Secretive and unregulated, sovereign wealth funds are investing billions of dollars in weakened American financial institutions. Should we be worried?

– Matt Freedman, MSF ’08

The Renaissance of Latin America
– Jose Roberto Magana, MBA/MSF ’08

Remittance: Capital Flight or Venture Capital?
– Edouard Begin, MSF ’08

Capital Markets of Southeastern Europe
– Zivko Bajevski, MBA/MSF ’09

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When in Reykjavik: Doing Business in Emerging Markets
Our international students provide tips for doing business in developing nations.

Readers’ Corner

BRIC and Mortar: Commercial Real Estate in Emerging Markets
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Microfinance institutions intend to lift individuals out of poverty and promote economic growth in developing countries. This article looks at the progress, challenges, and prospects of microfinance.
– Richard Watson, PhD Candidate
Boston College Financial – a magazine written and managed by our graduate students – seeks to bridge the gap between financial research and practice, provide a platform for our students to publish their work, and connect with the industry.

Building on the success of previous issues, we are pleased to present the fourth issue of the magazine, which focuses on trends and developments in emerging markets. Brazil, Russia, India, and China (BRIC) and other emerging markets have tremendous potential and are becoming increasingly important on the world stage. At the same time, recent turmoil in the credit markets shows that emerging market economies are not entirely “decoupled” from the United States and Europe.

With guidance from the Carroll School of Management’s finance faculty – in particular, Edward J. Kane, Jeffrey Pontiff, and Jun Qian, three renowned experts in financial markets and investments – our students have produced thorough background articles and have conducted insightful interviews. In addition to inspiring and informing the larger graduate-school population, this issue will benefit working professionals who influence, and are influenced by, emerging market developments.

Like its predecessors, this issue of Boston College Financial demonstrates a spirit of passion and learning about finance that will be both evident and contagious to its entire readership. Boston College Financial not only has an important impact on our students’ careers, but also enhances the reputation of our graduate programs in finance.
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Editorial Letter

Welcome to the fourth issue of *Boston College Financial*, the finance magazine written, edited, and managed by BC graduate students. In this issue, we focus on emerging markets and the opportunities and challenges they face.

From Buenos Aires to Shanghai, we will examine the economic and political transformations taking place in emerging markets and uncover some amazing investment opportunities in stocks and real estate. We will peek into the secretive world of multibillion-dollar sovereign wealth funds, and then discover how the poor and disenfranchised have bootstrapped their way out of poverty.

Of course, this sweeping look at emerging markets could not have been possible without the Carroll School of Management’s diverse graduate student body. We are fortunate to have Jose Roberto Magana from Central America and Zivko Bajevski from Southeastern Europe share their insights into these dynamic regions. Although they are not as highly covered by the media as China and India, Latin America and Eastern Europe are undergoing sweeping changes that should not be ignored.

Matt Freedman spoke with Charles I. Clough, Jr., Chairman of Clough Capital Partners, about the controversial sovereign wealth funds. These massive funds are taking large positions in American companies and are not well understood by the public. We appreciate Mr. Clough taking the time to share his views.

On the other side of the spectrum, Edouard Begin and Richard Watson were interested in microfinance as they examined the effects of microloans and remittance on local economies. Small loans and money transfers clearly can make a significant impact on millions of lives around the world.

Finally, no emerging market issue would be complete without a look at BRIC. Many of the most expensive cities in the world now lie in emerging markets. Patrick Keefe discusses the explosion of commercial real estate in Brazil, Russia, India, and China.

We wish to express our sincere gratitude to the industry experts who shared their knowledge and expertise: Charles Clough, Luka Flere of KD Group, and Nate Parmelee from the Motley Fool. As always, we also are indebted to our faculty advisors and Maryanne Spillane McInturf, who especially enhanced the final product.

Finally, we hope that you will enjoy this issue as much as we enjoyed putting it together. We invite you to write us with any comments or suggestions that you may have at bcfinancial@bc.edu.

Sincerely,
The BC Financial Staff
The Rise of Sovereign Wealth Funds

By Matt Freedman, MSF ‘08

I was lucky enough to enjoy a series of conversations during the week of Monday, January 21, 2008, with Mr. Charles I. Clough, Jr., ’64, Chairman and CEO, Clough Capital Partners, LP. Several of Mr. Clough’s comments are inserted throughout the piece where appropriate.

Secretive. Unregulated. Huge. Powerful. Nontransparent. Unaccountable. Sovereign wealth funds (SWFs) have been characterized in the media and by prominent policymakers in the United States and Western Europe with an air of suspicion and skepticism. This raises the question: What is everyone so worked up about?
Recently, several emerging market sovereign wealth funds made a big splash as they invested huge sums into several of Wall Street’s largest banks (see Figure 1). While their large and timely capital injections may prove to have stopped the bleeding when the United States financial system needed it most, a large proportion of the American people, as well as several prominent politicians, seem to be approaching the shakeup in the global financial power structure with a markedly ethnocentric xenophobia.

Sources: WSJ.com, CNN.com; the structure of several of the most recent deals was merely reported at the time of the publishing of this piece and is subject to change.

Figure 1. Notable Sovereign Wealth Fund Investments

<table>
<thead>
<tr>
<th>Announced</th>
<th>SWF Acquirer(s) Involved in Deal</th>
<th>Target (Stake)</th>
<th>Value (USD billions)</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/14/2008</td>
<td>Government of Singapore Investment Corp.; Kuwait Investment Authority</td>
<td>CitiGroup</td>
<td>12.5</td>
<td>Passive investment; convertible preferred</td>
</tr>
<tr>
<td>1/14/2008</td>
<td>Kuwait Investment Authority; Korean Investment Fund</td>
<td>Merrill Lynch</td>
<td>6.6</td>
<td>Passive investment; convertible preferred</td>
</tr>
<tr>
<td>12/24/2007</td>
<td>Temasek Holdings Ltd.</td>
<td>Merrill Lynch</td>
<td>4.4, with an option to buy 6 before 3/28/08</td>
<td>Passive investment; common stock</td>
</tr>
<tr>
<td>12/10/2007</td>
<td>Government of Singapore Investment Corp.</td>
<td>UBS AG (9%)</td>
<td>9.75</td>
<td>Passive investment; convertible notes</td>
</tr>
<tr>
<td>11/28/2007</td>
<td>Abu Dhabi Investment Authority</td>
<td>Citigroup (-4.9%)</td>
<td>7.5</td>
<td>Passive investment; equity units with mandatory conversion to common shares</td>
</tr>
<tr>
<td>1/21/2007</td>
<td>China Investment Corp.</td>
<td>Blackstone Group (10%)</td>
<td>3</td>
<td>Non-voting stake</td>
</tr>
</tbody>
</table>

While there exist certain areas of genuine concern regarding SWF investment, it has become clear that much of the anxiety and animosity regarding the potential threats of SWFs has been overstated. Mr. Clough has labeled the hostile reaction toward foreign investment as xenophobic, while Morgan Stanley’s Mark Bradley is surely not alone on Wall Street these days in singing the praises of sovereign wealth funds as model investors, calling them “massive, passive, and patient.”

**What Is a Sovereign Wealth Fund?**

According to the United States Department of the Treasury, a sovereign wealth fund (SWF) is “a government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves of the monetary authorities,” with the important distinction that “SWF managers typically have a higher risk tolerance and higher expected return than traditional official reserve managers.”

Many countries that have long run significant current account surpluses or enjoyed booming commodity export revenues are generating foreign currency reserves beyond established benchmarks of reserve adequacy used to support immediate needs and purposes. Some have created sovereign wealth funds to manage the additional resources.

There are two major types of SWFs, which are categorized based on the source of the foreign exchange assets. The growth of each type has been driven by powerful macroeconomic trends over the past several decades.

Commodity funds have grown tremendously with the recent boom in commodity prices, especially oil prices. As a result, several major petroleum-exporting nations, notably in the Middle East, have built enormous foreign currency reserves. The excesses of these reserves are often deployed through sovereign wealth funds. Commodity funds are believed to control approximately two-thirds of SWF assets.

Noncommodity funds are typically capitalized through large current account surpluses. Many funds of this type are found in Asian nations, with China’s SWF the most prominent, and are driven by booming exports and favorable exchange rate regimes. Noncommodity funds are believed to control around one-third of SWF assets.

Sovereign wealth funds operate with goals that vary from stabilization of commodity revenue to diversification of public assets away from commodity price exposure, to saving for future generations, to capital inflow sterilization.

While SWFs have existed since the 1950s, their size has increased significantly in recent years. This growth in size, coupled with the secretive nature of many sovereign wealth funds and several recent high-profile investments, has caused more dramatic media coverage of late.

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Figure 2. Notable Sovereign Wealth Funds

<table>
<thead>
<tr>
<th>Country</th>
<th>SWF Title(s)</th>
<th>Assets (USD billions)</th>
<th>Inception year</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Arab Emirates</td>
<td>Abu Dhabi Investment Authority</td>
<td>688.875</td>
<td>1976</td>
</tr>
<tr>
<td>Norway</td>
<td>Government Pension Fund – Global</td>
<td>316-380</td>
<td>1996</td>
</tr>
<tr>
<td>Kuwait</td>
<td>Reserve Fund for Future Generations</td>
<td>213-310</td>
<td>1953</td>
</tr>
<tr>
<td>China</td>
<td>China Investment Corporation</td>
<td>200</td>
<td>2007</td>
</tr>
<tr>
<td>Russia</td>
<td>Stabilization Fund of the Russian Federation</td>
<td>122</td>
<td>2004</td>
</tr>
<tr>
<td>Singapore</td>
<td>Temasek Holdings</td>
<td>108-159.2</td>
<td>1974</td>
</tr>
<tr>
<td>Libya</td>
<td>Oil Reserve Fund</td>
<td>50</td>
<td>2005</td>
</tr>
<tr>
<td>Qatar</td>
<td>Qatar Investment Authority</td>
<td>50</td>
<td>2005</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>$2,085.3-2,541.9</strong></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Morgan Stanley and OECD.

Estimates for current SWF asset calculations vary widely among sources, in large part due to the nontransparent nature of many SWFs, and in particular the Abu Dhabi Investment Authority (ADIA). Some estimates place as little as $200 billion to $300 billion in the coffers of the ADIA, while other prominent institutions estimate that total at $875 billion. Assuming the $875 billion estimate to be true, the Abu Dhabi Investment Authority could afford to pay each inhabitant of Abu Dhabi over $1 million.

In its recent article on the topic of sovereign wealth funds, entitled “Asset-backed Insecurity,” The Economist presents data regarding SWF assets provided by Morgan Stanley. Additionally, the Organization for Economic Cooperation and Development (OECD) published a list of the 11 largest SWFs. In some cases, OECD estimates for a specific SWF are larger than that of the Morgan Stanley data, and vice versa. The data in Figure 2 represent the range between the two publications.

Size Is Relative

While SWF management of $2–3 trillion in assets is certainly a large sum in absolute terms, a better idea of the relative position and potential role of SWFs in global financial markets is obtained through comparison with other asset classes and pools of capital.

Sovereign wealth fund assets can be made to look small when compared with the $62 trillion currently under management by private institutional investors. However, SWF assets are (by many estimates) larger than hedge fund assets under management ($1.5 trillion) and private equity assets under management ($700 billion) combined. In addition, SWF assets are projected to grow at much faster rates than either hedge fund or private equity assets. This is an easy scenario to imagine considering China’s exchange rate regime, soaring commodity prices, recent hedge fund losses, and the tight global credit conditions that are hampering the pace of private equity deal flow.

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Historical Context

Recent investments by sovereign wealth funds have raised concerns among many policymakers and have garnered highly publicized animosity from several prominent politicians, drawing dramatic news headlines in the process. However, domestic resistance to foreign investment is hardly a new phenomenon in the United States.

When Japan was in its ascendancy during the 1980s, its investment in several “strategic” industries in the United States, including banking, agriculture, real estate, and electronics, alarmed many Americans who saw Japan primarily as an industrial rival and a threat to America’s place atop the global financial and economic throne. In the eyes of many Americans, Japan’s supposed rise to global domination was in full swing when Japan made investments in trophy properties such as Rockefeller Center and Pebble Beach golf resort. These investments, in particular, struck a chord, and seemed to reinforce the notion that America’s grip on global financial supremacy was slipping.
Despite the largely symbiotic macroeconomic realities of the relationship between the United States and Japan during this time, many commentators and policymakers reacted with hostility and protectionist attitudes toward Japan’s increase in direct investment in the United States:

“When Mitsubishi’s investment in Rockefeller Center was disclosed, a New York TV station broadcast old war movies featuring Japanese fighter pilots strafing American soldiers. Images of the cavalry coming to the rescue might have been more appropriate. In the past five years, Japanese investors have paid top dollar to buy hotels, golf courses, raw land, and office buildings all over the U.S., even though demand for commercial real estate has been sluggish.”

Cavalry Coming to the Rescue…Sound Familiar?

As it turned out, however, Japan lost its shirt on both the Rockefeller Center and Pebble Beach investments, and the country suffered through a crippling financial crisis and economic stagnation throughout the 1990s.

Just as people feared Japanese global supremacy, a disturbing number of Americans now appear distrustful not only of the SWFs that have “bailed out” several titans of America’s financial sector, but of the Wall Street banks themselves.

A recent survey conducted by market research group Strategy One delivered surprising results, as over 50 percent of respondents said that they “trusted Citigroup less” in the wake of foreign investment in the company, with a figure of 45 percent in a similar poll directed at Merrill Lynch. The results smack of protectionist undercurrents among the American people.

While there are certainly some legitimate concerns raised by SWF investment in the United States, which are discussed below, policymakers should place this current bout of foreign investment into context. It seems as though, to the contrary, recent investment has been met with hostility on the part of the American people.

Case in Point – DP World Fiasco

Shortly after the acquisition by Dubai Ports World (DP World) of British firm Peninsular and Oriental Steam Navigation Company (P&O) was made public, a political firestorm ensued in Washington, D.C., as it became clear to members of Congress that a Middle-Eastern company would gain management control over U.S. port facilities. The acquisition had received approval from the U.S. government Committee on Foreign Investment in the United States (CFIUS), whose role it is to “review foreign investments in a manner that preserves national security without creating unnecessary or counterproductive barriers to participation in the U.S. market.”

Nonetheless, several prominent politicians strongly opposed the acquisition. Mr. Clough echoed the sentiments of many Americans: “I thought it was unfortunate because it was probably the most blatant form of xenophobia. It was inappropriate and, frankly, quite ignorant.”

Despite the President’s strong disapproval, the House Appropriations Committee overwhelmingly voted (62-2) to approve a measure blocking the DP World acquisition. Under intense Congressional pressure, Dubai Ports World backed out of the deal shortly after the vote. One potential reason for the Congressional outburst against the DP World deal is that Congress was excluded from CFIUS activities until the 2007 passing of the Foreign Investment and National Security Act (FINSA). (A more detailed discussion of CFIUS and FINSA can be found below.) While it is difficult to separate Congressional ire regarding its exclusion from the CFIUS procedure from genuine concern for United States national security, the results of Congressional action are not difficult to interpret.

Legitimate Issues

There are several legitimate concerns regarding SWF investment. However, the concern most potentially disruptive to financial markets posed by SWF investment is public backlash and potential subsequent protectionist sentiment and policy. With this in mind, SWFs do present several policy issues that need to be addressed, perhaps most importantly to assuage suspicion and hostility surrounding their activities. These concerns generally boil down to issues of transparency and accountability.

Increased transparency could go a long way to ameliorate some of these negative feelings. As indicated by the Breakingviews Sovereign Wealth Fund Risk Index in Figure 4, the most concerning aspect surrounding SWF activity is the lack of transparency common to
many of the largest sovereign wealth funds. In fact, of the largest 10 to 15 sovereign wealth funds, only one, the Government Pension Fund of Norway, fully discloses its investment activity. This phenomenon of nontransparency can potentially cause several problems.

Figure 4: Breakingviews Sovereign Wealth Fund Risk Index

<table>
<thead>
<tr>
<th>Sovereign Wealth Fund</th>
<th>Country</th>
<th>Size (BN)</th>
<th>Transparency</th>
<th>Strategic Control</th>
<th>Political Relationship</th>
<th>Total Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>China Investment Corporation</td>
<td>China</td>
<td>$200</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>11</td>
</tr>
<tr>
<td>Qatar Investment Authority</td>
<td>Qatar</td>
<td>$60</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>National Development Fund</td>
<td>Venezuela</td>
<td>$18</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>Abu Dhabi Investment Authority</td>
<td>United Arab Emirates</td>
<td>$875</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>State General RF</td>
<td>Oman</td>
<td>$6</td>
<td>5</td>
<td>2</td>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>National Fund</td>
<td>Kazakhstan</td>
<td>$15</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>Stabilisation Fund</td>
<td>Russia</td>
<td>$128</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>8</td>
</tr>
</tbody>
</table>

Sources: Breakingviews.com; selected content from Breakingviews Sovereign Wealth Fund Risk Index. Transparency, Strategic Control, and Political Relationship are scored from 1 to 5, with 5 having the most risk.

Very little is known about the investment strategies, holdings, and portfolio positions of most SWFs. This uncertainty introduces concerns regarding the potential destabilization of financial markets, although SWFs seem more likely to calm, rather than to destabilize markets. According to Robert M. Kimmitt, deputy secretary of the U.S. Department of the Treasury, “They are not highly leveraged, and it is difficult to see how they could be forced by regulatory capital requirements or sudden investor withdrawals to liquidate their positions quickly.” However unlikely, it is possible that actual or even perceived shifts in asset allocation, forced position liquidations, or risky investments made by large SWFs could have a destabilizing impact on global financial markets.

One popular criticism of SWFs has been that they will use their massive coffers to make investments with political, rather than economic, interests in mind. This scenario should not be cause for concern. First, SWFs have a long track record of passive investment for the purpose of a high return on investment. In fact, recent high-profile SWF investments have all been passive investments, in which the SWF has actively avoided obtaining voting rights or board seats within target companies. Second, global economic forces could very well correct any inefficiency caused by a major company acting in political, rather than economic, interests. Shareholders would certainly not benefit from a political strategy, and it is likely that competitive markets would render any firm run in such a way inefficient, in which case it would cease to be competitive and lose business.

Kimmitt raises the issue of whether the “formation of SWFs perpetuates undesirable underlying macroeconomic and financial policies.” This subter tactic on the part of SWF managers could include using SWFs to control money supply or manipulate the domestic currency. One such example of currency manipulation would be the hoarding of foreign assets to prevent upward pressure on domestic currency.

Edwin M. Truman of the Peterson Institute for International Economics suggests a blanket policy establishing “an internationally agreed standard to guide the management by governments of their cross-border investments.” He adds that this policy should “apply to the gamut of international investment activities of governments, starting with traditional foreign exchange reserves and extending to stabilization funds, nonrenewable resource funds, sovereign wealth funds, government-owned or controlled entities such as pension funds, investment holding companies, and miscellaneous international assets.” His policy addresses important issues, suggesting mandates on SWF investment strategy, the role of government in the investment process, increased transparency as a means to achieve accountability, and behavioral guidelines.

In the near term, it is unlikely that many SWFs would agree to an international program as rigorous as the one proposed by Truman. It would be relatively easy to draft a set of best practices as described by Truman, but gaining widespread acceptance on the part of SWF governments is a far more difficult task.

The “Truman plan” faces a second, potentially far more serious set of long-term macroeconomic issues. Truman’s “gamut” of government-related investment vehicles is expansive. Applying stringent rules to the activity of any pool of capital can result in unintended restrictions in investment choice and capital flows. To take such a risk with

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Structured Securitization – The Missing Link

The newspaper headlines have been hard to miss. After taking write-downs of unprecedented magnitude, many of the largest banks on Wall Street have become desperately undercapitalized in recent months, and have recently been “bailed out” by an international group of investors led by sovereign wealth funds. Citigroup is off over 55% from its 52-week high, while Merrill Lynch and Morgan Stanley are both down around 49% from their respective 52-week highs. Wall Street is on sale, and sovereign wealth funds are some of the only players with the deep pockets and ability to move quickly enough to take advantage of what appear to be cheap price tags on some of the world’s most recognizable financial brands. The massive investments beg the question: How did Wall Street get itself into this mess to begin with?

Structured finance, and securitization in particular, is at the core of the subprime mortgage-driven credit crunch that has roiled Wall Street and global credit markets over the last several months. A more distant cause can be traced to the 1% interest rate environment created and maintained by former Federal Reserve Chairman Alan Greenspan in the wake of the attacks of September 11, 2001. As intended, this policy ignited the economy, and with it the housing market. It is in this context of strong economic activity that structured securitization exploded.

What is securitization, and how did it cause the subprime fiasco?

The concept of securitization, in the words of Mr. Clough, is a “brilliant” idea that addressed an important social concern and provided a customized investment solution for sophisticated investors. Securitization helped to address the problem of “redlining,” whereby banks, and the financial system, were accused of refusing to write mortgages for the residents of low-income inner-city neighborhoods. Banks could not supply mortgages to this demographic because the credit risk was simply too great for any individual financial institution to assume. Securitization solved that problem when it pooled subprime loans together, allowing the system, rather than any individual financial institution, to collectively bear the risk. As Mr. Clough notes, securitization “created a structure where the poor could get credit.”

Professor Edward J. Kane, James F. Cleary Chair in Finance at Boston College, points out another interesting aspect of structured securitization as it related to low-income mortgage lending, which he also believes to be “brilliant.” Specifically, he notes that the political capital created by establishing a mortgage structure for low-income borrowers was used as “political cover to financial institutions for making very risky high-leverage loans that regulators could not adequately criticize or control.” This may have helped pave the way for the reckless lending that eventually contributed to the subprime mortgage meltdown that has crippled the U.S. financial sector, and credit markets in particular.

Too much of a good thing

When the United States housing market began to soften, homeowners could no longer count on home equity cushions and refinancing; therefore, subprime delinquencies began to rise. Early payment defaults, or missing two out of the first four mortgage payments, also spiked. Perhaps most detrimental to mortgage originators, forced repurchase clauses were also increasingly invoked by investors in mortgage-backed securities, whereby the mortgage lender must repurchase the loan in the event that early payment default occurs. This forced lenders to erase accounting gains on previously originated loans.

“Like most good ideas, securitization was abused and now it has to be repaired.”

– Charles I. Clough Jr. ’64

Due to the securitization of subprime loans, the housing market downturn has affected not only subprime mortgage holders, but also the financial services firms that were holding these securities in droves, often through off-balance-sheet entities known as structured investment vehicles. Unable to price or sell mortgage-backed securities in illiquid markets, banks were finally forced to take write-downs on these assets to recognize on their balance sheets the plummeting value of these assets. Shortly thereafter, SWFs entered the picture, recapitalizing several of the largest U.S. banks that were hit the hardest by bad bets on subprime mortgage-backed securities.

In the case of the securitization-driven subprime mortgage fiasco and consequent global credit crunch, regulators and policymakers have once again proven reactive to market participants. Perhaps they can stay ahead of the curve and be proactive on the SWF front to ensure that foreign investment can be conducted without undue restrictions resulting from reactionary protectionist policy on the part of anxious target nation legislative bodies.

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1 As of the close of markets, Friday, Jan. 18, 2008; data courtesy of Yahoo! Finance.
3 Allan N. Krinsman, Summer 2007.
a pool of assets as large as Truman suggests could have troubling medium- to long-term consequences for cross-border investment. It may be of greater benefit to begin the process of establishing SWF best practices by making modest improvements in transparency that improve upon the status quo, and building upon small successes as the regime – as well as the confidence and support of the international community – gains traction.

National Security Concerns

Protecting a country’s economic sovereignty and national security are important concerns in considering foreign investment. However, encouraging cross-border investment is also of great importance. Foreign direct investment, although more commonly done through corporations rather than governments, has been one of the strongest engines of global economic growth in recent decades. While a balance between encouraging investment and protecting national security must be carefully struck and closely monitored, recent responses to SWF investments indicate that this balance is out of alignment.

Says Richard Marston, professor of finance at the University of Pennsylvania’s Wharton School, “Clearly, there are industries where we would be concerned about certain countries having an ownership interest. You do worry that these are governments, and you worry about their motivation.”17 Perhaps concern would be justified if Iran’s Oil Stabilization Fund were attempting to acquire United States defense contractors. However, the threat is overstated. Of the most prominent recent investments in United States financial-sector assets, much of the capital has come from China, Korea, Singapore, Kuwait, and the United Arab Emirates. The United States has full diplomatic relations with all these countries. While the lack of transparency is certainly a potential cause for concern, it should not be worrying for national security reasons.

Policy Response

One of the major domestic concerns regarding foreign investment in the United States during the time of the DP World controversy was the lack of communication between CFIUS and Congress. Along with a subsequent feeling of exclusion from such an important process as considering the security of our nation, this lack of communication seemed to deeply upset some members of Congress. This can be evidenced by the fact that prominent Republican Party members such as Bill Frist publicly broke ranks with President Bush in the wake of the DP World situation. To address this bureaucratic tension, Congress passed the Foreign Investment and National Security Act (FINSA) of 2007, which specifically addresses this issue with a section of the legislation titled “Increased Oversight by Congress.”18 This section mandates Congressional briefing on all CFIUS investigations, while the legislation targets investment in critical U.S. infrastructure, potential terrorist threats, and arms control as major national security concerns.19

It is important to consider several aspects of the legislation and the role of CFIUS in U.S. economic and security policy. First, FINSA targets “covered transactions,” which include only mergers, acquisitions, and takeovers of entire companies by a non-U.S. entity. This legislation, and CFIUS review, would not apply to any of the high-profile SWF investments made recently in the U.S. financial sector. Second, it is useful to put the role of CFIUS into perspective regarding merger and acquisition (M&A) activity in the United States. In 2006, there were approximately 10,000 M&A deals in the United States, 1,730 of which were cross-border transactions; 113 of these came before CFIUS review (6.5%); and none were blocked.20 Several prominent policymakers have called for International Monetary Fund (IMF) and Organization for Economic Cooperation and Development (OECD) involvement in establishing a set of best practices for SWF cross-border investment. The OECD appears up for the challenge, as the organization states “OECD countries and non-OECD partners are looking for ways to address these concerns while avoiding unnecessary restrictions on international investments,” emphasizing the importance that “high standards of transparency, risk management, disclosure, and accountability are observed.”21 Additionally, the IMF is currently producing a set of voluntary “best practices” to address issues such as disclosure, governance, transparency, and fund structure. It is particularly encouraging that the OECD has been careful to include nonmember states in the policy discussion, as most large SWFs are managed in nonmember states, with the notable exceptions of Norway, Korea, and the United States.

The OECD has been careful to mind the balance between keeping an open investment policy and protecting national security interests. As Deputy Secretary of the Treasury Kimmitt points out, the benefit of the doubt should go to SWFs at this point, as they have

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Real estate has become an increasingly sought-after asset class during the current decade. After the “irrational exuberance” of the late 1990s and the following market crash, investors wanted to invest in something concrete. After all, what is more concrete and rational than owning real estate? Domestically, the pace of commercial real estate investment has been unprecedented, although it now seems to be slowing due to the credit crisis and the rise in values fueled by the abundance of capital and relaxed credit standards. As the emergence of globalization becomes increasingly apparent, investors are now seeking returns from real estate investments around the world. Global direct investment in commercial real estate reached $759 billion in 2007, more than doubling the $354 billion reached in 2003.¹

The term “BRIC” was coined in 2003 by Goldman Sachs’ head of global research, Jim O’Neill. He and his team theorized that the economies of BRIC (Brazil, Russia, India, and China) would each rise meteorically to rank in the top six worldwide by 2050. With this predicted rise, and the increasing popularity of real estate as an asset class, capital has started to flow into real estate investments in these emerging markets. Of course, there are risks, which generally include currency risks, political risks, over-investment, and, in some cases, corruption and outdated infrastructures. Despite this, real estate investors seem willing to try their hand to gain the extra return. In the long run, demographics and economics will determine the value and demand for real estate. Growth in population, labor force, as well as personal and national incomes are necessary to drive demand. This article examines the current state of real estate investing in BRIC and the prospects going forward.

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (MN)</th>
<th>GDP (US$ in purchasing power parity)</th>
<th>GDP Growth (2007)</th>
<th>Resources</th>
<th>Primary Commercial Real Estate Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>188</td>
<td>$1.84</td>
<td>4.9%</td>
<td>Oil, metals, coffee, sugar, soy</td>
<td>São Paulo, Rio de Janeiro</td>
</tr>
<tr>
<td>Russia</td>
<td>141</td>
<td>$2.08</td>
<td>7.6%</td>
<td>Oil, gas, metals</td>
<td>Moscow, St. Petersburg, “Millioniki”</td>
</tr>
<tr>
<td>India</td>
<td>1,130</td>
<td>$2.97</td>
<td>8.5%</td>
<td>Coal, metals, English-speaking workforce</td>
<td>Mumbai, New Delhi, Bangalore, Hyderabad, Pune, Chennai</td>
</tr>
<tr>
<td>China</td>
<td>1,322</td>
<td>$7.04</td>
<td>11.4%</td>
<td>Oil, coal, metals</td>
<td>Beijing, Shanghai, Guangzhou</td>
</tr>
</tbody>
</table>

Source: CIA World Factbook

Brazil: Time to Deliver?

Brazil has long tempted investors with the promise of market-beating returns. Since that promise has gone mostly unfulfilled until recently, now may be the time for Brazil to deliver on its potential. Blessed with abundant and diverse natural resources, including a recent mammoth off-shore oil discovery, Brazil is naturally looked upon as a future supplier to the emerging world’s growth.

With a population of 188 million – the tenth-largest economy in the world by GDP and an expected rise to the fifth-largest economy by 2050 – it is easy to see why Brazil is catching the eye of global real estate investors. Recent GDP growth of 4% in Brazil is strong, but slower than the other BRIC nations. Seeing that India and China have already seen a rise in values, Brazil could be the market of choice for the smart money. A potential catalyst is the widespread speculation that Brazil’s debt rating will soon be raised to investment grade, setting off a massive wave of investment. This upgrade would mean lower borrowing costs and could provide an extra $21 billion from foreign investors.

Several factors contributed to the investment boom in the residential development market. Since current President Luiz Inácio Lula da Silva took office in 2003, inflation has been corralled to a manageable 3.4% per year, and interest rates have fallen from a high of 25% to 12%. Workers’ salaries have outpaced the cost of living, creating purchasing power for the growing middle and lower-middle classes. Credit has become readily available to these buyers for the first time ever, and banks are lending more due to legislation enacted in 2004 that simplifies the once-difficult task of foreclosure. Mortgages were previously only available over 15 years with a 35% down payment and an interest rate well over the current 12%. Now 30-year mortgages are available with 20% down.

The largest mortgage provider, government-operated Caixa Econômica Federal, estimates that there is a housing shortage of 7.9 million homes. There has been a rush to capitalize on this demand. Chicago real estate mogul Sam Zell, through his company Equity International, has made significant investments in

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Brazilian real estate companies, partnering with GP Investments, a Brazilian private equity firm. He invested $50 million in privately held Brazilian multi-use developer Gafisa in 2005, representing a 32% stake in the company. Equity International also partnered with GP Investments in 2006 to back BR Malls, a retail operator. They then took the company public on the BOVESPA in April 2007, raising $295 million. Equity International’s website states that they are looking to grow BR Malls through acquisitions in the highly fragmented retail market. Retail has been strong with high demand for modern shopping centers. Vacancy is reported to be only 2%.9 “Equity International is extremely bullish as relates to real estate opportunities in Brazil,” says Gary Garrabrant, CEO of Equity International.10

In late July 2007, Advent International raised $1.3 billion in the largest Latin American private equity fund to date. “Due to factors like macroeconomic stability, GDP growth, and mainly the increase in real estate credit, we expect strong and solid growth for the next [several] years,” says Patrice Etlin, head of investments in Brazil for Advent International. “Evidence is the fact that Brazilian real estate companies have been able to reach capital markets in a way never seen before.”11

The office market has been particularly strong in the two major cities of São Paulo and Rio de Janeiro. With demand for quality office space easily outpacing supply, rental rates for class A office space grew 25% and 17% in each city, respectively, in 2006.12 Vacancy for class A space in Rio de Janeiro fell to 2.1%.13 Rental rates in both cities were higher than those in Boston, San Francisco, and downtown New York. Midtown New York is the only location in the Americas that commanded higher rents.14 Broker Cushman and Wakefield reports that buying opportunities are few and far between, and that prime properties that do come for sale are frequently sold off market.15

Real estate investment in Brazil is certainly not without risk. Rich in oil, metals, coffee, sugar, and soy, the Brazilian economy has benefited greatly from the commodity boom and is therefore susceptible to commodity prices. A softening of these markets could have a ripple effect throughout the economy. Brazil is also somewhat diversified in its commodities, unlike Russia, which is much more heavily reliant on oil and natural gas.

Another risk is Brazil’s strained infrastructure. Building and maintaining roads, rails, and ports will require significant investment if the economy is to grow as predicted. Although it is not as poor as India, there is a lack of rails and ports, which can be crippling if Brazil is to rely on commodity exports for growth. In October 2007, The Economist reported:

This investment (in infrastructure) is overdue. While exports have been booming, Brazil has not built much in the way of roads, ports, or airport runways for the past years. It is not unusual for ships to have to wait outside big ports, such as Santos, for up to two weeks before being allocated a slot to dock and unload. An aerial film of Brazil just after the soyabean harvest would show a collection of some of the longest traffic jams on earth.16

To meet the demand, Brazil is turning to the private sector for infrastructure investment. In October 2007, the country auctioned off rights to 1,600 miles of toll roads.17 President da Silva is also promising more public money, and an upgrade of the country’s debt

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to investment grade, which some feel is imminent, would go a long way in helping to meet this challenge.

Russia: Europe’s Hot Spot

Similar to Brazil, Russia is blessed with abundant natural resources, specifically oil and natural gas. Russia’s embrace of capitalism is fully starting to take hold, and there has been an exponential increase in foreign investment. Foreign direct investment (FDI) in Russia for the period January to September 2007 stands at $19.5 billion, up 93% from the prior year period.\textsuperscript{18} GDP growth was 7.2% in 2007 and is predicted to be in the 5% range yearly to 2012.\textsuperscript{19} Russians are experiencing a rise in disposable income, accessing consumer credit for the first time, and exhibiting growing consumerism. There is strong interest from global corporations to capitalize on this new Russian consumer, yet there is a lack of retail and office space when compared to the rest of Europe. With all of these factors, you can see why real estate investors, including former AIG CEO Hank Greenberg, are placing bets on Russia.

Although Moscow is the largest city in Europe, with over 10 million people, it has one-seventh the office space of London.\textsuperscript{20} Moscow is now considered the most expensive city in the world in which to live, and office rents are the fourth highest in the world (see Figure 3).\textsuperscript{21} Vacancy for class A office space runs at 1.6%.\textsuperscript{22} Demand is driven by global companies looking to increase their presence in Russia. A brief look at the Q3 2007 market summary from Colliers International lists General Motors, Oracle, and PepsiCo as new class A office tenants. Although yields on prime office and retail properties have come down over the past few years, they are currently at 8–9%, which is still higher than other central and eastern European cities by 250 to 300 basis points. Yields in some of the other less developed Russian cities are 10–11%.\textsuperscript{23}

One notable investor betting on Russian real estate is Hank Greenberg. Through Starr Investments Russia, a subsidiary of Starr International Co., of which Greenberg is the chairman, he will invest “hundreds of millions” in prime offices, residential housing, and hotels.\textsuperscript{24} Initial plans are to invest in both land for development and existing properties in Moscow. Development is booming in an attempt to keep up with demand.

Retail supply in Moscow has grown four-fold since 2002. Despite this growth, the supply could still double and remain well below the average for European cities.\textsuperscript{25} The retail situation is similar in St. Petersburg, the fourth-largest city in Europe, with a population of 4.6 million.\textsuperscript{26}

After Moscow and St. Petersburg, there are 11 other cities with populations over one million, the so-called “Millioniki,” as they are collectively referred to by Jones Lang LaSalle. In their report titled, “Russia in 2007: The Year of the Millioniki,” they write that these cities have been largely unexplored by commercial real estate investors and developers, and that they represent a huge opportunity going forward as retail space is severely lacking when compared to the European average. Shopping centers with supermarkets are still rare in many Russian cities, where open-air markets are still widespread. Several Russian and European supermarket chains, including X5 Retail Group and Carrefour, are ramping up operations to fill the void. Supermarkets are expected to triple their presence and raise demand for leased space.\textsuperscript{27}

Russia can be a daunting place to do business, and risks to the general business environment are risks to real estate investments. Corruption, organized crime, and a powerful centralized government that is not afraid to push big business around, especially in the energy arena, are a few of the problems.

Another risk to real estate investment is that Russia is losing population – the only BRIC nation to do so. Population growth stands at -0.5% and has been declining since 1991. It is expected to continue to decline as the birth rate is low and the mortality rate is high. For real estate demand to grow long term throughout the country, population growth is key.

Because corporations and real estate investors believe that the opportunity in Russia outweighs the risks, they are continuing to invest.


\textsuperscript{27} Maria Ermakova, Dec. 2007.
India: Riding the IT Outsourcing Wave

The world’s most populous democracy with 1.1 billion people,\(^2\) India is home to the largest English-speaking workforce outside of the United States. India is benefiting greatly from the boom in information technology (IT) outsourcing and spending. The rise of the Indian economy has sent a wave of demand for real estate throughout the country, particularly in the residential, office, and retail segments.

Real estate has been appreciating 30% annually, and total values are expected to rise from $16 billion in 2006 to over $60 billion by 2010. The office, residential, and retail sectors have all been strong. With India’s IT-related business growing at 50% per year since 1993, demand for quality office space has skyrocketed, and there is simply not enough supply.\(^2\) India had eight of the top ten best-performing office markets in 2006, with rents rising anywhere from 40–100%.\(^2\) According to Cushman & Wakefield’s September 2007 Mumbai market report, values and rental rates for prime and class A office space in Mumbai are up 50% on the year.\(^3\) Mumbai is now the second most expensive office rental market in the world, outranked only by London’s West End.\(^4\) Although Mumbai is most notable, New Delhi, Hyderabad, Pune, Chennai, and Bangalore are also experiencing a rise in demand and development. Subsequently, a fast-growing and increasingly affluent middle class is exhibiting growing consumerism and bringing huge demand for retail and residential housing. Estimates of the housing shortage run as high as 20 million homes.\(^5\) The planned entry of retail giants Wal-Mart, Carrefour, and Starbucks should continue to drive demand for leased space.\(^6\)

Another factor that has greased the wheels is the Indian government’s strong commitment to development. The country has traditionally been politically daunting due to overlapping jurisdictions, corruption, and stifling bureaucracy. In May 2005, the government passed legislation making it easier for foreign direct investment. Since


\(^{30}\) Cushman & Wakefield, “Office Space Across the World 2007.”
these restrictions on foreign real estate investment have been eased, foreign direct investment has increased from 5% of all investment in 2004 to an estimated 26% in 2007. Another example is the designation of certain areas as special economic zones, or SEZs. Within a SEZ, the normally heavy regulatory burdens are streamlined.

There are several risks and complications when considering whether to invest in real estate in India. The country’s infrastructure is highly strained, and the inability to support real estate development and general economic growth is a serious risk. India is also notorious for complicated and antiquated regulatory processes and corruption. Taxes are complicated, title issues can often arise, and transaction costs are high. Duty stamps, which are a state charge for documents processed, are 11–12% of the purchase price compared to a 2–3% average globally. Rent controls are still in effect in some locations. Building codes are not as strict as in the West, making buildings more susceptible to damage in fires and earthquakes.

Finally, some fear that the Indian economy may be overheated, and too much foreign investment has already been made. The biggest risk is a stock market or real estate crash. When Sam Zell visited India in April 2007, he commented to local real estate executives that they were “on the brink of excess.” Some areas of the country have seen a drop in prices. The Reserve Bank of India has tightened monetary policy in an attempt to keep inflation in check and prevent a bubble. The other side will argue that the demographic numbers and GDP growth predictions (7.5% per year through 2013) are staggering, and the needed investment is just starting. Despite the risks, India is considered by many to be the BRIC nation with the most long-term potential.

**China: Can It Live Up to the Hype?**

China seems to take the cake when talk turns to emerging markets. As the most populous nation in the world with 1.3 billion people and GDP growth of 11.4% in 2007, you cannot flip a few pages in a financial magazine or go more than a few minutes on CNBC without a mention of China. The economy is booming, and the country’s potential is tremendous. Real estate investors are lining up, despite the complications of investing in a communist country and talk of bubbles due to over-investment.

But 2008 should be an interesting year, as there is a wealth of new property hitting the market in Beijing and Shanghai, and lively debate centers on the effect this will have on those markets. The market and the pace of development have been so strong that the Chinese government has taken significant steps to slow down the economy (more on that later). China’s acceptance to the World Trade Organization in 2001 has opened up opportunities to foreign companies, which now look to house regional headquarters in China. Global companies, such as Wal-Mart, McDonald’s, IKEA, IBM, AIG, Nokia, and Citigroup, to name a few are tripping themselves in the race to get their brands and operations established in China, driving demand for office space. China’s strength in manufacturing has spurred strength in industrial property. Many companies are housing R&D in China as well, taking advantage of the large, highly skilled labor pool. Growing GDP has created more purchasing power, spurring residential and retail demand. High-profile events such as the 2008 Beijing Olympics and the World Expo 2010 in Shanghai have spurred investment as well. This is especially true for investment in infrastructure, which overall has been excellent, making China unique among the other BRIC nations.

More than 40 cities in China have populations over one million, and China has been adamant about developing these cities under the belief that there are no further gains to be made in rural productivity. Investors initially favored China’s first-tier cities, but now the money is flowing into select second-tier cities, chasing higher returns. Local developers dominate the market, but foreign investors have made inroads in the past few years, focusing mostly on established class A properties in tier-one cities. Although more restrictions have been put in place, foreign investors are feeling more comfortable with China.

Risks and complications are numerous. Since the communist Chinese government owns all land, there are complications around the required land-use contracts. Transparency is low, with poor and incomplete information on transactions. There are also complicated new rules on everything from financing to legal entities, to taxation, to timing on transactions and developments. The government is quick to issue new regulations when they see a potential problem on the horizon. Now the focus is on providing reasonably priced housing, so development for leisure and luxury properties is reduced.

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**CONTINUED ON PAGE 42**
The promise of microfinance is to give the economically active poor the ability to expand and diversify their enterprises to increase their income and improve their quality of life. Through sustainable investments in micro-businesses, microfinance institutions intend to lift individuals out of poverty and promote economic growth in developing countries. This article will look at the progress, challenges, and prospects of microfinance.
What is Microfinance?

Microfinance is the provision of financial services to the economically active poor. It includes banking activities as well as social intermediation services.¹

<table>
<thead>
<tr>
<th>Figure 1. Microfinance Activities</th>
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<tbody>
<tr>
<td>Banking activities</td>
</tr>
<tr>
<td>Small business loans</td>
</tr>
<tr>
<td>Secure savings</td>
</tr>
<tr>
<td>Scoring/appraisal of investments/borrowers</td>
</tr>
<tr>
<td>Establishing substitutes for collateral</td>
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</tbody>
</table>

Economic activities supported by microfinance include farming, fishing, herding, as well as other small businesses such as food retailing, garment making, and carpentry. In general, microfinance clients are those who have some form of employment and who are not severely destitute. In some countries, such as Bangladesh, clients are predominantly women. As of November 2007, the Grameen Bank (among the world’s largest microfinance institutions) had approximately 7,387,542 members, 96.7% of which were women.²

The History of Microfinance

Commercial microcredit provided by financial institutions dates back to the 19th century, with pioneers like Hermann Schulze-Delitzsch and Friedrich Wilhelm Raiffeisen of Germany, who formed the earliest urban and rural credit unions. However, modern microfinance is generally considered to have originated with new lending methods in the 1970s, as well as new financial technology that began in the 1970s and 1980s and then accelerated with the information revolution of the 1990s.

The earliest of these modern institutions emerged in Indonesia, India, and Latin America as self-sufficient intermediaries providing small loans and voluntary savings services. Through the 1980s, lending and savings services began to be combined, and with this increased integration came recognition as formal financial institutions. For example, the Grameen Bank (literally “village bank” in Bangla), founded in 1976 by Mohammad Yunus in the rural villages of Bangladesh, transformed into an independent bank by 1983. By the 1990s, non-governmental organizations (NGOs) in Bolivia were transformed into licensed financial institutions, enabling their access to commercial debt and investment.³

The profitability and viability of these institutions made possible large-scale financial outreach to low-income segments of the population. Information on these breakthroughs spread widely, and a variety of countries began experimenting with microfinance in the 1990s. By the late 1990s, in a few countries such as Bolivia, microfinance institutions actually began to compete for low-income clients.

Contemporary Microfinance Worldwide

The scale and scope of microfinance is large and growing. Perhaps the best source of statistics on contemporary microfinance is the MIXMarket website (http://mixmarket.org). Started as a way to link microfinance institutions (MFIs) worldwide with investors and donors, it offers an impressive array of indicators on the performance of MFIs. As of January 2008, there are 1,128 MFIs in 101 developed and developing countries. Financial performance, outreach, and other evaluation metrics can be compared for individual MFIs.

Although aggregate MFI statistics for different countries are not available from the website, searches by region or country can be performed to isolate MFIs operating within that particular geographic area. Also available are country profiles containing macroeconomic variables and population statistics. When put together, a picture begins to emerge about the impact of microfinance in the area.

For example, Uganda has a population of approximately 30 million, with a gross national income (GNI) per capita of approximately $300. Of the 22 MFIs operating in the area, six are credit unions, six are NGOs, nine are for-profit financial institutions, and one is a full-fledged bank. Together, these MFIs have an estimated 267,000 active borrowers (less than 1% of the population) and a total loan portfolio of $43 million. The average loan balance is $536, suggesting that these MFIs are likely targeting the wealthier segments of the population. Even after removing the bank, the average loan balance is $295, approximately the same as the GNI per capita. Thus, in Uganda at least, microfinance has considerable room to grow.

How Microfinance Differs from Conventional Banking

Despite high demand and evidence of profitability, conventional loans and savings vehicles are unavailable to low-income clients. This puzzle can be understood in terms of three economic problems.⁴


a brief review of which will help to underscore the differences between conventional banking and microfinance.

Banking and Microfinance

One of the major problems in providing commercial banking services to the poor is returns to scale. Low-income segments typically inhabit underdeveloped areas, and are only able to manage small amounts of credit (e.g., less than $100) with their incomes. But screening candidates for loans and monitoring repayment progress entails costs, so banks prefer dealing with clients who have larger incomes and larger borrowing needs in areas that already have comfortable levels of infrastructure.

Information about who has good versus bad credit risk is also difficult to obtain, leading to adverse selection (with a standard example being the “lemons” problem in a used car market).

The last major obstacle is moral hazard – specifically the fact that the poor do not have any collateral to post for banks in the event of non-payment. This implies that it will be the bank and not the borrower who will bear the consequences of default. Thus, once the loan is secured, the entrepreneur has an incentive to shift from safe projects to risky ones in order to obtain higher payoffs (when the risky projects are successful); this in turn leads to low recovery rates when default occurs.

So how exactly does microfinance overcome these problems? As an example, the Grameen plan uses a group loan process. It works by bringing five entrepreneurs with separate projects together who then apply for a loan as a group. If the loan application is successful, the first two members of the group get their loan; and if they are successful meeting the repayment schedule, two more members get their loans. If these four are successful, then the fifth member (the group leader) gets her or his loan.

Using this strategy, the Grameen Bank addresses all three of the above problems by effectively transferring them to the group of borrowers themselves. Notice that potential group members will be highly selective about who they will join with, since they can only get loans if other members succeed in their investments and repay their debts. The effort of screening candidates is thus borne by the group, minimizing adverse selection and improving returns for the banks. Also, the fact that some members must first successfully repay their loans greatly reduces moral hazard. In fact, borrowers actually have incentives to share expertise and help each other out, in order to stave off business failure. Lastly, banks can leave it to the borrowers to track the repayment progress of their members, meaning fewer loan officers are needed for loan monitoring. This allows loan returns to be attractive even at a greatly reduced scale. The loan recovery rate for the Grameen Bank is approximately 98%, while conventional lenders in Bangladesh achieve a recovery rate of 30–40%.

Criticism of Microfinance

However, if microfinance is so profitable, and if there is high demand, then why has this demand not been met? Thomas Dichter, an international development expert, has argued that microfinance has not led to the results hoped for by practitioners and advocates. He notes that the average poor person is not an entrepreneur, and that access to credit is used largely for consumption. Moreover, he argues that economic history reveals that:

- Earlier forms of microcredit were not significant to small business development;
- The democratization of financial services began with savings, not credit;
- Economic growth came before (or at best alongside) movements to democratize financial services; and
- Credit for the poor followed the savings movement and developed almost entirely in relation to consumption.

We cannot necessarily assume, then, that microcredit will lead to economic development and poverty reduction.

Indeed, if microcredit were used primarily for consumption, it might even be damaging to economic progress. The debacle of consumer microcredit in Bolivia serves as a warning. In the 1990s, success in the commercial credit arena gave microfinance lenders confidence that consumer credit could also be lucrative, so they began to compete vigorously for clients. Borrowers took full advantage of quick and easy credit, and some maintained two or more loans at a time. This inevitably led to a crisis as consumers became over-indebted and delinquencies began to mount.

When recession hit the country in 1999 as a result of troubles throughout South America, loan officers began spending more and more time wheedling collections from customers, resulting in a backlash against microcredit. Unions and other debtor associations began blaming lenders for provoking social ills from suicide to prostitution, and demanded immediate debt relief. Unfortunately,
regulations to strengthen consumer credit (e.g., limits on borrowing by restricting the amount of debt service to 25% of an individual’s income) came much too late; and by mid-1999, the consumer lending movement came crashing down. Nearly all consumer-lending operations disappeared. The microfinance industry in Bolivia will also have to cope with debtor associations for the foreseeable future.

The profitability of some microfinance institutions has also engendered criticism from those who view the proper role of microfinance as a tool for alleviating poverty. In Mexico, Banco Compartamos is a breathtaking financial success story. Launched in 1990 as a village banking program to provide working capital, it has achieved an enormous growth rate in clients while maintaining high levels of profitability.\(^6\)

Over the 1996–2006 period, return on equity averaged 47% and never dropped below 27%. Rapid growth and profitability have allowed Compartamos to access capital markets, beginning with a debt issue in 2002 (of $70 million) and an initial public offering of a 30% stake in April of 2007 (approximately $450 million). As of the third quarter of 2007, Compartamos serves over 765,000 clients and has a portfolio of $3.5 billion.

Given the origins of Compartamos as a nongovernmental organization, some feel that its conversion to a large for-profit bank is a step backward. In a critique of Compartamos, Muhammad Yunus compares the profit-driven external investors of global capital markets to traditional village moneylenders that exploit the poor: “Some are saying that the IPO will give a significant boost to the ‘credibility’ of microcredit in global capital markets. But that’s my fear, because it is the wrong kind of ‘credibility.’ It is leading microcredit in the moneylenders’ direction. The only justification for making tremendous profit would be to let the borrowers enjoy it, not external profit-driven investors. The ideal model would be one that puts full or majority ownership of the MFI in the hands of the clients. Borrowers of Grameen Bank own 94 percent of its shares.”\(^7\)

Yunus takes particular issue with interest rates approaching 100% per year, arguing that annual rates can be comfortably under the cost of funds plus 10–15% at most. In 2005, Compartamos’s interest yield on its average loan portfolio was 86%\(^8\). Rates offered by other MFIs in Mexico ranged between 23% (Caja Popular) and 103% (FINCOMUN). But when stacked against comparable MFIs – those that target the same population segments – Compartamos’s rates are considerably higher. The median rate for low-end MFIs was 35.4%, and the median rate for village banking MFIs was 47.2%.

What Is the Appropriate Role of Microfinance?

In the microfinance industry, a rift continues between those who feel that affordability is the key for poverty reduction and those who feel private-sector delivery is necessary for sustainability. The stakes are high, as government policy toward the industry will continue to be shaped by arguments from both sides. Michael Chu, a former Wall Street financial specialist and former president of ACCION International, summed up the two perspectives as the “poverty” camp and the “sustainability” camp.\(^9\)

The poverty camp feels that a future where for-profit operators dominate microcred invites exploitation of the poor through excessive interest rates. Thus, countries that endorse the connection with capital markets will merely be trading their village moneylenders for non-local – but equally greedy – investors. At an annual interest rate of nearly 100%, the poor are not undertaking many profitable projects, thus inhibiting economic growth. Also, investment that comes from foreign sources seems to pave the way for poor countries to transfer the fruits of their labor to wealthy countries. Moreover, the poorest clients will be ignored, because private markets care for profits and not the destitute.

The sustainability camp sees donor and government involvement in microfinance as a guarantee that the growth of microfinance

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will be limited. While they may have a more genuine concern for the poor, donors and governments are notoriously prone to fads, while the private sector has relatively deep pockets and will stick with a moneymaking activity whether or not it is in fashion. With an estimated 500 million microbusiness operators worldwide, the scale of the need is well beyond the reach of donor and government funding. Access to capital markets, on the other hand, could change the very nature of banking. Instead of servicing just the top 25–30% of the population of the developing world, banks could soon be meeting the demand of the remainder. Also, if the future home of microfinance becomes the private sector, charity can be directed toward poverty alleviation for the extremely poor.

Although the two camps have different views about how microfinance should be delivered, both would agree that outreach – the number of clients served – is the ultimate long-term objective of microfinance. Given its short history, however, there is little evidence to substantiate claims that either form of delivery will offer superior longer-term results. Nevertheless, each side will make its pitch to shape government policy. Different countries will no doubt strike different balances between delivery by donor/government institutions and private-sector organizations. Fortunately, tools like the MIXMarket website allow us to track the success of these approaches over time.

Conclusion

Microfinance is a growing industry with the potential to radically transform the lives of the economically active poor. In the space of a few decades, it has reached emerging countries around the globe and has helped to strengthen their economies. Once an isolated grassroots movement, it is now beginning to integrate with global capital markets. This remarkable success can be traced to the ability of microfinance to address key economic obstacles such as returns to scale, adverse selection, and moral hazard. But the outreach achieved so far has really just been the tip of the iceberg. The delivery of microfinance to the majority of the poor in the developing world will depend on the regulatory approach adopted in each country to deal with the twin goals of poverty alleviation and sustainability. The best long-term strategy has yet to be demonstrated. But just as the information revolution helped to spawn the growth of microfinance worldwide, it can also help us to track our progress and to share information about successful policies. In this sense, we might expect microfinance to adapt and improve so that its promise can ultimately be fulfilled.

Richard Watson is a Finance PhD candidate at the Carroll School. He holds an MSF degree from Boston College as well as a bachelor’s degree in biological sciences and an MBA degree from the University of Alberta. His prior experience is in biotechnology and healthcare management. He can be reached at watsonrc@bc.edu.
Latin America is a dynamic region that is often characterized by political instability, economic crises, and commodity booms. However, since 2002, the region has enjoyed resurgence. Over the last four years, Latin America has received $231 billion in foreign direct investment (FDI) inflows, signaling that the region is attracting significant attention from investors. This renewed economic bonanza coincides with a period of political stability, macroeconomic strength, and decreasing external debt. This article will examine changes in the major Latin American countries and the underlying causes behind them.
The evolution of democracy was one of the most important factors in the long-term developments of the region. Through open debate and consensus, countries like Chile, El Salvador, and Mexico were able to establish market-friendly reforms with strong regulatory background. As ruling minorities fade away in most of these countries, young democracy faces significant challenges, such as corruption and radicalism. On the other hand, elections in Brazil, Argentina, El Salvador, Mexico, Peru, Ecuador, Costa Rica, and Colombia took place without any major disruption.

Chile is a prime example of democratization. After the dictatorship of Augusto Pinochet ended in 1990, the country kept its impressive pace of economic development and free market approach. Along with democratic reforms, Chile was able to extend the circle of capitalism by reducing restrictions to free trade and privatizing public companies under the rule of making the state “as big as necessary, but as small as possible.” Chile was the pioneer of putting into private hands several functions that its neighbors considered “strategic” for the government: banks, utilities, pension funds, airports, and roads, among others.

To make such important transformation possible, Chile as a society worked hard to establish democracy. The leftist parties, previously excluded groups during Pinochet’s ruling, were forced to build bridges and seek common ground with parties that were more conservative in economic affairs. This interaction ended with a moderate coalition that recognized the benefits of a laissez-faire economy and emphasized the distribution of wealth through government programs to reduce poverty, to increase the living standard, and to promote economic stability.

Brazil and Mexico represent other impressive examples of democratic evolution. Mexico was able to overcome a longstanding tradition of a single ruling party with strong support of the population and to convert smoothly into a democratic system with other political parties, convincing its own population that democracy was for real. For Mexico, this transformation was part of a metamorphosis that changed dramatically the nerves of the country over the last decade (see page 26 Case Study: Tequila Crisis).

Brazil, on the other hand, demonstrated that democracy works as a legitimate way to promote changes when citizens can participate. Its current president, Luiz Inácio Lula da Silva, is a former union leader who frightened investors with his orthodox past in his 2002 campaign. Market participants feared that President da Silva would undertake a less responsible management of public finances to address his social agenda, potentially declaring a default on international bonds. Despite Lula developing a socialist orientation, the country has been well managed with responsible public spending, macroeconomic stability, and an emphasis on economic growth. President da Silva also took unpopular measures, such as the social security reform, which reduced labor benefits and has not boosted the minimum wage beyond reasonable levels. The lessons learned from Brazil’s experience imply that a change is possible and even welcomed, but investors demand results and appropriate conditions to risk their money. Confidence moves along with clear messages of commitment to offer the best possible conditions for investment and employment. When President da Silva was re-elected in 2006, the market applauded with lower risk premium spreads over Brazil’s sovereign debt. In Latin America as a whole, the hope that power finally resides with the majority has increased the confidence in democracy.

Improving Fundamentals

For the first time in decades, Latin American economies appear to be well managed. Leaders are implementing sound economic policies, reducing government intervention, and fighting inflation. The GDP per capita of a selected sample of countries in Latin America has been steadily improving since 2001, fueled by soaring prices of oil, corn, copper, orange juice, and other commodities. This contributed to broadening the middle-class base. The challenge for Latin America is to use these proceeds as seed funds to develop other industries, invest in human capital and infrastructure, and improve its financial system. Currently, around 13% of GDP is devoted to social expenditure, 1% below that in developed countries.

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During the last century, capital in Latin America was scarce, and labor and land were resources that did not provide any significant advantages. Recently, capital around the world has become abundant, thanks to an unusual scenario of low interest rates; thus natural resources have become increasingly more important to fuel the impressive economic growth from the developed and developing world. With interest rates approaching zero in the developed world, Latin America offered an appealing opportunity to investors with stable economies, high interest rates, and currencies becoming stronger against the U.S. dollar. The sophistication of capital markets in general, along with hedge funds hunting for market inefficiencies, also played a role in bringing capital inflows to the region.

During the 1990s, some Latin American countries opened their economies to international investment, only to discover the need for further structural reforms in their economic, judicial, and political systems. These reforms included labor flexibility to facilitate the allocation of resources among sectors, the streamlining of both legal and economic processes to ease the settlement of disputes, the creation of new companies, and the strengthening of the state in its role as a referee, not as a player in the game. These reforms were necessary to attract foreign capital as well as to boost confidence from local investors.

Recently, trade has increased its percentage of GDP from an average of 32% in 1998 to almost 50% by 2006 (see Figure 2), suggesting that countries have benefited from increased interaction with other economies. Although there is an ongoing debate of whether free trade is the best pathway for the region’s development, Latin America is definitely more willing to woo foreign investments and to boost trade than ever before.

Other important factors that explain Latin America’s honeymoon with investors are the availability of more information from countries along with the willingness from these countries to become more transparent. Mexico and Brazil, for example, now publish detailed information regarding public finance, monetary policies, and even government contracts. On the other hand, large Latin American companies, such as América Móvil, Petrobras, and Bancolombia SA, are listed in the NYSE and Nasdaq, adhering to tight standards for information disclosure at the same time that their securities become more liquid.

Reducing Debt

While the total external debt of the most powerful countries in the region, in terms of size, has been shrinking, their currencies appreciated against the U.S. dollar, making nominal debt even lower. The economic expansion has increased tax collections; at the same time, these countries have become more responsible in managing their resources, and thus need less foreign capital to finance fiscal deficits. In addition, debt levels as a percentage of GDP have kept declining, making debt ratios more manageable. Figure 3 shows the evolution of external debt for a selected sample of countries in the region.  

Figure 3. External Debt of Selected Countries in Latin America

With a few exceptions, fiscal deficits have been cut or controlled; the economies enjoy monetary stability while external debt keeps coming down and foreign reserves rise. Reducing external debt is crucial for these countries, because without significant exchange rate fluctuations, interest service funds can be allocated in several other areas such as infrastructure or social programs. Despite the improvement, Latin American countries must demonstrate that they are ready to weather the next big crisis by attracting capital to be invested in long-term assets.
Instead of wasting the opportunity given by investors, Latin American countries should start diversifying their economies with industries that also provide better jobs for its citizens. Although commodity prices seem to go north perpetually, the crash during the 1980s should provide a lesson that current price levels are subject to volatility.

Finally, dictatorial regimes in the 20th century proved to be incapable of bringing the right conditions to improve the welfare of citizens and so became the source of human rights abuses, nepotism, and corruption. The young democracies in Latin America must deal with problems that are expected under democratic systems: the fight against corruption, the establishment of a mechanism for social auditing, the promotion of freedom of speech, and the increase of participation of the common citizen into political affairs. Latin America must develop the idea of understanding that differences between rich and poor are normal, but both groups should be treated equally in terms of rights and responsibilities.

Jose Roberto Magana is a student in the full-time MBA/MSF Program. Previously, he was the head trader of the fixed income portfolio of Banco Agricola S.A. in El Salvador. He seeks to pursue a career in the telecom industry with a special focus in Latin America. Jose can be reached for comment at maganaj@bc.edu.

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Remittance: Capital Flight or Venture Capital?

By Edouard Begin, MSF ’08

International remittance rates hit an all-time high in 2007. The World Bank estimated that more than 150 million immigrants worldwide transferred more than $300 billion in remittances in 2006 from the developed nations where they work to the less developed nations from where they originated.¹

This article will show how remittance has a significant effect throughout the global economy. From putting food on the table to cars in the driveway to currency reserves in the coffers of developing central banks, remittance funds help drive global consumption, growth, and poverty alleviation.

What Is a Remittance?

Economic development over the last 30 years has created a large flow of opportunity seeking labor from nonindustrialized countries to industrialized ones. From 1990 to 2000, the number of migrants in the more developed regions increased by 23 million, or 28%. In many instances, the people who constitute this mobile labor force have migrated from undeveloped regions of the world, oftentimes leaving their families behind. While working for a wage in the industrialized countries, these workers send a portion of their earnings back to their home countries to help support the families and friends whom they have left behind. In conducting this transfer of funds, the migrant worker in the industrialized nation has become the remitter, while the family or friends back in the migrant’s home country have become the receiver.

Who Facilitates This Exchange?

A remitter can use two channels for sending funds to the receiver: the formal and the informal. The formal network is primarily composed of banks, credit unions, wire-transfer services, post offices, and microfinance institutions. This channel is highly regulated and monitored by banking officials. Western Union and MoneyGram International are the largest players in the wire-transfer service remittance arena. According to the company websites, Western Union and its affiliates have 320,000 agent locations in more than 200 countries and territories, while MoneyGram International has more than 125,000 locations worldwide.

The formal process of remitting involves the sender conducting business with a distributor. The remitter will write a check or exchange cash with the remitting service for a fee. Western Union’s policies, as of January 2008, involve the company charging a $15 fee to send $100 to Mexico from Massachusetts, using their “money in minutes” service. By using Western Union, you have the option to send money by Internet or phone, or by visiting a Western Union location. After the distributor receives the request for remittance, the information is forwarded to a third party who then processes, reconciles, and pays out the monies to the recipient, as exhibited by Figure 1.

The informal process of remitting can be quite similar to the formal network, or it can be creative and completely unique. The unregulated informal network is composed of unofficial distributors, such as family, friends, missionaries, and merchants specializing in money distribution.

A more creative example of informal remittance takes place within the Ghanaian community in Europe. Ghanaian health-care insurance brokers are selling health plans, with the health service based in Ghana, to remitters abroad in hopes that the remitters will be willing to sponsor their family members for health coverage. The premiums are paid for in the foreign location while the service is rendered back in Ghana, thus eliminating currency transfer while creating a domestic health-care service industry.

Hand-carried funds by travelers is another popular form of informal remittance transfer. Some experts believe hand-carried funds amount to as much as 25% of all informal remittances leaving the United Kingdom.

Why Informal and Formal Networks?

Formal networks are required to follow international and domestic banking regulations. When circumstances exist where regulations prohibit certain countries or locations from participating in the international banking market, informal networks provide the only alternative. Immigrants who lack the language skills, proper documentation, or legal status necessary to conduct business within their host country’s economic system often choose to send their savings through the informal capital distribution network, where the employees speak


4 Frank N. Peke et al., 2007.
their language and often have a cultural understanding of what the remitter requires as a customer. The avoidance of taxes or other regulations is another incentive to use the informal network.

In some countries, such as Venezuela, informal networks are actually cheaper to use than formal networks. Stringent currency control regulations create a secondary “black” market for certain foreign currencies. Informal networks offer a lower service fee on transactions because of the money made on currency conversion in the black market. With the existence of such extra-regulatory demand factors, it is easy to understand why the World Bank estimates roughly $150 billion of worldwide remittances are sent through informal channels. When you add this value to the known quantity of formal remittances, you come up with a $450 billion-a-year industry.

Who Uses Remittances?

Friends and family of remittance senders have been the traditional recipients of remitted funds. They use the remittance for basic life necessities, such as food and shelter. According to the World Bank:

For millions of families around the world, remittances are the life-line that lifts them out of poverty. The vast majority of these flows are spent on basic needs of recipient families such as food, clothing, and shelter. This consumption, combined with investment in healthcare and education, constitutes 80–90% of remittance spending; the remaining 10–20% of remittances includes a mix of formal and informal savings and investments. Financial access and financial literacy are two key factors to unlocking the development potential of remittance flows.

Remittance receivers, who are fortunate enough to have a surplus in personal savings, are able to take advantage of savings and loan products when banks are geographically present. The recipients can document their remitted funds as a form of income when applying for car or home loans, thus allowing them to further their consumption beyond basic commodities. This new demand will need suppliers, so in theory the local economy will seek entrepreneurs who then may need to hire assistants, and so on.

Commercial banks in developing countries have also become dependent upon remittances. They use the remitted funds as capital reserves so that they can lend additional funds to consumers and businesses. Over the past 10 years, some banks have begun to use the stable remittance funds as collateral for securitization. Figure 2 illustrates how banks like Bancolombia, the largest commercial bank of Colombia, and Banco Itaú Holding, the largest commercial bank in Brazil, are using the remittance system for leverage in the international capital markets. In an effort to capture this potential business, Bancolombia and Bank Itaú have opened offices offering remittance services in countries that contain large populations of citizens living abroad. Banco Itaú, for example, in 2004 opened its first branch in Tokyo, Japan, which is dedicated to helping immigrants transfer money from Japan to Brazil.

By securitizing remittance, banks in developing countries are able to borrow at rates that are below those required by global debt markets for unsecured debt issues. Increased capital reserves from securitization have created a more vibrant lending environment in the banks’ respective national economies. With increased domestic lending, the multiplier effect has created business opportunities that may not have existed without this increase in capital reserve.

With this large amount of external funds coming into their countries, foreign governments are able to earn higher tax revenues from increases in economic activity. An IMF study by Prachi Mishra found that a one-percentage-point increase in remittance inflows in 13 Caribbean countries increased private investment by 0.6 percentage points. Figure 3 depicts how large some of these remitted funds are to their destination countries. El Salvador, for instance, relies on remitted funds for 16.2% of its GDP.

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Remittance: Capital Flight or Venture Capital?

Remittances also have proved to be an important source of funds in times of national economic duress. Research has shown that remittance rates tend to be countercyclical in recipient countries. In times of crisis, remitters have shown that they are there for their family and friends.

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<tr>
<th>Figure 3. Remittance as Percent of GDP, 2004 (%)</th>
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<td>0 5 10 15 20 25 30 35</td>
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<tr>
<td>Tonga</td>
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<td>Jamaica</td>
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<td>El Salvador</td>
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Source: World Bank

Concerns

With strong inflows of foreign currency, recipient countries may see a strengthening of their currency in world markets. This is especially true for countries where remittances make up a large proportion of GDP. A pronounced strengthening of currency caused by remittances would have a counterproductive effect on the recipient economy. Manufactured goods would become less competitively priced in global markets, thus leading to job losses and a faltering industrial base. Large and stable flows of remittance also could lead to the recipient becoming less inclined to work. As a result, this would lower the overall productivity within the economy.

Recommendations for the Future

From putting food on the table to increasing capital reserves in the coffers of central banks and domestic lenders, remittances are a crucial part of emerging market economies. In a post-9-11 world filled with anti-terror legislation (e.g., the Patriot Act) and protectionist ideals, potential political backlash from offering remittance services and increased costs associated with regulatory compliance have kept many smaller, legal, and legitimate financial players from taking part in the cross-border transfer of remittances. This has created a few very large and powerful players who are allowed to operate without the threat of start-up competition. Industry and government leaders must look at this business with a more progressive viewpoint, taking into account all of remittances’ implications on welfare and business. A major priority for foreign governments and multinational banks should be to have all of the remittance money integrated into the global economic system. World governments should craft a plan that allows for domestic banks from origin countries to operate overseas, thus giving the remitter and receiver a direct line of transfer. This increase in bank services, coupled with some form of legitimizing identification card, should further facilitate the formal distribution of remittances. An increase in the volume of legitimate fund transfers, brought on by less regulation and more competition, will decrease the cost of remittance service offered by the formal network. And, in turn, a decrease in cost will further strengthen the shift from informal to formal networks.

A more formal economic choice for migrant workers is in the best interest not only of the migrant, but also of the society as a whole. We need to show the disenfranchised that savings and investment can give them a say in world affairs.

Edouard Begin is an MSF 2008 candidate and a member of the Graduate Finance Association. Prior to attending Boston College, he participated in a variety of entrepreneurial business ventures on the island of Martha’s Vineyard. He can be reached at begine@bc.edu.

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An Interview with Luka Flere

By Zivko Bajevski, MBA/MSF ‘08

Luka Flere is the Senior Portfolio Manager – Head of Research at KD Group, the largest privately owned Slovenian asset management firm with $1.45 billion under management. KD is present throughout Southeastern Europe, including offices in Bosnia, Bulgaria, Croatia, Romania, Serbia, and Slovakia.

Prior to joining KD in 2005, Mr. Flere worked at the Central Bank of Slovenia in the Analysis & Research Department. He holds an MSc in Economics from Università Bocconi, Italy, and a BA from Ljubljana University, Slovenia. He is a Level III CFA candidate.
The stock exchanges across Southeastern Europe have exhibited very strong and rapid growth over the last couple of years. What are the most important trends that have influenced the growth in these markets?

During the last few years, stock markets in the region exhibited extraordinary returns. To cite just a few examples, indices with the highest return in the region over the last three years turned out to be the Macedonian MBI with a 760.2% increase, followed by the Croatian CROBEX with 275.0%, the Serbian BELEX with 256.2%, the Bulgarian SOFIX with 203.4%, the Romanian BET with 169.0%, and the Slovenian SBI20 with 149.3%, all measured in U.S. dollars. To keep a proper perspective, the MSCI Emerging Markets Index returned 129.7% for the same period, whereas the S&P 500 Index increased merely 21.2%.

The single most important factor that spurred growth was the real and nominal convergence of these markets toward the European Union. All these economies suffered at the beginning of the 1990s, as they broke apart from the socialist and communist regimes – Bosnia was especially hard-hit by the war raging for over three years. However, they have managed to overcome the obstacles in the transition period and are now on a much faster growth trajectory than the rest of developed Europe. According to the preliminary 2007 estimates, average GDP growth in the region amounted to between 5% and 8%, compared to 2.7% in the EU15. The main growth drivers are growth in the construction and telecommunication sectors, development of the financial industry, increasing inflow of foreign direct investment, and efficiency gains arising from the ongoing privatization. Domestic demand is also starting to pick up.

However, what is really striking about the stock markets in the region is not only the tremendous past growth and bright prospects, but also the extremely low correlations these markets exhibit both to developed markets and other global emerging markets outside the region. As such, investment in the region could greatly increase diversification.

What are the sectors/industries that have been most interesting for investors?

When analyzing new emerging and especially frontier markets, one usually starts with blue chips. Hence, as Balkan countries have introduced market economies and established stock exchanges, most of the investors first focused on blue chips. Banking, being one of the pillars of each economy, has become one of the most appealing sectors for investors. It is hard to generalize for the whole region,

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1 EU15 is the original 15 countries in the European Union before the 2004 expansion to include 10 new states.
but in countries like Serbia, where banking penetration ratios are extremely low and there is tremendous growth potential for the coming years, banking is still an attractive sector. On the other hand, we have Croatia where the central bank heavily tightened loan origination in 2007 and the banking sector suffered accordingly.

Among other sectors, one of the most prosperous has been construction and infrastructure. All countries throughout the region invest large amounts of money to update the infrastructure since not enough money was invested under the old regimes. Therefore, what we are seeing is a construction boom with highways, other general infrastructure, and residential and commercial property being developed. Another interesting sector has been tourism due to the attractive beaches on both the Adriatic and Black Seas, which makes these destinations alluring. Therefore, we consider some of the companies operating in this industry to be attractive asset players.

In the third quarter of 2007, the stock markets across Southeastern Europe exhibited very high volatility in their indices. The Stoxx Balkan 50 Index was up over 40% for the year, before falling to a positive 23% for the year. What are the main reasons for the high volatility of these markets?

First, I would like to point out that indices are not representative since we do not have an index that would cover all markets in the region. After stellar performance in the last couple of years, a correction is nothing unusual; however, it is important to clarify what caused increased volatility. The main reason surely lies with the dispute over the status of the Serbian province of Kosovo (Kosovo Albanians are demanding independence from Serbia), and consequently we are seeing increased political instability. December 10, 2007 was set as the deadline when the international mediating troika (representing the EU, Russia, and the U.S.) should have submitted its report on Kosovo to the UN. Tensions amplified as the date approached, spurred by radical politicians on both sides. The talks concluded without a breakthrough, but nothing dramatic happened as Kosovan leadership withdrew from unilateral actions.²

Three countries, namely Bulgaria, Romania, and Slovenia, have already joined The EU, and Slovenia, the first of these accession countries, adopted the Euro in 2007. Other countries are either negotiating or in the process of commencing negotiation talks with The EU and are led by pro-European governments striving for EU and European Economic and Monetary Union (EMU) membership. Therefore, finding a solution for Kosovo and the continuation of the convergence toward The EU could serve as a catalyst of future growth in these markets.

² Editor’s note: Shortly after this interview took place, Kosovo declared independence from Serbia.
What are some of the future growth trends that you foresee in these markets? Do you anticipate more IPOs? Introduction of derivatives?

We remain bullish on the region as we think there is still high growth potential. The macroeconomic environment is likely to remain favorable with GDP growing faster than in developed Europe, and the political situation is stabilizing. Past evidence shows one of the major pitfalls of the Balkan markets has been low liquidity; although it has been continuously increasing, it still remains rather low.

Looking forward, we expect to see liquidity improving as we anticipate both greater activity on the markets and a number of IPOs. Last year, we saw a few very successful placements, the second-largest Slovenian bank NKBM, the Romanian gas distributor Transgaz, the Croatian telecom company T-HT, and two Bulgarian banks – to name just the largest. We expect this to continue throughout 2008 as there are still numerous interesting companies looking to go public (the primary source being the ongoing privatization process), and the appetite for regional IPOs remains very high. Stock exchanges also are constantly improving their trading systems and infrastructure. In that context, we saw a merger between the two Croatian stock exchanges last year, and we are expecting the introduction of derivatives trading in Croatia and Romania.

Who are the main investors in the capital markets of Southeastern Europe? Domestic vs. Foreign?

We have seen increasing interest for the region amongst foreign investors in the last few years. The proportion of foreign investors in total volume traded on stock exchanges has been increasing consistently. For example, in Romania the average foreign participation in total volume terms averaged 27% in 2006 and increased to 37% in 2007, predominately due to Romania’s accession to the EU at the beginning of 2007. A slightly different pattern has been observed in Serbia, where foreign participation amounted to 42% in 2005, increased to 48% in 2006, and fell to 40% last year due to increasing political instability. Main foreign investors come either from more developed countries in the region like Slovenia, other European countries that have acknowledged the potential of the region (e.g., Austria, France, Sweden, etc.), or Russia.

Do you see the lack of transparency regulation as a major issue that inhibits the growth of the markets? If so, what attempts are being made to improve the regulation and transparency?

Transparency is surely one of the major pitfalls of these markets. We have to keep in mind that transition started 17 years ago, and that some “managers” did not really know how to behave in market economies. Therefore, what we see in practice is patchy corporate governance records, limited use of International Financial Reporting Standards (IFRS), and manipulation of earnings. Progress has been made, however, and the EU again serves as a catalyst for change since all countries wanting to enter the EU have to adopt common European law acquis communautaire, or EU aquis. This assures all countries will adopt and enforce EU laws and best practices.

What about institutional investors? Do you foresee them becoming more active and important investors in the stock exchanges?

It is difficult to generalize for the region as a whole. In some countries that used voucher privatization, institutional investors, in particular privatization funds, already play an important role. In addition, we see pension reforms being adopted throughout the region and the subsequent emergence of pension funds which are becoming important players in the markets. Adding the growing mutual fund industry to the equation, we realize institutional investors already play an important role.

There has been a significant increase in the number of investment funds available in Southeastern Europe. Do you see an increasing number of investors using the investment funds as a long-term savings vehicle?

Absolutely. In general, people are not familiar with stock exchange mechanisms and the mutual funds industry. At KD, we have been working hard in recent years to educate the general public about the benefits of investing in mutual funds, and we are now starting to see the results. Slovenia and Croatia are by far the most developed in this respect with an average investor holding approximately 1,400 EUR p.c. and 850 EUR p.c., respectively. We expect to observe similar trends in other countries in the region.

What is KD Group’s vision, and how do you intend to maximize on the potential of the Southeastern Europe markets?

KD is one of the largest privately owned asset management firms in the region with $1.45 billion under management. We position ourselves as the investment manager of choice and have local presence throughout the region. Headquartered in Slovenia, we have asset management companies in Bosnia, Bulgaria, Croatia, Romania, Serbia, and Slovakia. We truly believe in the potential
the region has to offer and are therefore very optimistic about the future. Because we are aware of the risks posed by liquidity challenges and transparency issues, we have analysts located throughout the region who understand the local markets and issues. Therefore, we believe that we are well placed to deal with these issues.

Zivko Bajevski is a first-year MBA/MSF student. After graduating from Temple University, he worked as a financial consultant for six years. Zivko is interested in pursuing a career in investment management. He can be reached at bajevsky@bc.edu for further comment.
ETFs and ADRs: Big Returns for Small Investors

By Joseph Khattab, MSF ’08
American investors are looking to emerging markets for growth opportunities – and with good reason.

Consider that the Bank of New York Emerging Markets 50 Index returned 38.1% on average over the last five years, compared to only 12.9% for the S&P 500 Index. The United States and Europe simply cannot keep pace with the burgeoning economies of Africa, Asia, Eastern Europe, and Latin America.

Retail investors – particularly those with high risk tolerances and long time horizons – should have some exposure to emerging market equities in their personal portfolios or retirement accounts. Portfolios with international diversification will be more efficient (i.e., have a better risk/reward trade-off) than a portfolio of U.S. securities, according to Modern Portfolio Theory.

However, navigating emerging market investments is complicated and carries additional political, currency, and informational risks. The next sections will present an overview of emerging market investments, as well as an interview with an investment advisor for more insight into the risks and opportunities in these regions.

Emerging Market Funds

Mutual funds are a convenient way to own a diversified portfolio of emerging market stocks. Literally hundreds of funds are available; Morningstar lists 126 diversified emerging market funds rated 2-stars or better. With so many options, it is difficult to choose the best funds. Low expenses, experienced management, and a history of consistent performance are important qualities to look for in a fund.¹

Investors rotated out of U.S. equity funds in favor of emerging market funds in 2007, according to research from EPFR Global. Analysts predict a period of slow growth in the United States, and some pundits, including former Fed Chairman Alan Greenspan, believe there is a large probability of recession as consumers struggle with high energy prices, unmanageable debt, and a weak housing market. Thus, emerging market funds provide alternatives to ostensibly lackluster U.S. equities.

Exchange-Traded Funds (ETFs) are another option. State Street, Barclays, Vanguard, and other asset managers developed ETFs that track emerging market countries and indices, giving small investors access to these markets. ETFs trade on major exchanges, similar to stocks, making it easy to buy, sell, or even short them. They also tend to have smaller expense ratios than their mutual fund counterparts.²

International ETFs continue to perform well and attract assets. Net assets of iShares MSCI Emerging Market Index soared from $2 billion in 2004 to $18 billion in 2007, and iShares Brazil Index grew from $200,000 to over $4 billion.³ Many country-specific ETFs delivered double-digit returns in 2007.

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<th>Figure 1. 2007 Returns for Selected ETFs</th>
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<td><strong>Fund Manager</strong></td>
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<td>iPath MSCI India Index ETN</td>
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<td>iShares MSCI Brazil Index</td>
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<td>iShares FTSE/Xinhua China 25 Index</td>
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<tr>
<td>SPDRs</td>
</tr>
<tr>
<td>Vanguard Emerging Mkts Stock Index</td>
</tr>
</tbody>
</table>

*Began trading in March 2007

ADR

Sophisticated investors may want to own foreign stocks directly via American Depository Receipts (ADRs), which allow investors to buy foreign stocks through a U.S. exchange. For example, Chinese energy giant PetroChina trades on both the New York Stock Exchange and the Hong Kong Stock Exchange. ADRs give investors the ability to choose specific stocks, as opposed to equity funds that hold a basket of stocks. Thus, ADRs are a good option for experienced investors who believe they can identify undervalued securities and beat the indices.

The largest emerging market ADRs are concentrated in energy and telecom, as one might expect. However, the face of emerging markets is changing: investors will find opportunities across most sectors, including IT, financial services, and even Internet stocks.


³ iShares prospectus.
Figure 2. Largest Emerging Market ADRs

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Enterprise Value (USD MN)</th>
<th>Industry</th>
<th>Headquarters</th>
</tr>
</thead>
<tbody>
<tr>
<td>PetroChina</td>
<td>317,541</td>
<td>Oil and Gas</td>
<td>China</td>
</tr>
<tr>
<td>China Petroleum &amp; Chemical Corporation</td>
<td>301,840</td>
<td>Oil and Gas</td>
<td>China</td>
</tr>
<tr>
<td>Petroleo Brasileiro</td>
<td>258,858</td>
<td>Oil and Gas</td>
<td>Brazil</td>
</tr>
<tr>
<td>Companhia Vale do Rio Doce</td>
<td>174,090</td>
<td>Metals and Mining</td>
<td>Brazil</td>
</tr>
<tr>
<td>China Life Insurance</td>
<td>132,477</td>
<td>Insurance</td>
<td>Brazil</td>
</tr>
<tr>
<td>América Móvil S.A.B. de C.V.</td>
<td>110,675</td>
<td>Wireless Telecom</td>
<td>Mexico</td>
</tr>
<tr>
<td>China Telecom Corporation Limited</td>
<td>81,744</td>
<td>Integrated Telecom</td>
<td>China</td>
</tr>
<tr>
<td>Companhia de Bebidas das Américas (AmBev)</td>
<td>50,229</td>
<td>Brewers</td>
<td>Brazil</td>
</tr>
<tr>
<td>Vimpel-Communications</td>
<td>43,581</td>
<td>Wireless Telecom</td>
<td>Russia</td>
</tr>
<tr>
<td>Telefonos de Mexico SA de CV (TELMEX)</td>
<td>43,011</td>
<td>Integrated Telecom</td>
<td>Mexico</td>
</tr>
</tbody>
</table>

Source: Capital IQ, as of Jan. 12, 2008

Risk and Reward

Of course, higher returns invariably come with higher risk. In May 2006, emerging markets experienced a “correction,” resulting in the EM indices losing almost 20% of their value over a two-week period. Similar corrections occurred in the summer of 2007 and then again at the end of 2007. This volatility is typical of developing markets, and 20% drops are not uncommon. The five-year chart of the S&P 500 Index looks tame compared to the ups-and-downs of the iShares MSCI Emerging Market Index.

In addition to volatility, emerging market investors face currency risk, enhanced political risk, and different reporting standards. If that were not enough, research shows that emerging markets are becoming more correlated with U.S. markets, making them less of a hedge against U.S. recession. Thus, investing in emerging markets can be more challenging than investing in U.S. equities.

Interview with Motley Fool Global Gains

I turned to Nate Parmelee for advice on investing in emerging markets. Nate is a senior advisor for Motley Fool Global Gains, an investment advisory service that helps retail investors find the best stocks in foreign markets. Nate identifies undervalued international stocks through diligent fundamental analysis and brings a wealth of international experience, including three years in Japan working for General Electric. In 2007, Global Gains’ stock recommendations outperformed both the S&P 500 Index and the MSCI EAFE Index (a benchmark for international stocks) by over 10%.

How much exposure to emerging markets do you recommend for a 30-year-old professional, perhaps?

NP: It used to be that this was an easy question. Emerging markets were almost uniformly risky. But today, some of the most forward-thinking, progressive multinational companies in the world are domiciled in emerging markets, like Embraer from Brazil and Cemex from Mexico. Our first focus is not usually related to place. We want to hold excellent businesses acquired at reasonable prices. The next consideration should be diversification among industries and countries. But any time we can acquire a well-diversified, reasonably priced group of high-quality companies in emerging markets, we are happy to do so. U.S. investors should also consider that many small-to-midsize companies in the United States and other developed markets rely on emerging markets for sales growth as another way to gain exposure.

What is the best way to gain exposure to emerging market stocks? ETFs? Mutual funds? ADRs?

NP: This is mostly a question of time, temperament, and interest level. If you dedicate a lot of time to your investments, owning shares or ADRs of individual companies is a great way to invest in emerging markets. Investors that have less time to dedicate toward following investments can still do very well with mutual funds that have managers with good long-term track records. ETFs are great for specific countries that can be expensive to invest in otherwise. Just make sure that you adjust the manager’s performance for fees.

Are you a “top-down” analyst? That is, do you start with a promising region first, and then start looking at stocks in that region?

NP: We generally think of ourselves as bottom-up analysts looking to understand the business first and then its valuation. But there certainly are times that a country’s market gets beaten down, and we start to look for attractive businesses within the country. Simply put – even if macroeconomic conditions are not ideal, we will buy if we see value in a name.
Do you use any mechanical screens to identify undervalued stocks? Does technical analysis ever come into consideration?

NP: We screen a great deal on different valuation criteria and for price declines, but technical analysis does not enter the picture. We are much more concerned with how a business is presently valued and what its future looks like than we are with past price history.

How do you assess a country’s political risk, and how does political risk factor into your valuation models?

NP: Mostly, it is a lot of reading and researching. Government websites, publications such as The Economist, and other publicly available resources provide enough material to assess a country’s political risk. Generally, we’re looking for what economic policies the government is promoting, how the government handles its budget and taxes, and how business-friendly a country is overall. Greater political risk means we require a larger discount to what we think a business is worth. At the extreme end, where assets might be seized or nationalized, we would require a very large discount to our estimate of asset values or avoid a country altogether.

I know your team likes to meet with executives at companies you are researching. Are EM executives more forthcoming with information than their U.S. counterparts (perhaps due to regulations)? Are there opportunities to acquire information more aggressively?

NP: We mainly focus on investments that are available for purchase in the United States, which means the companies have to follow similar fair disclosure practices that U.S. companies do. That means management cannot share privileged information with us. However, we still find talking with management teams invaluable, because we get answers to specific questions we have, their thoughts on strategy, and also a feel for how the company views and treats its minority shareholders. More and more countries’ securities regulators offer company filings online, though usually only in the native language. We are not above getting these documents and translating them.

Brazil, Russia, India, and China (BRIC) are grabbing all the headlines. Should investors be looking at emerging market countries besides BRIC?

NP: Yes, absolutely. We always believe in trying to look where others are not. One of the interesting trends that we see is companies based in China and India setting up factories in other markets, like the Philippines and Vietnam. Investors should pay attention to these economies, because as costs rise in the BRIC countries, these will be the low-cost producers of the future. Some countries, like Vietnam and Chile, are actively seeking out free trade agreements and looking to fill that role.

Tell us about one stock on your radar and how you found it.

NP: Grupo Aeroportuario Centro Norte (OMA) has exclusive contracts to operate 13 airports in Mexico. We found this idea after following two other airport management companies in Mexico. The company manages a mix of tourist and business airports and collects fees on a per-passenger basis. Traffic is increasing through the airports, because of a proliferation of low-cost carriers that offer a better travel experience than buses at a similar price point. OMA also is increasing the number of retail shops in its airports – something government operators did not do, because they were not concerned with maximizing revenue – which is a logical step when you have a captive audience.

Could you tell us about an emerging market stock you recommended that did not work out and what you learned from it?

NP: We started Global Gains at the end of 2006 and thus far we have been fortunate not to have an emerging market recommendation blow up on us. We have actually had more challenges in developed markets, with our biggest challenges coming from companies with exposure to Canada and, believe it or not, the United States. But that is because we have been concerned about valuations in many of the emerging markets and have been careful to pick our spots. We like the big emerging markets a great deal; but right now many companies have been priced for perfection, so we are waiting until the consensus is a little less optimistic.

Joseph Khattab is a Boston College MSF 2008 candidate. He is a graduate of the University of Virginia and previously worked in equity research and financial journalism. He can be reached at khattab@bc.edu for further comment.
As emerging markets become increasingly important to U.S. corporations, American executives may find themselves traveling to exotic locations like São Paulo, Brazil, or Bangalore, India. Doing business in a foreign country is always challenging, whether you are building relationships, negotiating a deal, or having a business dinner. Knowing the customs and protocol in different regions can mean the difference between sealing that big deal or going home-empty handed.

Here are some tips to help business travelers in emerging markets, courtesy of the Carroll School of Management’s diverse student body:

When in China...

- You should receive business cards with both of your hands to show your respect.
- If someone pours a beverage for you at a business dinner, you can either say “thank you” or use your second and third fingers of your right hand to tap on the table. This is a hand sign to say thank you.

Han Lee, MSF ’08
Shanghai, China

When in Taiwan...

- Bribery is not expected in Taiwan anymore. However, if you have planned a small “facilitation fee” in advance, you might be ahead of your competitors/bidders from a first-impression point of view.
- Taiwanese may try to bribe you, due to the fact that some U.S. buyers have practiced the art of accepting bribes for years without letting their U.S. parent company know. Therefore, it may help to reveal your moral standards up front to avoid confusion.

Hao-Ming Yu, MSF ’08
Taipei, Taiwan

When in Thailand...

- Thais address each other with the word “Khun” followed by the first name. They do not address others by their first name or nickname until they are well acquainted. Many foreigners impress Thais by addressing them with the Khun preface.

• Usually, Thais expect our foreign guests to be punctual. So act accordingly, even if your Thai host is late.

Aekpoj Mahaphan, MSF ’08
Bangkok, Thailand

When in Central America...

• When dealing with government officers, refer to them using academic titles (Ingeniero/a, Licenciado/a, Doctor/a, etc.).
• People in Central America are not normally on time, so be prepared to wait.
• Networking is very important. Everything is done on recommendation and influence.

Jose Roberto Magana, MBA/MSF ’08
San Salvador, El Salvador

When in Venezuela...

• You must be very patient because there are constant delays and usually people do not arrive on time to meetings.
• Usually, women say hello and good-bye by giving one kiss on the cheek to both men and women. Men just give a handshake to each other.
• Venezuelans speak very loudly and are very passionate in negotiations. Humor is appropriate anywhere, anytime. You have been warned!
• If you plan to send documents to Venezuela, use private couriers like FedEx or UPS. The regular mail does not work.

Andreina Zubazaretta, MBA ’08
Caracas, Venezuela

When in Bulgaria...

• You can achieve better results by setting up a business meeting in a café or a restaurant than in a regular office environment. Bulgarians like to socialize and spend some time learning about the other party before talking business. Do not rush them! They prefer to take their time finishing a drink or a meal. (Buying a shot is not a good idea.)
• If invited to a dinner at your host's home, it is considered rude to refuse to try a dish. Try it at least once even if you do not like it.

Denislav Ivanov, MSF ’08
Pavlikeni, Bulgaria

When in Iceland...

• Getting straight down to business is appreciated, and Icelanders tend to be very direct in their speech. This should therefore be expected when doing business in Iceland and not taken offensively.
• Establishing a friendly and personal relationship is a good way to do business. Business dinners are the preferred form of entertainment. It is considered appropriate to talk business over a meal or a drink.
• Very few Icelanders have original surnames. Surnames are based on the father’s Christian name plus “son” or “daughter.” Icelanders do not use “Mr.” and “Ms.” among themselves, although they might do so when among foreigners. Calling Icelanders by their first name is usually more appropriate than using the surnames.

Halla Kristjansdottir, MSF ’08
Reykjavik, Iceland

When in Egypt...

• Bargaining is a must. You will have to be extremely patient because bargaining is a priority at both the institutional and retail level and cannot be rushed.
• The best thing any institution or individual investor can do is make many connections, especially with high-ranking individuals, as this will take care of many impediments that can face investors in Egypt. For example, if an investor wants a piece of land for a project, he will find himself burdened with obstacles like taxes or even existing lawsuits that involve the land.
• Given that Egypt is family oriented, it would be a very good idea for a foreign investor to establish relationships with a business partner by inviting a member of his family to dinner. For example, the foreigner could invite the Egyptian partner and his wife. It gives a feeling that a family has formed and fosters a strong relationship.

Amr Osman, MSF ’08
Cairo, Egypt
The Rise of Sovereign Wealth Funds

CONTINUED FROM PAGE 11

historically proven to be model passive investors: “The evidence so far suggests that SWFs are seeking to generate higher investment returns without generating political controversy.” It would be terrible policy to alienate this asset class on account of xenophobic reactions to an unfamiliar new presence in global financial markets.

Indeed, sovereign wealth funds are typically model long-term investors, capable of providing stability to global financial markets and liquidity to markets, industries, and companies that may otherwise have much greater difficulty obtaining capital, especially in a pinch. With this in mind, sweeping protectionist policy must be avoided, as it is likely to be more harmful than any SWF investment.

Matt Freedman is a 2008 MSF candidate at the Carroll School. He holds a bachelor’s degree from Washington University and has interests in asset management, private equity, and risk management. He can be reached at freedmma@bc.edu.

We would like to thank Mr. Clough for his time and patience in providing valuable insight into recent financial developments, as well as the current and likely future role of sovereign wealth funds in global markets.

BRIC & Mortar: Commercial Real Estate in Emerging Markets

CONTINUED FROM PAGE 17

The other risk is an overheated market. Cranes litter the backdrop in pictures of any major Chinese city. As mentioned briefly before, there has been so much development and investment that the Chinese government has taken steps to slow down the economy and reduce speculation. The first measure, in 2005, was the introduction of a 5.5% tax on properties sold within two years of purchase. Further measures to curb residential speculation were initiated in 2006, including raising mortgage rates and limiting presales on developments. In addition, the government curbed leverage by requiring developers to have 35% equity in new projects.

With a wave of new building growth, the debate centers on whether a bubble will form or if these new buildings will simply help to meet the strong demand. That being said, it is hard to argue that the outlook for the real estate market long term continues to be excellent due to the compelling macroeconomic story.

Summary

Real estate investing in emerging markets is a fascinating topic, and this article just scratches the surface. Despite being off to a fast start, too fast for some, the wave of global real estate investing is still in its infancy. With much of the world still developing and yet to adopt modern standards of real estate financing and property ownership, there will be unlimited opportunity going forward. For example, there are currently no rules allowing REITs in any of the BRIC nations, although they are rumored to be in the works in Brazil and India. As this article demonstrates, the returns can be phenomenal for early entrants, but the risks and complications of investing in these markets prove that it is not for the faint of heart. All risks considered, the long-term demographics are hard to argue. Investors need to be careful, however. As John Maynard Keynes noted, “The market can stay irrational longer than you can stay solvent.”

Patrick Keefe is a 2009 MBA candidate at the Carroll School. He holds a bachelor’s degree from Northeastern University. His prior experience is in mortgage finance and residential real estate brokerage. Patrick is a level I CFA candidate with an interest in real estate-related investment management. He can be reached at keefep@bc.edu.

41 Cushman & Wakefield, "Asia Pacific Investment Report."
Magazines and Online Resources

Many magazines and online resources publish emerging market news, data, and research. Most financial websites have a free section dedicated to international markets; others, including the Wall Street Journal Online, require a subscription.

Some of the most useful free online resources are:

- **Bloomberg.com**. The ubiquitous information company provides in-depth coverage of economic, financial, and political developments in virtually every part of the world.

- **Economist.com**. This respected magazine offers news, commentary, and economic data on its website. It also has useful country profiles, city guides, and rankings for the best and worst places to do business.

- **The Motley Fool** (fool.com). This irreverent website offers stock market commentary and investing strategies. Emerging market stocks, funds, and ETFs are discussed daily.

- **FT.com** (http://www.ft.com/markets/emerging). Financial Times makes it easy to find relevant emerging market news and commentary.


Financial and Research Centers

Comprehensive and thorough research is available at some of the world’s leading financial centers. These resources were incredibly valuable in putting together this issue of the Boston College Financial:

- **Inter-American Development Bank** (www.iadb.org). IADB is the main source of multilateral financing for economic, social, and institutional development in Latin America and the Caribbean.

- **International Monetary Fund** (www.imf.org). The IMF promotes international monetary cooperation, fosters economic growth, and provides temporary financial assistance to countries to help ease balance-of-payments adjustment. The IMF also publishes a quarterly publication, Finance and Development.

- **World Bank** (www.worldbank.com). The World Bank’s mission is to support global poverty reduction and improve living standards. It provides low-interest loans, interest-free credit, and grants to developing countries for education, health, and many other purposes.

- **U.S. Treasury - Office of International Affairs** (http://www.ustreas.gov). The Office of International Affairs performs constant surveillance and in-depth analysis of global economic and financial developments and engages with financial market participants, foreign governments, and financial institutions to develop and promote good policies.

- **CIA - World Fact Book** (www.cia.gov/library/publications/the-world-factbook). The country profiles in the World Fact Book have a plethora of geographic, political, economic, communication, and other useful data.

- **Organization for Economic Cooperation and Development** (www.oecd.org). One of the world’s largest sources of economic and social data, OECD monitors trends, analyzes and forecasts economic developments, and researches social changes or evolving patterns in trade, the environment, agriculture, technology, taxation, and more.

Additional Internet Resources:

- Goldman Sachs (www.goldmansachs.com)
- PricewaterhouseCoopers (www.pwc.com)
- Deloitte Touche Tohmatsu (www.deloitte.com)
- Ernst & Young (www.ey.com)
- Jones Lang LaSalle (www.joneslanglasalle.com)
- CB Richard Ellis (www.cbre.com)

Books

Banker to the Poor by Muhammad Yunus
Amazon price: $10.20 Paperback 288 pages
Muhammad Yunus established a bank devoted to helping break the cycle of poverty in developing countries and started the microfinance movement. This is his story in his own words.
Microfinance Handbook: An Institutional and Financial Perspective (Sustainable Banking with the Poor)
by Joanna Ledgerwood
Amazon price: $30 Paperback: 304 pages
One of the major products of the World Bank’s Sustainable Banking with the Poor project, this book gathers and presents up-to-date knowledge directly or indirectly contributed by leading experts in the field of microfinance.

Bangalore Tiger by Steve Hamm
Amazon price: $18.21 Hardcover: 288 pages
Bangalore Tiger is the remarkable story of IT company Wipro and its impact on the other Indian “tech tigers.” BusinessWeek senior writer Steve Hamm takes you inside the halls of this transnational phenomenon to reveal the secrets behind Wipro’s business.

Investing in Emerging Markets by Robert F. Bruner, Robert M. Conroy, Wei Li, and Elizabeth F. O’Halloran
Amazon price: $35 Paperback: 97 pages
The authors summarize the numerous considerations facing investors in emerging markets and recommend appropriate responses to guide investors under particular circumstances.

The World is Flat: A Brief History of the Twenty-First Century (Updated and Expanded) by Thomas Friedman
Amazon price: $10.88 Paperback: 672 pages
The latest version of Friedman’s book gives us an update on globalization, its opportunities for empowerment, its achievements at lifting millions out of poverty, and its social and political problems.

Investments
By Zvi Bodie, Alex Kane, and Alan J. Marcus
Co-written by Boston College’s own Professor Alan J. Marcus as well as Boston University Professor Zvi Bodie, this latest edition is the place to start to understand all about investments in any country.