

A regulatory framework for venture capital funds in Belarus

Alexander Lehmann

German Economic Team Belarus

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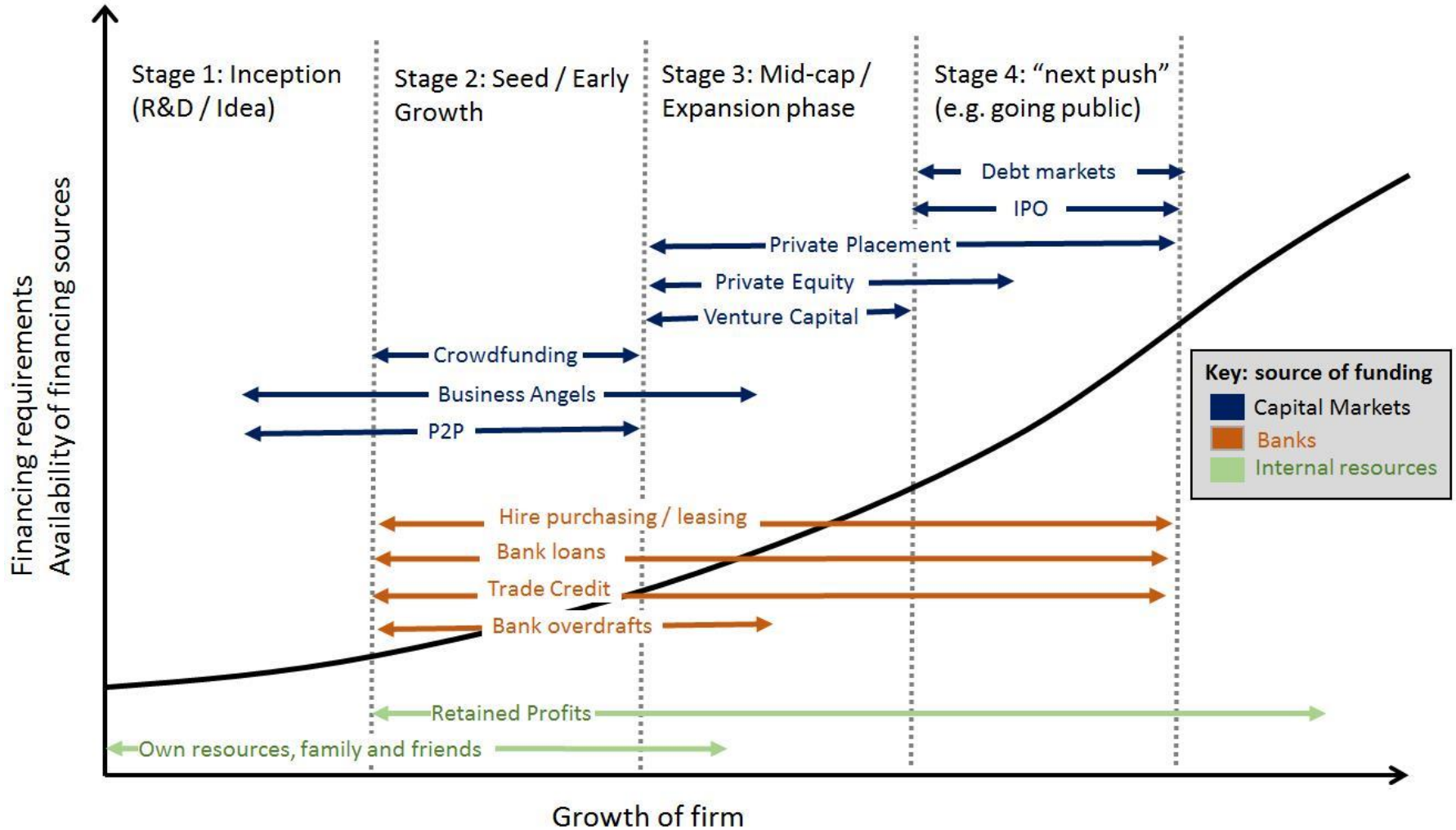
References

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1. Introduction and key points

- Belarus has considerable potential in the ‘knowledge economy’. But a large number entrepreneurs/start-ups with promising concepts are constrained by inadequate debt and equity financing
- Some of these financing constraints are justified by poor framework conditions, in particular enforcement and corporate governance standards, which should be reformed
- Other constraints represent failures in the financial market, and the fact that banks are not equipped to structure equity deals

It is important to make financing at all stages of a company's growth available



Source: European Commission

2. The business model of private equity and venture capital

- Typically well-informed investors, such as wealthy individuals or local institutional investors
- These investors participate in defining the mandate of the fund
- ... and commit to a capital contribution for at least 5 years

Financial stability risks are therefore limited:

- The investment fund does not require liquidity or a regular valuation
- Concerns about investor protection are also less relevant than for funds aimed at retail investors
- As investors are closely involved in defining the fund's strategy, issues of disclosure at the fund's launch and over its lifetime are less pressing
- The majority owners in investee companies and other stakeholders, such as employees, need to accept a close involvement by the fund management

The investor landscape in emerging Europe

- VC normally has a very small share of overall SME financing
- The EU VC market is itself underdeveloped, depth is only about 12 per cent of that in the US
- The sharp drop in global flows after the financial crisis has only partially been made up
- CEE region is still underserved by PE/VC: EBRD estimates number of suitable firms at 40,000, compared to only 800 recipients to date
- Poor corporate governance and protection of minority shareholders are the key constraints
- Investor activity is concentrated in central Europe, Russia and Turkey
- Fundraising/investment in CEE: EUR 620 m / EUR 1.6 bn for total private equity and only EUR 100 m raised for dedicated VC (16% of total CEE PE)
- Poland and Hungary account for over half of the total

The economic potential of venture capital

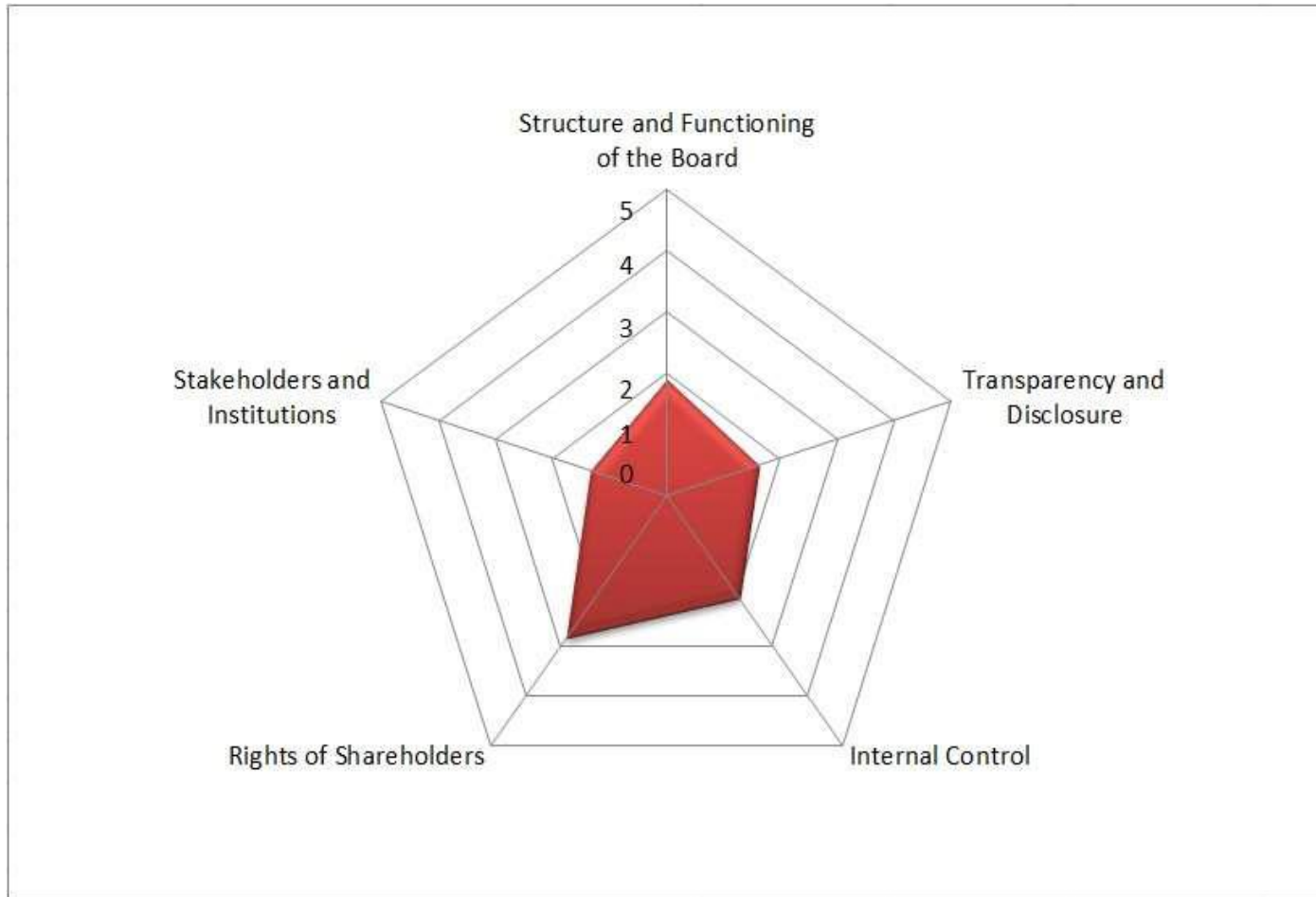
- VC will spur innovation by overcoming financing constraints of young companies. As a highly risky sector VC requires private sector expertise and risk sharing
- Empirical literature on private equity/VC involvement (e.g. EBRD, 2015)
 - PE funds help investee firms gain access to credit, and will raise its capital spending
 - Monitoring, governance and operational restructuring raises innovation and productivity within the firm
- There is an extensive empirical literature on the impact of private equity on the wider economy, also confirmed for the VC segment:
 - Positive impact on corporate revenue growth, employment and labour productivity, albeit only after about three years
 - Capital expenditures more than make up for any asset reductions implemented in the course of operational restructuring

3. General principles in investment fund regulation

The broader legal, institutional and tax conditions are important:

- VC regulation is part of a broader environment that will need to be receptive for risk capital. Key aspects are:
 - Investor protection, corporate transparency and corporate governance
 - Transparent and predictable taxation that is efficiently administered
 - Contract enforcement and protection of intellectual property rights
 - Ultimately, liquid local capital markets or alternative exit options
- The wider innovation framework and economic growth are also important:
 - Local innovative activity
 - Government R&D spending and public start-up programmes

Corporate governance legislation and practices in Belarus



Source: EBRD

Key: Very weak: 1 / Weak: 2 / Fair: 3 / Moderately Strong: 4 / Strong to very strong: 5

Principles of the International Organisation of Securities Commissions (IOSCO)

- IOSCO fosters predictability and transparency in capital market regulation
- Belarus is not a member of IOSCO, though membership should be an objective over the medium term as it would reassure international investors

Principles 24-28 on Collective Investment Schemes (CIS):

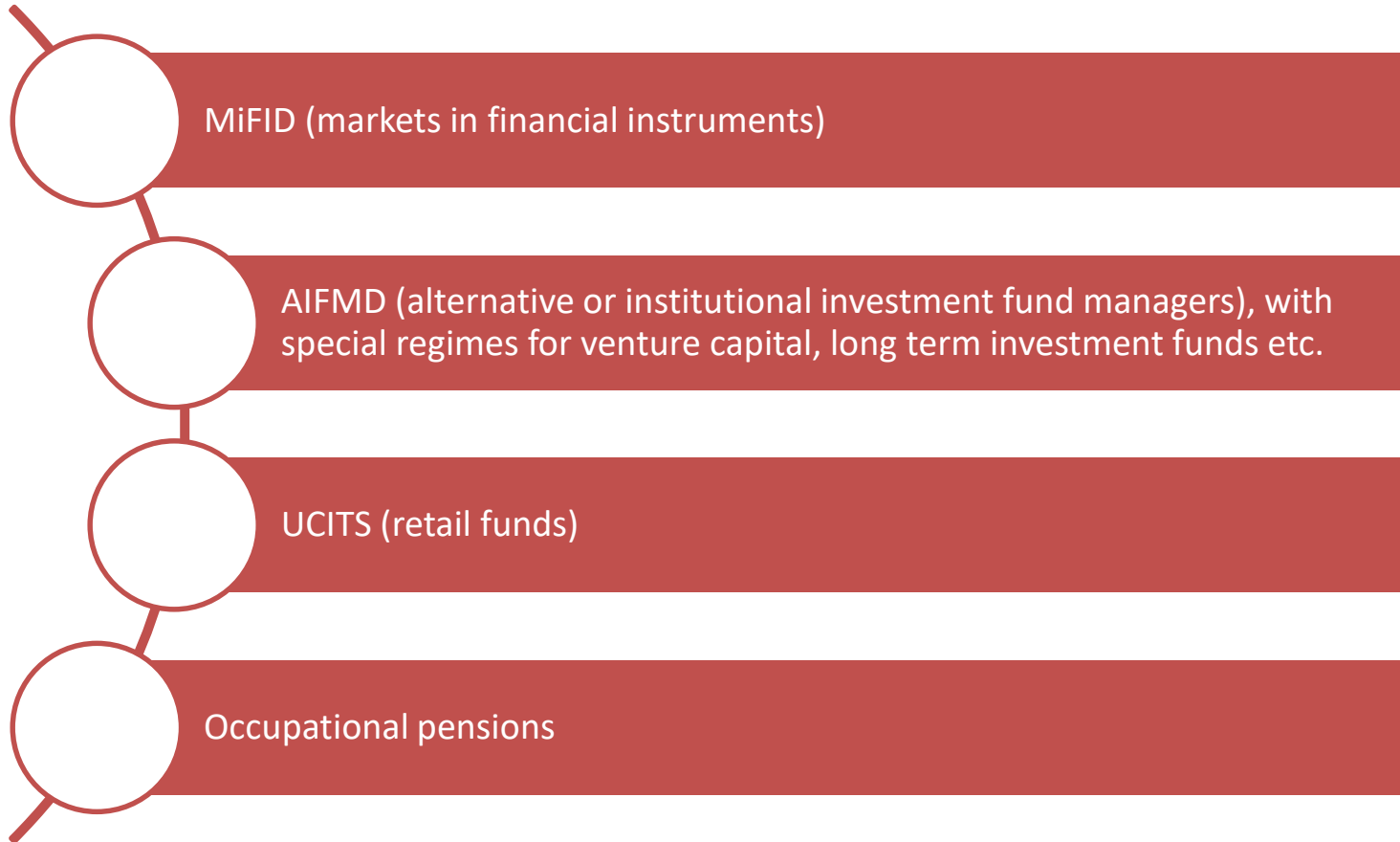
- Set standards for eligibility, governance, organization and operational conduct of CIS
- Set rules on legal form and structure
- Require disclosures similar to individual issuers, so that investors can evaluate suitability of the investment
- Provide transparent basis for valuation and redemption
- But not necessarily a need for ongoing valuation in typically illiquid investments

The EU investment law

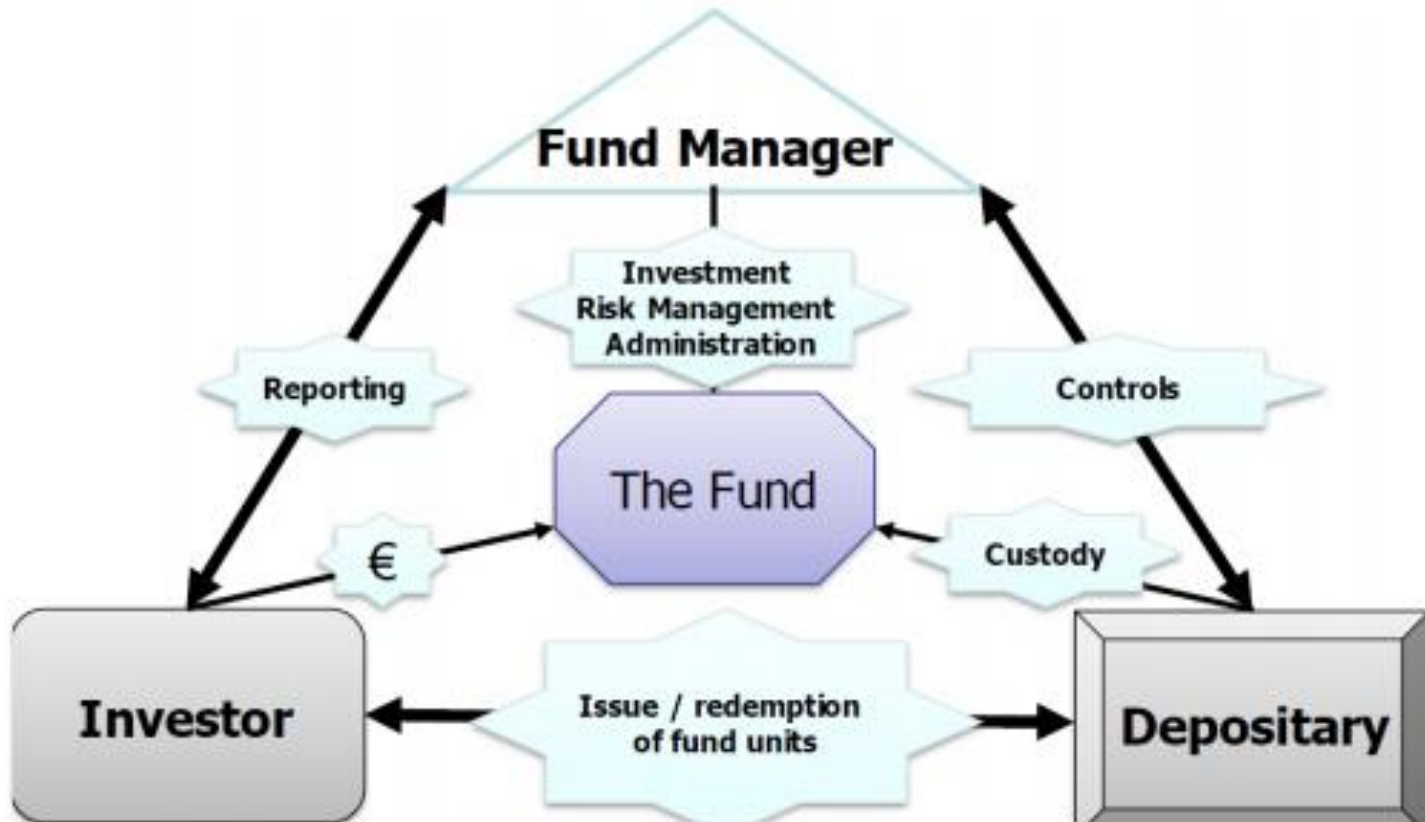
Individual
investments



Collective
investments



The 'investment triangle' protects investors (though it is waived for venture capital funds)



Source: Zetzsche, 2017

5. Conclusions and specific issues to be considered by the working group

- VC will only develop within an environment that is supportive of minority equity participations
- As such, the regulatory framework for investment funds should be broad, covering all stages of equity financing
- Sector specific preferences for venture capital, on the other hand, should be kept to a minimum. However, there might be a case for certain tax and funding preferences
- Principles developed by IOSCO offer some useful guidance. There is no need to adhere to complex European legislation
- Allowing foreign funds access to Belarus, and reforming the broader regulatory conditions for this purpose, appears as most promising in the short term

References

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- EBRD (2017): [Corporate Governance Assessment Belarus](#).
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- Zetsche, D. (2017): [The Anatomy of European Investment Fund Law](#).

Contacts

Dr Alexander Lehmann

lehmann@berlin-economics.com

German Economic Team Belarus

c/o BE Berlin Economics GmbH

Schillerstraße 59, D-10627 Berlin

Tel: +49 30 / 20 61 34 64 0

Fax: +49 30 / 20 61 34 64 9

www.get-belarus.de

Twitter: @BerlinEconomics

Facebook: @BE.Berlin.Economics

