THE ROLE OF WEALTH FUNDS IN AN ENTREPRENEURIAL ECONOMY

Over the last decade, the role of the state in global economic policy has deepened, which particularly has implications for sovereign wealth funds (SWFs). SWFs – government-owned investment vehicles established with a purpose to boost the national economy – originated in the 1950s but have grown significantly since then, now possessing huge amounts of investment capital. In this article, the authors argue that while each SWF has its own unique objective, on a whole SWFs are becoming key drivers of the entrepreneurial economy. Furthermore, they argue that the success of SWFs is contingent on building trust, establishing a reputable brand, inhabiting a start-up mindset, and subjective decision-making.

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TURKISH POLICY QUARTERLY

Summer 2017

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The entrepreneurial ecosystem with a multitude of shifts is introducing many profound transformations to the global economy. First, with proliferated connectivity and now with diminishing copying cost, our society is going forward with exploding computer power.[1] The change occurring in our economy now is more substantial and severe compared to the change mainframe computers of 1960s and personal computers & Internet of 1990s introduced. Rapid progress in areas such as artificial intelligence, big data, the mobile industry, the Cloud, Internet of Things, 3D printing, and robotics are swiftly coalescing to disrupt traditional business models and pervade the markets faster than before. Technology is not only changing the goods and services sector, but also the "location," "method," and "speed" of production, as well as the job market with automation. All together, they are "flattening the world" – i.e. a situation where the competitive playing field between industrial and emerging market countries is leveling – with financial and technological boom and bust cycles, hereby transforming our lives in many ways.[2] These will eventually introduce major leaps forward for society, as well as a constant disruption of the status quo, hence, forming a new order.

The genesis of this new order requires all sovereigns to take action in order to join the newly forming affluent elite. In other words, to stay the course, states need to empower their people to be competitively innovative, and to introduce few monopole powers that own selected markets in which they can set their own prices.[3] To create (and maintain) lasting value in a flat and connected world, this is becoming irreversible.

Today, technology pioneers are investing in connecting the next billion. The world is reaching a population of seven billion people, but only one billion has access to broadband connection; four billion do not even have connection to the Internet; and two billion do not have phones.[4] They are connected to the world, but not to the digital one (i.e. the Digital Divide).[5] Hence, the inclusivity of the "unconnected" to the digital world will have disruptive and upending financial and political outputs, as it did before during distinct stages of economical evolution.

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[1] "Technology: Reshaping the global economy," *Standard Chartered*, 19 January 2015, https://www.sc.com/en/news-and-media/news/global/2015-01-19-technology-reshaping-the-global-economy.html

[2] Thomas L. Friedman, *The World Is Flat 3.0: A Brief History of the Twenty-first Century,* (New York: Picador 2007).

[3] Peter Thiel, "Competition is for Losers," *The Wall Street Journal,* 12 September 2014, https://www.wsj.com/articles/peter-thiel-competition-is-for-losers-1410535536

[4] Mustafa Ergen, "Dilemma of digital divide," *Daily Sabah*, 29 February 2016, https://www.dailysabah.com/op-ed/2016/03/01/dilemma-of-digital-divide

[5] "The Digital Divide, or the digital split, is a social issue referring to the differing amount of information between those who have access to the Internet (specially broadband access) and those who do not have access." "The Digital Divide," *Internet World Stats*, http://www.internetworldstats.com/links10.htm

Promoting entrepreneurship is one of the most effective ways to increase inclusivity. Targeting a bottom-up process of specialization and differentiation would give rise to the formation of a new culture of entrepreneurial clusters. However, the remaining question is how to ignite this.

In developing countries, undeniably, the state can play a key role. To accelerate economic catch-up, a top-down approach can be put into action.[6] With its comparative advantage, the state can trigger institutional innovation and indigenous culture for a new startup economy that has technology adoption, venturous economy, entrepreneurial spirit, and innovation clusters as its foundation. Additionally, to ensure faster growth rates, entrepreneurship requires higher and subjective investment backing. This is due to the entwined nature of entrepreneurship and investment backing, and the fact that the state is in a better position to plan public and private contributions as well as regulations.

"The world is reaching a population of seven billion people, but only one billion has access to broadband connection."

Sovereign Wealth Funds

In this context, sovereign wealth funds (SWF), government-run investment vehicles that manage state-owned assets, are becoming pacesetters for entrepreneurship. So far, SWFs have not only been effective in asset management, but also in playing a shock-absorbing role (i.e dampening short-term market volatility) in both developed and emerging economies.

Although the formation of SWFs is not necessarily novel, two thirds of wealth funds were established in the last decade alone.[7] Today, there are 82 SWFs in 40 different countries with a total value combined of more than 7.5 trillion dollars, which is projected to double by 2020.[8] SWFs can be either commodity based or non-commodity based (43 percent of total 7.5 trillion dollars).[9] The former is financed by exporting commodities and the latter by excess of foreign currency reserves from current account surpluses.[10]

[6] The "catch up effect" is a theory speculating that since poorer economies tend to grow more rapidly than wealthier economies, all economies in time will converge in terms of per capital income.

[7] "Sovereign Wealth Funds: Their Role and Significance – A Speech By John Lipsky, First Deputy Managing Director, International Monetary Fund," *International Monetary Fund*, 3 September 2008, http://www.imf.org/en/News/Articles/2015/09/28/04/53/sp090308

[8] "Turkey's Sovereign Wealth Fund Promises Better Governance, More Synergies to Bolster Returns," *Bonds and Loans,* 8 May 2017, http://www.bondsloans.com/news/article/1398/turkeys-sovereign-wealth-fund-promises-better

[9] "Fund Rankings," *SWFI Institute*, http://www.swfinstitute.org/fund-rankings/

[10] Richard Wilson, "An Introduction to Sovereign Wealth Funds," *Investopedia*, http://www.investopedia.com/articles/economics/08/sovereign-wealth-fund.asp

Upon founding, each SWF typically has a number of tailored objectives. Firstly, if a state is exporting nonrenewable resources or accumulating foreign exchange reserves, it may seek a stable income against volatile commodity prices and finite supplies to avoid cycle inducing fluctuations, as well as to spread the wealth amongst generations.[11] Newly-forming funds also aim to nurture a diverse economy for a post-commodity era, or a pension plan for the state's aging population. Most SWFs invest in foreign assets and tend to be traditionally passive investors, primarily making long-term investments in government bonds and equities.[12]

Nowadays, SWFs are increasingly investing in private equity firms and hedge funds. This is due to poor returns in public markets and the reluctance of technology firms to be listed on the stock exchange.[13] Hence, there is a desire for better risk management and diversification. This makes SWFs an indispensable instrument for new venturous economies. Not only do these economies have a higher appetite for risk but they also have the granted state exemptions to leverage on behalf of their investments. Therefore, a shift in the organization of SWFs has been taking place; away from traditional asset management and towards an entrepreneurial economy with a more pervasive and encompassing approach to foster a dynamic culture. SWFs are sought after to promote entrepreneurship and innovation, as well as to increase investor confidence while attracting increasing public interest.

The first SWF, Kuwait Investment Authority, was established in 1953 and invests in excess oil revenues. At the moment, the largest Fund is Norway Government Pension Fund with 922 billion dollars assets under management (AUM). SWFs are primarily located in Asia (41 percent) and the Middle East (40 percent). The 10 largest SWFs in size (50 percent commodity) have 5.5 trillion dollars AUM, corresponding to 75 percent of the total value of all SWFs. Three major funds in particular can be considered headliners: Abu Dhabi's Investment Authority (1976), Singapore's Government Investment Corporation (1981), and Norway's Government Pension Fund (1990).

There are governments that have already orchestrated their SWFs as an entrepreneurial investment vehicle. For example, the governments of Singapore, South Korea, and Taiwan have achieved substantial results and their achievements are considered

[11] "Sovereign Wealth Funds: Their Role and Significance -- A Speech By John Lipsky, First Deputy Managing Director, International Monetary Fund," *International Monetary Fund*, 3 September 2008, http://www.imf.org/en/News/Articles/2015/09/28/04/53/sp090308

[12] This group includes the Abu Dhabi Investment Authority (ADIA), the Norway Government Pension Fund - Global, the Government of Singapore Investment Corporation (GIC), the Kuwait Investment Authority (KIA), the Saudi Arabian Monetary Authority (SAMA), China Investment Corporation (CIC), the Stabilization Fund of the Russian Federation, Temasek Holdings (Singapore), the Reserve Fund of Libya, the Revenue Regulation Fund of Algeria, the Qatar Investment Authority (QIA), Canada's Alberta Heritage Savings Trust Fund and USA Alaska Permanent Fund.

[13] Jerome Engel et al., "Pursuing Innovation: Sovereign Wealth Funds and Technology Investment," *SSRN*, 3 November 2016, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2864853

as economic catch-up in literature.[14] Recently in 2017, Softbank created the 97 billion dollar Vision Technology Fund with backing from the UAE's Mubadala, Saudi Arabia's Public Investment Fund (PIF), Apple, and Foxconn. Most of them have a physical presence in the Silicon Valley. In April 2016, China Investment Corporation, Temasek, and Singapore's Government Investment Corporation participated with 4.5 billion dollars in the Series B round of Alibaba Group, which is the largest equity deal for a technology company.[15] In June 2016, PIF directly invested around 3.5 billion dollars into Uber and also participated in one billion dollar funding round to the e-commerce company Noon. France's BPI (27 billion dollars as of 2017) has been the world's most active funds investing in private technology companies.[16] Abu Dabi Investment Council invested in WhatsApp in 2013, received an impressive return when Facebook acquired the company in 2014.

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These are merely the tip of the iceberg according to the Sovereign Wealth Center. From 2015 to 2016 alone, 47 deals were made in the technology, media, and telecommunications sectors, compared to only 93 for the past decade (2003-2014).[17]

Sovereign Wealth Funds and Entrepreneurship

SWFs aiming to ignite entrepreneurship should enforce three pillars: entrepreneurial human capital, venture capital, and capital in kind. A Fund can orchestrate this with a private sector mindset and government power. SWFs should create a venture capital ecosystem as well as organize the capital in kind contribution of the state as an investment. This could be procurement or marketing power or something else that can give advantage to the company to be invested. When considered with regulations, cashless power is also substantial if harmonized accordingly.

[14] Jong-Wha Lee, "The Republic of Korea's Economic Growth and Catch-Up: Implications for the People's Republic of China," *Asian Development Bank Institute*, April 2016, https://www.adb.org/sites/default/files/publication/183353/adbi-wp571.pdf

[15] "Co-investments are rare; Temasek Holdings and GIC backed the iTutorGroup, Xiaomi, and Alibaba's Cainiao. Also, QIA is a co-backer of Uber alongside the PIF at 45 billion dollars valuation, and QIA backed Flipkart along with GIC twice at valuations of 7 and 11 billion dollars in 2014 and 2016. KIA and BPIFrance each invested in the company BedyCasa, while Temasek and China Investment Corporation have each participated in funding to Didi Chuxing," *CB Insights*, https://www.cbinsights.com/

[16] "The government of Singapore owns the world's second (Temasek – $194B) and third most active funds (GIC - $350B). Malaysia's Khazanah Nasional Berhad (KNB - $35B) is in fourth and France's Caisse des Dépôts et Consignations (CDC - $165B) is at fifth." "Where The World's Ten Most Active Sovereign Wealth Funds Invest In Tech," *CBInsights Research Brief*, 17 January 2017, https://www.cbinsights.com/research/sovereign-wealth-tech-startup-investors/

[17] Note that there are views to be aware of overpricing to avoid a similar 2000 dotcom bubble. Jerome Engel et al., "Pursuing Innovation: Sovereign Wealth Funds and Technology Investment," *SSRN*, 3 November 2016, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2864853

In orchestration, SWFs need to collaborate with the central bank in order to align with the home country's economic policies, and to introduce an efficient resource management to "smoothen government expenditures." To sustain continuous support, independent investment decision-making processes and accountability procedures are key common governance structures. Additionally, in an investee country, there is a tendency to monitor and regulate foreign SWFs. Therefore, transparency is key.[18]

Tips for a Successful Sovereign Wealth Fund

SWFs operate most efficiently with public support, which contributes positively to its brand value. Also, if executed like a startup the Fund becomes more agile. Additionally, should subjective decision-making be present, high-risk but disruptive deals that displace market establishments can be successfully executed.

- **Building trust.** This starts with open information and dissemination to ensure that the mission and vision of the SWF is understood and supported thoroughly. Trust in economic transactions and venture investment is also key, as it would eventually enable the Fund to opt for bigger and high impact projects.[19] It would also help social capital to be kept in sync with business, technology, and innovation, as well as financially integrated.
- **Branding matters**. SWFs have to create a successful deal flow.[20] The brand has to accurately represent what the SWF is and what it aims to be. When considering closing a business deal, the participants take into consideration the key attributes and behaviors of the wealth fund and its team. A Fund's image goes beyond self-perception – it encompasses the way clients perceive it and its home country.
- **A start-up mindset helps**. A SWF can operate as the sole fund or, additionally, can inherit a wealth development function, which requires the fund to operate with a "hands-on" approach. Hence, the Fund has to be instrumental in engineering, finance, large corporation execution, and public policy to fulfill the range of deals from seed stage to very late stage. This blend and execution synergy is the recipe for success.
- **Subjective decision-making is important**. This skill may develop over time. Today, investment opportunities are vast. A Fund's ability to act and decide

[18] "Sovereign Wealth Funds: Their Role and Significance -- A Speech By John Lipsky, First Deputy Managing Director, International Monetary Fund," *International Monetary Fund*, 3 September 2008, http://www.imf.org/en/News/Articles/2015/09/28/04/53/sp090308

[19] Laura Bottazzi et al., "The Importance of Trust for Investment: Evidence from Venture Capital," *The Review of Financial Studies*, Vol. 29, No. 9 (September 2016), https://academic.oup.com/rfs/article/29/9/2283/2583666/The-Importance-of-Trust-for-Investment-Evidence

[20] "Branding and Venture Capital: Key Findings from BIG:VC," *DeSantis Breindel*, 19 August 2013, https://www.slideshare.net/desantisbreindel/branding-and-venture-capital-key-findings-from-bigvc/13-Page_131Brand_Impacts_Deal_Flow1

efficiently is crucial. SWFs should also be able to perform harmoniously for the sake of the long-term vision of the fund, as well as the state.

The Turkish Wealth Fund

Overall, SWFs are becoming strong players in the new era and they are growing in size and number to shape the global economy. The Turkish Wealth Fund (TWF), with its indigenous and novel vision plus sizable AUM was established in 20 August 2016 in tandem with the abovementioned global benchmark in mind. The TWF seeks to move Turkey up the value chain in critical technologies and sectors, and is based upon four pillars:

"A Fund's image goes beyond self-perception – it encompasses the way clients perceive it and its home country."

- Contributing to the efficient execution of state-owned corporations and resource synergy among them to sustain competitiveness, as well as improve their global footprint.
- Directing cash or capital in kind investment in start-ups and SMEs or private equity to empower the local entrepreneurial economy.
- Investing in national and international venture and private equity funds in order to be part of scalable value-driven economy.
- Improving engagement with the academic environment to establish mutual benefits and empower the human capital.

By law, the fund is being managed by a corporation, TWF Joint Stock Company, which is incorporated under the Turkish Commercial Code and reports to the Prime Minister. The TWF – as an institutional identity subjected to independent auditing – can establish other companies and sub-funds according to its framework set by the government and its strategic plan approved by the Cabinet. Furthermore, the TWF's Board approves decisions regarding investments, and divestments. The TWF, along with its project, investment and risk management committees, follows key guiding principles:

1. Globally accepted management practices;
2. Transparent governance and reporting;
3. Risk-return focus in operations;
4. Long-term performance focus;
5. Compliance to relevant legislation and regulation.

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The TWF aims to be the investment gate of Turkey. It has a strong and diverse portfolio that includes Turkey's largest bank, airline, and telecom operator. The TWF adopts the Santiago Principles of the International Forum of Sovereign Wealth Funds[21] and inherits state incentives to attract investors.[22] It will invest in technological prowess and entrepreneurial capital in order to contribute to the economic catch-up aligning Turkey's ambitious 2023, 2053, and 2071 plans. The TWF can be considered as another major move of Turkey to introduce openness to the implementation of commercial ideas coming from entrepreneurs with pluralistic ethoses.

In sum, SWFs are becoming key initiatives for a very long-term entrepreneurial strategy in the fast-paced digital economy. In general, technology investments bring challenges with high failure rates, scarce later stage financing, and a not-ready ecosystem. Hence, long-term patience is needed for a learning curve to train the right indigenous culture. In this regard, the TWF aims to be instrumental in developing local competencies for a fast paced entrepreneurial ecosystem and encouraging existing firms for global scaling.

[21] "The Santiago Principles consists of 24 generally accepted principles and practices voluntarily endorsed by *International Forum of SWF (IFSWF)* members." *International Forum of Sovereign Wealth Funds.* The Santiago Principles promote transparency, good governance, accountability and prudent investment practices whilst encouraging a more open dialogue and deeper understanding of SWF activities," http://www.ifswf.org/

[22] Erişah Arıcan, "What's Turkey's New Wealth Fund?" *The New Turkey,* 24 February 2017, http://thenewturkey.org/whats-turkeys-new-wealth-fund/