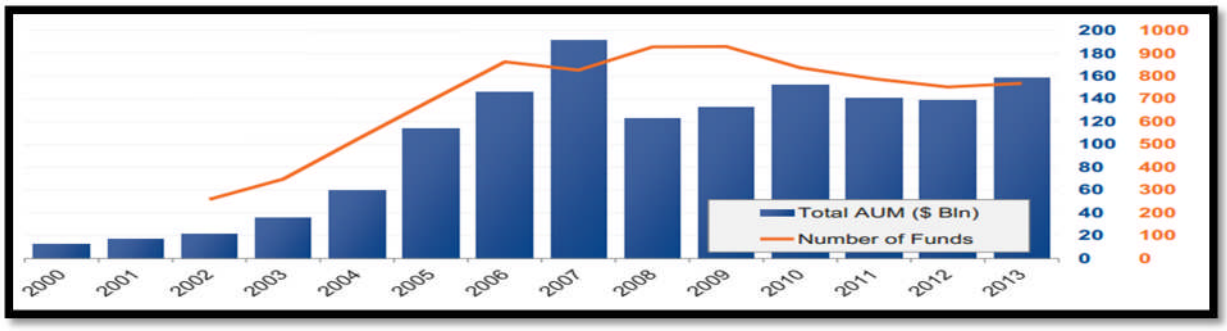

Figure 3: Growth of Hedge Funds in Asia (Shah, 2013)

The funds invested in the South Asian nation (which includes *India* as well as *Pakistan, Bangladesh, Nepal* and *Bhutan*) returned 29% in 2013. That compares with an average 7.3% gain for those investing in Asia (excluding Japan), 2.2% for Japan, 5.6% for North America and 1.4% for Europe (Shah, 2013).

Lately, India has witnessed the blossoming of its hedge funds industry. Hedge funds were recognised to have an important role in the Indian capital market (Kumar, 2007), leading India's capital market regulator to authorise the country's first domestic hedge fund in 2012 (Shamdasani, 2012). Hedge funds investing in India became the world's best performers in 2013 (Shah, 2013). In 2014, the average Indian hedge fund was up to 39.36%, outperforming the underlying markets by circa 10%. Managers running long/short equity strategies emerged as the clear winners posting gains of 54.83%. *Figure 4* shows the historical performance of Indian managers relative to the BSE Sensex Index and illustrates how managers focused on the country have rebounded after a relative stillness The AUM of hedge funds under Indian management rose to 5.3bn USD between 2004 and 2007 but dropped to 2.3bn USD in the following two years, increasing by only 0.5bn USD by 2013 (Shah, 2013). The average Indian

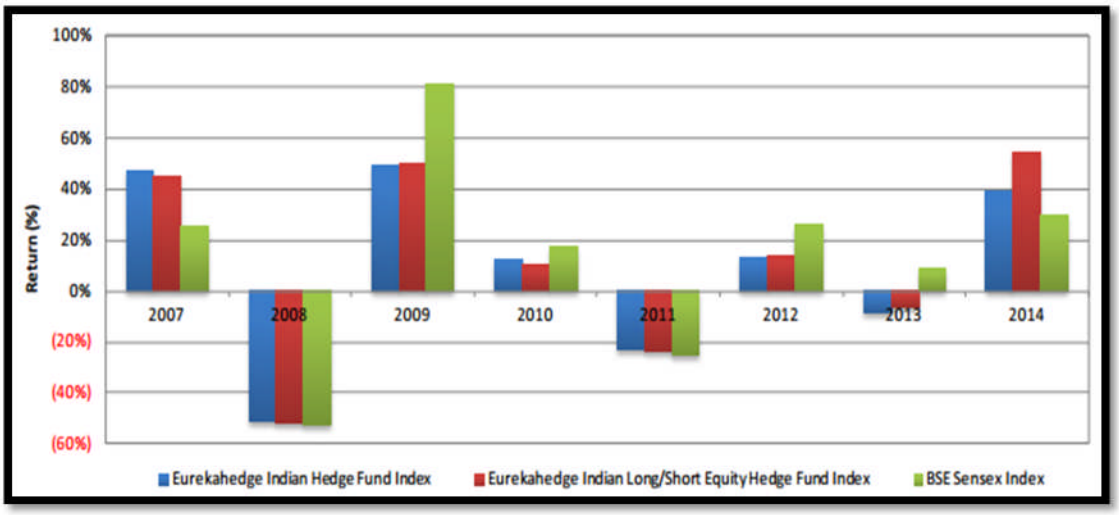

Figure 4: Performance of Indian hedge funds since 2007 (Eurekahedge, 2015)

hedge fund was down 50.66% in 2008, as seen in *Figure 5*, as a result of the financial crisis, showing steep performance-based losses and investor redemptions from which the Indian hedge fund industry has not completely recovered yet. Since 2009, Indian managers reported an eight year annualised return of 10.89 (Eurekahedge, 2015). The benchmark of S&P BSE Sensex Index increased to 25% in 2013, outperforming the 5.3% gain of both the MSCI World Index and the MSCI Asia Pacific Index and the 8.9% gain by the MSCI Emerging Markets Index. Indian-focused funds are mainly using equity-based strategies because the nation's corporate-bond market is less developed than of other countries. The long-short fund, which invests in Indian equities, has returned 13% in 2013 (Shah, 2013). In 2014, managers reported approximately USD 700million in performance-based gains with net inflows equivalent to USD 215million during the same year. While investor flows have not kept pace with manager performance in 2014, India remains a much better value proposition for investors compared to some of its emerging market peers and a clear beneficiary of the lower oil prices. In 2015, Indian hedge funds AUM are at their highest, at 3.45bn USD, approximately 36% below their 2007 peak of 5.36bn USD (Eurekahedge, 2015).

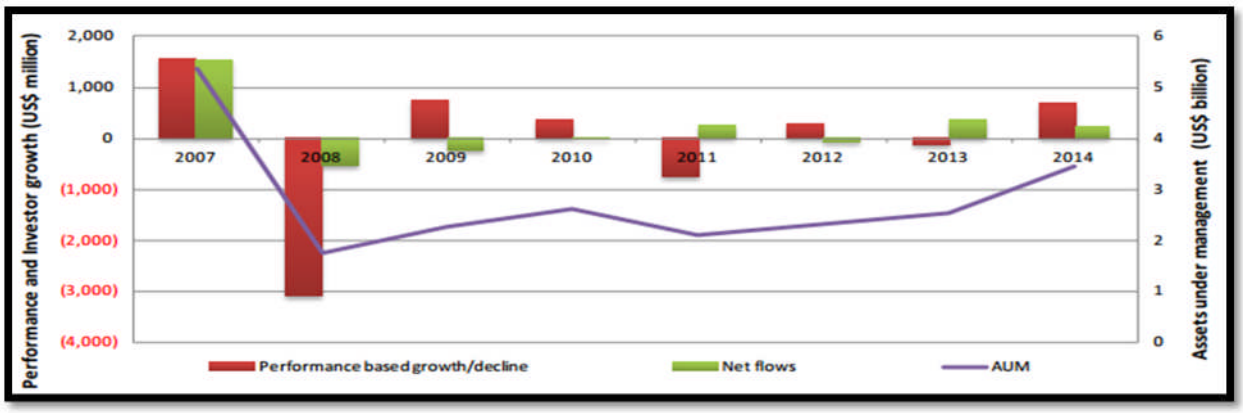

Figure 5: Growth of Indian hedge fund AUM (Eurekahedge, 2015)

Regarding hedge fund investments in India's Foreign Institutional Investors (FIIs), those interested must firstly register before they can deal in Indian securities. A main criterion as to whether one can be registered is that it should be regulated at its place of incorporation or operation(s). However, since most hedge funds are not regulated in their originating country, most hedge funds do not qualify under the Securities Exchange Board of India (SEBI) regulations and therefore, they use FIIs as an intermediary to access the Indian Capital Market using instruments called Participatory Notes (PNs) – a route usually preferred even if they qualify as an FFI, to avoid SEVI's regulations. The following figure (*Figure 6*) shows the movement of hedge fund into India (Kumar, 2007)

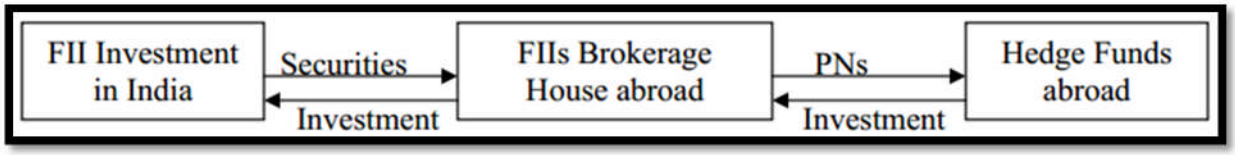

Figure 6: Movement of FFI investments in India (Kumar, 2007)

In addition, in 2012 a list of new alternative investment funds (AIF) announced by the SEBI, named Mumbai–based Forefront Alternative Investment Trust (FAIT) a Category-III fund — a class reserved for hedge funds. Such funds can employ varied or complex trading strategies and may utilise leverage via investments in both listed and unlisted derivatives (Shamdasani, 2012).Despite these, the leading hedge fund centre in the Asian-Pacific region, is Hong Kong, attracting 36% of the total managers, with 7 out of the ten largest hedge fund managers of the Asian-Pacific region being located there (including the 9.3bn USD Value Partners, which manages a number of long/short funds focused in that region). Hong Kong also accounts for 11% of the investors in that region, third after Japan (32%) and Australia (31%). According to Non-Asia-Pacific-Based Investors, the Greater China Region represents good opportunities (47%) (20% for India) (Preqin, 2013). However, it was not until recently (2006) that the Chinese securities market opened up to foreign investors while also allowing Chinese investors to make investments outside China (EYGM , 2014). Over the last approximately ten years, the growth of China and the Asian economies have brought benefits throughout the region, like the blooming trading economy of Hong Kong (CHA & SFS, 2013).

The first program, entitled *Qualified Domestic Institutional Investors* (QDII), was introduced in 2006 and aimed at giving Chinese investors access to overseas markets, allowing for new opportunities for investment funds. The regulations for the QDII were outlined in a brief document issued by the People's Bank of China (PBOC) in April 2006 and in 2007 the China Securities Regulatory Commission (CSRC) issued the Interim Measures for Overseas Securities Investment allowing qualified Chinese

fund management companies and securities firms to invest in offshore financial markets. Similarly, around the same period, the Qualified Foreign Institutional Investor (QFII) scheme was introduced in order to allow access of foreign investors to securities markets in China by allowing investments in the country's restricted Renminbi (RMB), by trading Chinese A-shares and other financial instruments through special accounts opened at designated custodian banks. In 2011, the RMB Qualified Foreign Institutional Investor (RQFII) pilot scheme was launched according to which, investors in Hong Kong are allowed to invest offshore RMB in the Chinese mainland securities markets through the Hong Kong subsidiaries of mainland securities companies and fund management companies. As of 2012, the QFII broadened its investments to include stock futures and warrants, and increased by 30%the shareholding limit in a single listed company by all overseas investors (EYGM , 2014).

In addition, China proposed the launch of its *Qualified Domestic Limited Partner* (QDLP) programme in September 2014, showing a further liberalisation of its capital accounts. It gives approval to six leading global hedge funds to raise 300mn USD of capital. Another domestic private fund, the *sunshine fund* also underwent regulatory changes in 2013, according to which funds in that market can be registered with the *Asset Management Association of China* (a self-regulatory body, sponsored by the *China Securities Commission*). Last year, the domestic market accounted for 22bn USD in AUM (Li, 2014). Since the introduction of the aforementioned programmes, China has emerged as the preferred location for hedge fund firms investing in Asia, with 30% located in that region in 2012, up 20% from the first quarter of 2009. Globally, China trails only the US, UK and Switzerland as the preferred location for hedge funds worldwide (HFR, 2012).

It should also be noted that Hong Kong's fast-growing hedge fund industry also benefits from lower taxation, in spite of the Asset Management Licenses being more difficult to be obtained as a result of the requirement for the recipient to undertake exams. However, moves have been made recently towards the simplification of certain aspects of Hong Kong's regulatory regime, such as granting an exam exemption for seasoned investment professionals and reducing license approval times to 10 weeks according to the Securities and Futures Commission (the "SFC") (CHA & SFS, 2013).

2.4 Private Equity and Venture Capital

Private Equity (PE) and Venture Capital (VC) are a constantly increasing source of financing for potentially high-growth companies, and their aim is to help more businesses to achieve growth by providing finance, strategic advice, and information. In Europe since 2000, more than 270bn EURO has been invested by professionals on PE and VC, in 56,000 companies, whilst between 2000 and 2004,

companies financed by PE and VC created 1mn new jobs, equivalent to a 5.4% compound annual growth per year (EVCA, 2007).

The *European Private Equity and Venture Association* (EVCA), in a report published in 2013, identified 1455 European private equity funds (between 1980 and 2013), which accounted for 400bn EURO of total commitments. The net-pooled Internal Rate of Return (IRR) reached 9.24% between 1980 and 2013 for the aforementioned companies, while buyout funds had an IRR of 11.41% and venture funds reported an IRR of 1.68%. Private equity funds in the top quartile were constant at a net pooled IRR of 20.82% (21.04% in 2012), whilst buyout funds had an IRR of 20.49% and venture funds totalled 18.51%. Regarding the top half, a net pooled IRR of 13.42% (13.68% in 2012) was found; buyout funds recorded an IRR of 15.13% and venture funds reached 11.28%. Overall, the highest returns were identified in years 1990-1994 (15.49% IRR) and 2000-2004 (13.73% IRR), with buyout funds in 2000-2004 showing an IRR of 18.44%. The best-performing venture funds were evidenced in the period 1990-1994, reaching a pooled net IRR of 12.87%. The strongest vintage year for all private equity with regards to IRR was 1995 at 42.94%, whilst the highest TVPI multiple was recorded in 1994 at 2.91. In the last 10 years, 2004 produced the highest IRR at 15.81%, closely followed by the 2009 year with 15.41% (EVCA, 2013).

In the same year (2013), EVCA published another report examining 1200 European private equity firms that covered 90% of the 555bn EURO in capital under management in the European market. The following graph shows the activity of the private equity firm's European offices (EVCA, 2014).

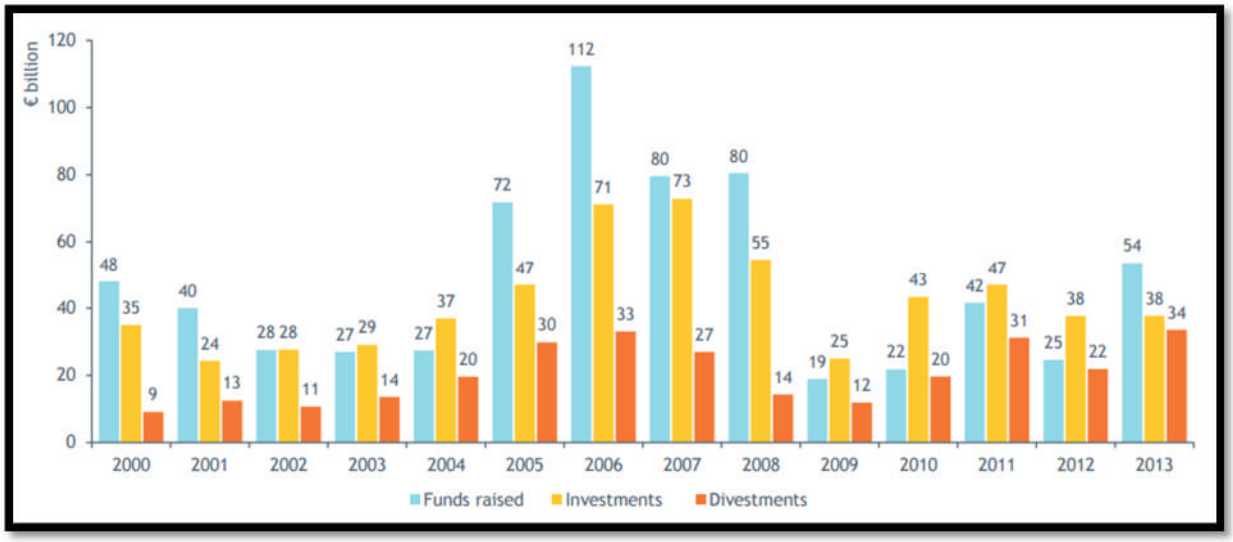

Figure 7: "Industry statistics" capturing activity by private equity firm's European offices (EVCA, 2014)

From the graph above, it can be seen that the amount of capital raised by private equity funds in Europe in 2006 was the highest recorded, at 112.3bn EURO. The share of venture capital in this fundraising was 17.5bn EURO, equal to 15.5% of the total funds raised. The successful fundraising was led by investor interest in buyout funds, but the relative share of venture capital in fundraising also increased. This was caused by low interest rates combined with easy credit conditions that prevailed at that time. This favourable environment was further reinforced by institutional investors' increasingly positive attitude towards asset classes underpinned by attractive returns generated by buyout investments. The appeal of venture capital also appeared to be slowly improving in response to an initial recovery in performance since the bursting of the technology bubble in 2000. Benefiting from favourable conditions, European private equity investments grew by 51% in 2006, at 71.2bn EURO compared to 47.1bn EURO the year before. Buyouts accounted for the most of the European private equity investment corresponding to 71% of the total investment. Venture capital also contributed to the growth of private equity investment by 40% to 20.8bn EURO. The increase in investment in 2006 was a natural reflection of good availability of funds for investment, which also boosted an increase in private equity average deal sizes. The prices paid for companies taken over by private equity houses and venture capitalists were relatively high and increasing in 2006 (Raade & Machado, 2008). In 2009, the amount of funds raised by private equity houses in Europe was at their lowest. As banks withdrew from the market and economic uncertainty grew, only 672 buyouts worth 30.5bn EURO closed in Europe. Exit activity was also quite weak, with only 322 exits valued at 23.7bn EURO recorded that year (White & Case, 2014).

In 2013, the total fundraised capital of 53.6bn Euro was approximately double the volume of 2012. This increase resulted from buyout funds of which, 12 funds raised more than €1bn each and represented 66% of the total fundraising. However, the number of funds in fundraising decreased from 266 to 253. Pension funds accounted for circa 40% of sources of funds. Fund of funds contributed 16%, followed by sovereign wealth funds (11%) and insurance companies (11%). About 26.2bn EURO was raised from institutional investors outside the European continent. Venture capital accounted for 8% of the total fundraising. The contribution from government agencies remained at 38%. Family offices and private individuals contributed 23% and fund of funds 12%. Buyout fundraising increased from 16.7bn EURO in 2012 to 44.9bn EURO, representing 84% of all fundraising. Overall investments in European companies remained stable. More than 5000 companies were backed in 2013 compared to 2012. Equity investments decreased by 3% to 35.7bn EURO. More than 40% of the companies that received investments in 2013 were backed for the first time. The total amount of venture capital invested increased by 5% to 3.4bn EURO. More than 3000 companies were venture-backed. Start-up

stage investments accounted for the majority of venture capital activity by 55% and the number of companies - 59%. More than 800 companies received buyout investments. The related equity amount invested reduced by 2% and the number of companies by 9%. More than 1000 companies had attracted growth investments. This represented an increase of 6% by the number of companies and a 10% decrease in the amount of equity invested (EVCA, 2014).

A total of 2290 European companies exited, representing former equity investments of 33.2bn EURO. The number of companies increased by almost 10%, while the amount divested at cost increased by 54%. The most prominent exit routes by amount were trade sale at 27%, sale to another private equity firm at 26% and sale of quoted equity at 14%. Approximately 40% of the divested companies followed these exit routes. The strength of public markets in 2013 was reflected by the steep increase in divestments by flotation (IPO). Divestments from venture capital investments by equity amount at cost increased by 21% to 2.2bn EURO. Buyout related exits at cost increased by 53% to 28bn EURO. For growth the total amount divested at cost increased by 54% to 1.8bn EURO (EVCA, 2014).

With the ongoing economic uncertainty in developed markets, many investors are shifting their focus on emerging markets in their private equity portfolios in order to achieve greater diversification and target potentially higher returns. BRICs have often been perceived to be the primary focus of private equity investment in emerging markets since they are now among the largest economies in the world, and continue to attract significant capital from private equity investors. Despite the fact that India and Russia experienced declines in investor interest between December 2009 and December 2011, both have seen growing investor interest in 2013 (Sutro, 2013). In 2010, India, Brazil, and China were among the top 10 target countries for private-equity investment by value (Market Overview, 2011). Furthermore, BRICs rank in the top 12 global economies by share of GDP, and are expected to be in the top six by 2018, as shown in *Figure 8*, as well as exceeding 50% of global private consumption (Jaeger, 2012).

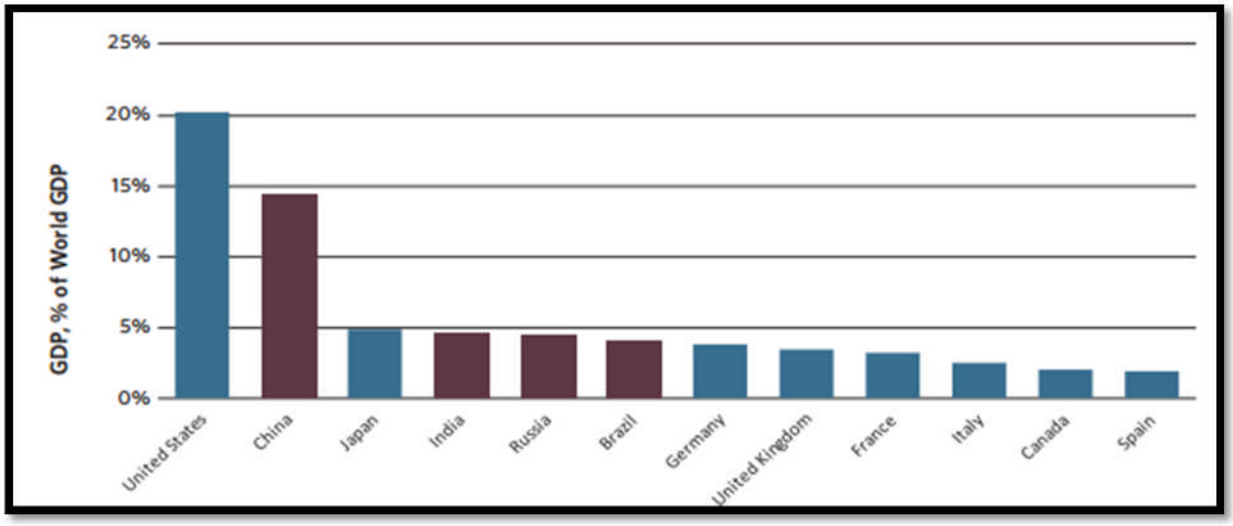

Figure 8: Top 12 countries by share of global GDP as projected for 2018.

The aggregate annual fundraising for private equity funds focusing only on BRICs has accounted for about a third of the total (33%), whilst the aggregate capital raised (35%) by emerging markets-focused funds between 2006 and 2012. In 2012, 112 funds raised an aggregate of 23bn USD, similar to 2010's levels, when 119 funds raised an aggregate 24bn USD in capital commitments from investors. In 2010, managers based in BRIC countries raised 69% of the aggregate capital and in 2012, this increased to 83%. In 2007, prior to the financial crisis, BRIC-based fund managers only represented 43% of the aggregate capital raised by BRIC-focused funds (Sutro, 2013).

Within BRICs, the private equity-backed buyout deals have undergone a significant growth in recent years, making up a larger proportion of emerging markets deals both in terms of number and aggregate deal value. In 2006, buyout deals in BRICs accounted for 53% of the number and 36% of the aggregate value of deals across emerging markets and in 2012, this increased even more, with deals in the BRIC nations representing 71% of the number and 70% of the aggregate value of emerging markets deals. The largest buyout deal that took place in the BRIC region was in December 2012, when the Carlyle Group, China Everbright, CITIC Capital and FountainVest Partners, agreed to take Focus Media, a digital media group based in China, private for 3.7bn USD. Regarding the emerging market venture capital deals, BRICS between 2008 and 2012, accounted for an circa 76% of the number and 87% of the aggregate value of venture capital deals taking place across emerging markets. The number of venture capital deals in BRICs has been increasing since 2009, from 270 deals in 2009, to 512 deals in 2012. The aggregate value of BRIC deals peaked in 2011 at 7bn USD, but fell in 2012 to $4bn. Finally, concerning Focused Fundraising, many fund managers raising capital to invest in the BRIC nations are raising single country-focused funds, instead of vehicles that plan to invest across multiple BRIC

nations. In 2006 and 2007, an average of 21% of the number and 24% of the aggregate capital of funds exclusively targeting the BRICs was raised by fund managers targeting more than one country. In 2012 this dropped to only 5%, and 4% of the number and aggregate capital raised by purely BRIC-focused funds. Of the 236 BRIC-focused funds currently in market, only 7% are targeting multiple countries (Sutro, 2013).

It is important to emphasize however, the degree of differentiation that characterizes each market. A look at the varied private equity returns in the BRICs across time underscores the importance of understanding the macroeconomic, regulatory and private equity dynamics in each country. The macroeconomic and structural improvements in Brazil (Jaeger, 2012) along with its stability, growth and credibility in the global economy (Market Overview, 2011) constitutes it an attractive place to invest. Pricing has also been relatively attractive, with the majority of deals between 2007 and 2012 executed at valuations of approximately 6.5x EV/EBITDA (Jaeger, 2012).The rise of the consumer class, the favourable demographics and a stable political environment make PE investment interesting tin Brazil; in 2010, its growth rose to 7.5%. The Brazilian government continues to stimulate growth. Major infrastructure investments have to be made in the coming years, and these present enormous business opportunities, as do the massive oil discoveries. The upgrade of government debt to investment grade has also reassured investors. According to the EMPEA Coller Capital surveys, Brazil replaced China as the most attractive emerging market for GP deal-making. PE took its first steps in Brazil in the middle of the 1990's. Several government measures, such as the "Plano Real", created currency stabilization, and a number of privatizations of state-owned companies helped to attract investors. In 1998, the PE industry in Brazil raised 3.7bn USD. But stability had still not been achieved and, according to Venture Equity Latin America, PE investments in Brazil represented more than 10.5bn USD in 2010. According to PwC, after accounting for 30% of the deals announced in 2009, in 2011 it reached 42% of the deals announced in 2010. It was only 20% in 2008 and 15% in 2007 (Market Overview, 2011).

Russia is the sixth largest economy globally, and the number of people earning more than 10000 USD annually has tripled in the last six years. GDP grew by 4% in 2010 to 1.58tn USD. The macroeconomic fundamentals necessary to attract PE investment exist, but some key factors stop investors. One such characteristic of Russia is the geographic vastness of its market, which implies not only cultural and economic disparities but also a division of the country into regions, territories and federal districts, each one having its own legal peculiarities. Additionally, the infrastructure is not developed homogeneously throughout the territory. Nonetheless, the real barrier to the development of PE is

the regulatory framework and the excess government interference. Despite this, the government launched a 10bn USD fund, entitled the Russian Direct Investment Fund, in order to improve Russia's attractiveness, with the State's finance being limited to a minor role of no more than 50% minus one share in any project, meaning that co-investors will hold the majority stake but will share the risk with the State. PE activity slowed down during the global crisis; in 2009, there were only 20 deals, with a total value of 217mn USD. In 201, 45 deals took place, equivalent to 815mn USD. In 2011, General Atlantic, a growth capital investor, made its first Russian investment of 200mn USD for a minority stake in the internet security firm Kaspersky Labs. However, this year's major transaction, and the one that might help to restore investor confidence, is that of U.S. private equity giant TPG Capital, which signed a 1.1bn USD deal to buy a 44% stake in St. Petersburg-based retailer Lenta LLC. TPG; this deal was partnered with the Russian state-controlled bank VTB Group (VTBR.RS) and the European Bank for Reconstruction and Development for this deal (Market Overview, 2011).

The Indian PE market is still undeveloped, since emerging in the early 2000s, but contrary to other emerging PE markets it is rapidly growing. Since 2005, more than 1,900 Indian companies have accepted VC and PE investments (Market Overview, 2011). India has received the greatest proportion of early stage deals between 2008 and March 2013 with 33% of the venture capital deals taking place in the country across this period, compared to 28% in Brazil, 20% in Russia and 23% in China (Sutro, 2013). In 2007, investments reached 17bn USD but this was heavily impacted by the global economic crisis and hence, declined by circa 60% in 2009 at 4.5bn USD. The market begun to recover and stabilise in 2010, and PE investment reached 8.13bn USD across 328 transactions, followed by 274 additional deals worth a total of 7.57bn USD, closed between January and August 2011. The gap between infrastructure needs and resources is growing, and the current level of infrastructure spending is expected to be doubled to 1,000bn USD, with the private sector contributing between 40% and 50%, thus creating additional investment opportunities in infrastructure such as roads, railways (Market Overview, 2011).

China's impressive economic growth (averaging circa 9% for the last approximately 25 years) required a robust industrial development with important investments in heavy industry and infrastructure. In terms of PE market, around 1000 PE/VC firms were actively invested in 2011. Prior to that, the deals were done mainly by global managers through their offshore funds. A major characteristic of the Chinese PE Market is that PE investments are made towards companies in order to reach their growth potential. The typical buyout deals seen to a massive extent in the more mature markets represent only 3% of the investments made in China. One of the consequences of this is that investors will only

take a minority stake in the companies they target, which means that they will have less influence on the business strategy and the moment of exit. However, this trend should change as the market matures, but the PE market is nevertheless doing great business in the meantime. Another notable trend in the Chinese PE market is the increasing number of new funds raised in the domestic currency Renminbi (RMB). This is mainly due to government support and a favourable regulatory framework for domestic activity. According to the Zero2IPO research centre, such funds accounted for to 40% of the capital raised for PE deals in 2010. The majority of them were collected by domestic managers. However, global PE firms, such as Blackstone or Carlyle, have shown strong interest in launching RMB denominated fund-raising strategies (Market Overview, 2011). Among BRICs, China has received the greatest proportion of venture capital deals, with 27% of those taking place within the country since 2008, consisting of Series B, C, or D and later deals, compared to 12% in Brazil, 12% in Russia, and 15% in India (Sutro, 2013).

2.5 An assessment

All the above vehicles and sources of funds are unevenly distributed between emerging and developed economies-the trend however is for emerging economies to play a leading role in some cases (such as SWFs) and an increasing one in others (e.g. FDI). All these are looking for opportunities to invest profitably and provide opportunities for financing to Europe, that can be leveraged in mutually advantageous ways.

As regards FDI, for example it can be suggested that the EU is well positioned as a direct investor in the BRICs. However, the share of EU firms in total FDI in China and India is low and not very dynamic. As investments in geographically distant places are mainly the focus of large corporations rather than Small and Medium-sized Enterprises (SMEs), who usually limit their foreign operations to nearby countries, policy changes may be necessary to expand EU presence, especially when given the high market potential in China and India. Since FDI is limited in some industries that are important to the EU investors, such as finance or telecommunication, the EU trade policy could revisit some extant measures such as caps to foreign ownership and restriction of foreign ownership as it can block the transfer of technology. In addition, as China's FDI outflows are dominated by state-controlled enterprises in natural resources or telecommunication, most of which enjoy a monopoly or monopoly-like situation in the Chinese economy, their expansion abroad may distort fair competition. The guidance for EU policy has been its strong commitment to open markets and fair competition and this may prevail over other concerns when dealing with investment issues of the BRICs. The EU may thus

be interested in a process of further mutual and balanced liberalization in the area of FDI to eliminate obstacles on both sides (Hunya & Stöllinger, 2009).

In relation to SWFs, most investments have been in terms of passive portfolio holdings rather than controlling stakes. Yet, some SWFs acquired control of stakes in companies, giving rise to fears that FDI could become a tool for national governments to pursue political instead of economic ends. Such concerns are spilling over into the broader debate over foreign investment, in a way that policies directed at SWFs might also end up restricting FDI by private investors (Marchick & Slaughter, 2008). It was also suggested that SWFs are mainly invested in domestic and regional markets showing home bias. SWF's should diversify their holdings between a risk adjusted portfolio comprised of stocks, bonds, and alternative investments. Due to their nature as guardians of national wealth, they are expected to target safe liquid assets such as highly rated corporate debt, and sovereign securities, while allocating a small portion of the portfolio to riskier investments such as growth stocks, private equity, and hedge fund activities (Balding, 2008).

Following the economic crisis of 2008-2010, Russian sovereign funds have been used mostly in order to sustain the federal budget and household consumption. They have also supported banks, because the government wished to preserve the savings of Russian citizens. This case shows that a SWF, such as the National Wealth Fund, can stay alive longer during downturn periods of crisis, and even provoke contra-cyclical movement. After a contraction in 2009, the Russian economy grew at around 4.5% of the GDP in 2010. Inflation has fallen, the current and capital accounts have rebounded, and the domestic currency has strengthened. On the contrary, the Chinese sovereign fund, the China Investment Corporation, was used to modify swiftly the investment policy in the country by substituting investments in foreign financial institutions for industrial projects (Peaucelle, 2010).

Finally, attractive investment opportunities do exist for private equity and venture capital firms in China, particularly in the early stage and growth equity space, although the larger end of the company spectrum is experiencing upward pressure on entry valuations. Russia benefits from an increasingly vibrant technology environment and is attractive to funds that focus on high-growth businesses in areas related to technology and innovation. Contrary to China, Brazil and Russia, India is a difficult market for traditional private equity strategies as challenges faced by investors include significant competition for deal flow, a persistent mismatch between private and public company valuations, a difficult exit environment, and an increasingly hostile political and fiscal environment. Yet, adverse market conditions can still present interesting investment opportunities, and some private equity investment firms have recently taken a contrarian view of the opportunity in India (Jaeger, 2012).

Furthermore, despite India showing the highest growth among the BRICs with respect to venture capital deal activity, the proportion of the number of BRIC venture capital deals represented by India has increased from 31% in 2008 to 55% in 2012 and the number of venture capitals deals taking place in India has grown from 120 in 2010, to 201 in 2011, and 282 throughout 2012 (Sutro, 2013). One of the main barriers holding back the PE boom in India seems to be the lack of regulatory support. Some changes in securities and tax law are being considered aimed at removing ambiguities concerning their treatment. In addition, the factor most likely to deter LPs from beginning to invest in India is that entry valuations are too high (Market Overview, 2011).

3. A European Opportunity

It is arguable that Europe could do more in order to leverage the huge sources of global surpluses in a way that enhances its role, helps herself and helps provide sources of profitable opportunities to the BRICs, SWF countries and its own HF, VC and PE firms, hence fostering sustainable development in Europe and more widely. Many proposals have seen the light in recent years from various sources. Below we focus on ideas propagated in a recent book by Holland (2014), which also critically appraises other suggestions, as these have been embellished by a group of scholars at the Pavia Declaration (s. Pavia Group, 2015)

The Pavia declaration starts from the observation that while the Eurozone crisis has many causes and culprits, it is mostly its citizens who are being asked to pay the burden of its costs, especially those in the European periphery. In particular, austerity in Greece and other member states is contributing to massive hardship which prejudices the commitment of the Rome Treaty to rising standards of living and of its first revision in the Single European Act to economic and social cohesion. Therefore "Europe is not working" either in the sense of assuring high levels of employment or in terms of the commitment to democracy of its founders.

The declaration points out that 'Structural reforms' that induce austerity while reducing social protection cannot be the condition of any assistance to debt distressed countries. The IMF in its April 2015 World Economic Outlook recognizes that employment protection is not found to have any statistically significant negative effect on productivity. An exclusive focus with reducing debt neglects that Europe could allocate surplus savings into productive investments especially because increased public investment raises output both in the short and long term, can crowd in private investment, and can reduce unemployment with limited effect on the public debt ratio (IMF, 2015). This is supported by a recent IMF paper (Abiad, Furceri, & Topalova, 2015).

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800

In the above context, if the EU is both to survive and flourish it needs to reassure its citizens that markets serve people rather than people serve markets, as well as that its institutions are working in their interest and adding value to what its member states otherwise cannot do as well by themselves. For some analysts this can only be achieved by new federal institutions, similar to those of the US. But Europe cannot wait for this. Without alternatives now it risks disintegration.

This is the main reason why the Declaration stresses feasible alternatives now. Europe already has the institutions and the decision-making procedures that could enable a recovery of investment and jobs. One of these is the European Investment Bank (EIB), whose lending for investments does not count on the debt of member states. Neither is there any need for national guarantees, for fiscal transfers, or for a "transfer union", since EIB bonds are serviced from project finance.

Those governments that want a recovery in employment have the power to act through the procedure of 'enhanced cooperation', which does not require unanimity, and which could by-pass entrenched opposition by a few member states to a bond-funded investment-led European recovery.

Supply side measures that reduce labour costs neglect the resulting reduction in aggregate demand, while in contrast supply side investment programmes can create aggregate demand.

Investment creating demand was the basis of the success of the Roosevelt New Deal in the 1930s, whereas after the crisis of 2007-2008 many EU member states have committed themselves to balanced budgets. Since then, the risk of depression and persistent unemployment and poverty in key member states and many European regions has mainly been the consequence of European austerity policy, whereas in other world regions and large economies policies have been either investment-led (East Asia) or demand-led (the USA).

The current trends in Europe are decreasing the ratios of labour income and investment to GDP. As an outcome, the crucial missing variable is the lack of aggregate demand. This reflects a private sector investment that still is a sixth below its pre-crisis level.

In European documents there is often an emphasis on export-led growth. But in a large market such as that of the EU, internal demand is often more important than external demand. EU member states trade mainly with themselves. The ratio of extra-European exports to GDP was lower than 10% before the economic crisis and the EU as a whole is broadly in balance with the rest of the world. There is, instead, a vast latent demand for social investments and employment and income generated by these, such as in health, education, urban regeneration and safeguarding the environment.

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Great structural economic differences among European countries and regions already existed at the time when the single European currency was introduced. These could not have been eliminated by uniform financial rules in Europe. Such differences increased during the crisis, and backward regions need specific productive investment programs. Structural differences between European countries and regions cannot be eliminated by reducing wages in an attempt to increase price competitiveness, nor by low level Structural Funds. They need a rediscovery of industrial, innovation and regional policies that foster structural competitiveness.

Quantitative easing has been necessary, but it is not sufficient for European economic recovery. This has been recognised by Mario Draghi who has stressed that it is governments that need to act to promote an investment-led recovery. Although bond finance of European investment is ruled out for the ECB, it has been the basis of EIB investment funding since 1958. This can be the key to recovery.

The current crisis can be resolved without new financial institutions, without Treaty revisions, without fiscal transfers between member states and without national guarantees for bond-funded investments:

1. A "New Deal for Europe" is feasible through bond-financed social and environmental investments and development projects similar to the Roosevelt New Deal but not needing a fiscal union since bonds, as in the case of the EIB, can be serviced by revenues from national governments which will increase with a recovery of investment and employment.
2. Europe could and should recycle global surpluses. The BRICS made plain in Washington in September 2014 that they would invest in Eurobonds if the EU were to issue them to finance a recovery. Sovereign wealth funds – and pension funds – have vast surpluses for which they struggle to find adequate investment outlets.
3. There should be a major increase of direct European investment, based on borrowing from the EIB and its sister institution the European Investment Fund(EIF) with the under-recognised advantage that borrowing from them does not count on national debt. The proposal for a European Fund for Strategic Investment (EFSI) and to define investment criteria for this neglects that no new investment criteria are needed for a bond funded investment recovery since the criteria for the EIB already include Trans-European Transport and Communications Networks (the TENs) and support for small and medium firms as well as investments in health, education, urban regeneration, green technologies and protection of the environment (cf. Essen European Council, December 1994, and Amsterdam Special Action Programme of 1997).

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4. There have been various proposals to mutualise national debt up to or in excess of the Maastricht debt limit of 60% of GDP. The proposal to do so above this level is subject to "moral hazard", whereas doing so up to the 60% limit is not. This could readily be converted into "Union Bonds" which, like the Erblastentilgungsfond of the Federal Republic on German reunification, are not traded nor used to leverage financial derivatives and speculation. The interest to service such bonds would be the liability of national governments from direct and indirect fiscal receipts generated by the recovery of investment, employment and incomes and would not need fiscal transfers between them.
5. The "golden rule" principle that, over an economic cycle, a government will borrow only to invest, rather than to finance current spending, should be adopted in interpretation of the Stability Pact. This should exclude public investment and national and regional co-financing of European financed projects from the Stability Pact's indicators.
6. An effective European Development Strategy was set out in the 1993 Delors White Paper on Growth, Competitiveness and Employment, which also proposed the European Investment Fund. Its vision of the future opportunities for European economy and society was unanimously endorsed by the Essen European Council of 1994 and needs to be recovered now. Bond finance from the EIB and EIF should enable synergies between research, development and restructuring of key sectors – green and alternative energy, green European transports, territory care, research on health, aerospace (as in the existing European Industrial Policy) – and should increase attention on the needs of European citizens. Public policy can help to extend, create and co-create markets and support business ecosystems and clusters, in mutually beneficial collaboration with the private sector, while respecting sustainability concerns, for the society and its own enlightened self interest.
7. There should be a resolution of insolvent banks through existing European procedures and institutions. The ECB and the European Stability Mechanism can restructure, recapitalise and resolve exposed banks on a case-by-case basis, without waiting for a fully-fledged Banking Union.
8. Existing financial resources at regional and local levels can be reinforced by issuing territorial and district bonds, creating stronger linkages between local financial resources and investment needs, and between collective share capital at local levels and support for management and worker buy-out initiatives through a regionalised European venture capital fund financed by European Investment Fund (EIF) and EIB bonds.

9. The capabilities of local and regional actors should be reinforced through local development projects funded by joint EIB-EIF European bond finance. This would enable a "resurgence" of local and regional capabilities, responding to community needs on the basis of public and social entrepreneurship and trans-regional and trans-national co-operation programmes, which have already been accepted in principle by the EU since the launch of the RECITE (Regions and Cities of Europe) programme in 1988.
10. With gains in direct and indirect fiscal receipts from recovery of employment and output, resources would be generated for a European Solidarity Programme to offset extreme poverty by guaranteeing a minimum European citizenship social standard. In the short term this could be funded from the interests accumulated within the European system of central banks (TARGET2 – Trans-European Automated Real-Time Gross Settlement Express Transfer System).

None of this excludes an increase of the European budget and a transition in due course towards European fiscal policy financed by the introduction of European carbon taxes, a Financial Transaction Tax, and a fair European tax on the profits of Multinational Enterprises or the harmonisation of European taxes on profits, avoiding fiscal competition among state members. But none of it depends on this. While support in due course for such a common fiscal policy would be reinforced by European governments showing that they can recover high levels of investment, employment, trade and wellbeing.

It is of course recognised that the aforementioned is but one set of proposals. It helps however show that if there is will thee is a way for Europe to help others help her. And that more can be done on this front.

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4. Summary and Concluding Remarks

This paper aimed at discussing the changing global financial and monetary system, including the rising influence of major emerging economies, such as those of Brazil Russia, India, and China (BRICs), as well as the role of Sovereign Wealth Funds (SWF) in these countries. A number of investment types were identified and discussed, i.e. Foreign Direct Investments (FDI),Sovereign Wealth Funds, Hedge Funds, Private Equity and Venture Capital, which provide potentially mutually beneficial opportunities for investment and their financing.

The paper sought to demonstrate that Europe could do more to leverage such opportunities at the public policy level, not just the private initiative level. A set of proposals have been discussed, drawing on writings by authors such as Stuart Holland and the Pavia Declaration. It is recognised that there are more and that the current policy orthodoxy is unlikely to favour these. Then again this is the very purpose of papers such as this one, namely to challenge and provide alternative heterodox ideas. If anything this helps levelling the playing field. Importantly we submit that if Europe wants to heal its wounds and become a positive global transformational leader (as opposed to consuming herself in internal acrimonious, seemingly unending fights), it should consider such ideas.

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Definitions

BRICs	An acronym that refers to the countries *Brazil, Russia, India* and *China* which are at a similar stage of economic growth. The term was firstly coined by Jim O'Neil in his 2001 paper entitled *Building Better Global Economic BRICs* (O'Neill, 2001)
Bonds	A bond is a tradable security (debt instrument) which is issued by a borrower (bond issuer) and represents a formal agreement between the issuer and the lender (bondholder). The issuer will repay to the lender the full amount borrowed plus interest over the lifetime of the bond. It represents a series of cash flows payable during the aforementioned lifetime. There are four main types of entities issuing bonds (London Stock Exchange , 2010):

1. Sovereign Government: Government bonds are issued by governments and in order to cover their net cash requirements (i.e. to meet the gap between the amount received in taxes and the amount required for government spending), to refinance existing debts or to raise new capital.
2. Supranational Entities: Such bonds are issued by international bodies comprising a number of sovereign member states. They are issued in order to raise funds to invest in development projects and include organisations like the European Investment Bank (EIB) and the Bank of International Reconstruction and Development (IBRD).
3. Local Government Authorities: Issued by local governments (such as borough councils), these bonds are of lower credit rating than the sovereign

ones, as they are not backed by the central government.

4. Corporate Bonds: Issued by private and public companies, such bonds are of lower risk than investing in the company's shares since, in the event of bankruptcy, creditors take priority over the shareholders in terms of repayment. However, bondholders do not have ownership rights over the company and therefore have no, or limited voting rights.

EU-15	The number of the European Union member countries before the accession of ten candidate countries on May, 2004. The countries are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom (OECD, 2005)
Foreign Direct Investment (FDI)	A cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise (OECD, 2013).
Hedge Funds	A hedge fund is defined an actively managed, pooled investment vehicle that is open to only a limited group of investors and whose performance is measured in absolute return units. However, as this definition excludes some hedge funds and includes some funds that are not hedge funds, an alternative theoretical definition is the *purely active* component of a traditional actively-managed portfolio whose performance is measured against a market benchmark. Therefore, hedge funds can be seen as a device to separate

	the *purely active* investment portfolio from the *purely passive* portfolio. It should be noted however that the theoretical definition is not implementable in practice since short positions require margin cash and has zero net investment and therefore, no cash available for margin accounts (Connor & Woo, 2004).
Private Equity	Private Equity is the provision of equity capital by financial investors – over the medium or long term – to non-quoted companies with high growth potential. Apart from the covering the finances required to create the business, it also includes the financing the subsequent development stages of its life cycle (EVCA, 2007).
Shares	A unit of ownership interest in a corporation or financial asset which gives the owner (shareholder) the entitlement to an equal distribution in any profits (if any re declared in the form of dividends) (Investopedia, 2015)
Sovereign Wealth Funds (SWFs)	Government-owned investment funds, set up for a variety of macroeconomic purposes. They are funded by the transfer of foreign exchange assets that are invested long term, overseas (Allen & Caruana, 2008). Please see referred paper for more definitions.
Venture Capital	A subset of private equity (see above), which refers to equity investments made for the launch, early development, or expansion of a business, emphasizing on entrepreneurial undertakings instead of mature businesses (EVCA, 2007).

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

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1 (Coordinator)	University of Leeds	UK
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