THE CUBAN ENTERPRISE FUND

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In 1989, following the fall of the Berlin wall, the United States Congress authorized and funded the creation of Enterprise Funds aimed at supporting private sector development in two formerly communist nations of Eastern Europe. The Enterprise Funds were organized as private, not-for-profit corporations run by independent non-governmental boards of businessmen and women who managed and invested the grants received from the United States Agency for International Development (USAID). The Enterprise Funds' mandates were to invest in small and medium sized corporations in Hungary and Poland which did not have access to capital. Following the fall of the Soviet Union in 1991, several other funds were established for Russia, Albania, the Baltics, Bulgaria, Central Asia, the Czech-Slovak Republics, Romania, and the Western newly independent states, with grants ranging from $30 million to $340 million. In all, the United States Congress appropriated over $1.3 billion in grants to 10 Enterprise Funds between 1989 and 1995.

The Enterprise Funds were first authorized through the Support for Eastern European Democracy (SEED) Act, approved unanimously by the United States Congress and signed into law by President George Bush on November 28, 1989. The bill, which was championed by Republican Senator Richard Lugar and Democratic Representative Lee Hamilton, both of Indiana, outlined a number of ways in which the United States could "support East European democracy by providing assistance to Eastern European countries which have taken substantive steps toward institutionalizing political democracy and economic pluralism," including:

- Encouraging international financial institutions to provide resources to these governments;
- Supporting the government's efforts to combat hyperinflation;
- Urging creditor governments to adopt generous and early debt rescheduling programs;
- Providing agricultural support;
- Creating the Polish and Hungarian Enterprise Funds to promote private sector development;
- Providing funding for Peace Corps missions and technical assistance in labor market reform and for the development of credit unions;
- Requiring the Overseas Private Investment Corporation (OPIC) to support projects to enhance the non-governmental sector and reduce state involvement in the economy;
- Authorizing the President to provide guarantees to the Export-Import Bank for liabilities incurred in connection with guarantees or insurance for financing exports of goods and services;
- Urging the President to seek bilateral investment treaties and establish a more stable legal framework for U.S. investment; and
- Expanding cultural, educational, and scientific exchanges through the establishment of Fulbright commissions, reciprocal cultural centers, scholarship programs, and other activities.

Members of the National Security Council staff, at that time, were also instrumental in the passing of the SEED Act, including now Secretary of State Condoleezza Rice and now Assistant Secretary of State for European Affairs Dan Fried.

STRUCTURE OF THE ENTERPRISE FUNDS

Following the authorization of the Enterprise Funds in 1989, the U.S. Government selected individuals with business and government experience from both the United States and the respective host country to serve on the board of each Enterprise Fund. Individuals with proven success in banking and venture capital investment were recruited from the highest levels of the business community to serve on the boards.

A *Foreign Affairs* article authored by John Birkelund, the Chairman of the Polish American Enterprise Fund, highlights the importance of an experienced and professional board in the success of the individual fund's performance: "Nothing can compensate …for deficiencies in the quality of fund management; boards must exercise vigilant oversight and correct problems promptly, just as they would in the private sector. Despite its virtues, the Enterprise Fund concept is successful only when care is taken in selecting both board members and management."[1]

According to a 1999 Government Accountability Office (GAO) Report: "[t]he Fund boards are responsible for establishing their own operating and investment policies and directing their corporate affairs in accordance with U.S. legislation and grant agreements. The Fund's senior management is generally American. The Fund's investment staffs, including senior investment officers and other investment professionals, are comprised of Americans, host-country, and third-country national employees."[2] This structure allowed oversight and decision-making to remain in the control of American board members while benefiting from on-the-ground knowledge and cultural understanding of in-country board members and staff.

Each Enterprise Fund was registered as a private, not-for-profit (501(c)(3)), non-stock corporation in the United States (mainly Delaware). The members of the Corporation (the U.S. Directors) stand in place of the shareholders and the members elect the Directors every three years. An operating agreement was signed with the USAID that required the Enterprise Funds to undergo routine audits but which allowed the Enterprise Funds to operate independent from government control or influence.

A PROVEN TRACK RECORD OF SUCCESS

Since Congress authorized the Enterprise Funds, the latter have been successful in promoting private sector development. Two GAO reports (1999, 2000) highlight the successes the Enterprise Funds have had in a number of areas, including building financial institutions, encouraging private sector development, training in-country entrepreneurs, creating jobs, attracting other private investment, etc. While the levels and timing of those successes have varied from fund to fund, positive reviews by United States government investigators and the interest of private investors serve as resounding endorsements of the Enterprise Funds' overall success. John Birkelund, Chairman of the Polish Enterprise Fund, describes this success: "[the enterprise fund model] has proven itself a unique and promising way to develop indigenous private-sector growth, and its efficient and flexible business-to-business approach should be expanded and emulated elsewhere in the developing world."[3] Similarly, a 1999 GAO report concludes that: "The enterprise funds in Central Europe and the former Soviet Union have supported private sector development in their host countries. Most have also helped strengthen financial institutions and encourage economic reforms."[4]

In fact, the Enterprise Funds have been so successful that in the particular case of the Polish-American Enterprise Fund, an initial USAID grant of $240 million in 1990 reached a total value of $360 million by 1999. The Polish Fund had invested in several dozen enterprises, a bank, a mortgage company, and a mi-

1. Birkelund, John P. "Doing Good While Doing Well." *Foreign Affairs* 80.5 (2001): 14–20.
2. U.S. General Accountability Office. *Enterprise Fund's Contributions to Private Sector Development Vary*. Washington: GAO, 1999, p. 4.
3. Birkelund, p. 20.
4. U.S. General Accountability Office, p. 21.

cro loan fund and had created a private management company to invest its funds. In the late 1990s, the Board decided to liquidate the Polish Fund. One half of its original investment, $120 million, was returned to the United States Treasury, a first for a United States foreign assistance program, and the rest was used to endow the Polish American Freedom Foundation, an initiative to provide grants for civil society building in Poland and surrounding countries. One of the Foundation's best investments was Fundusz Mikro, a micro loan initiative that has distributed 93,000 micro loans to 43,000 clients totaling $250 million over 12 years.

In addition to this success, the Enterprise Funds have been able to attract more than $744 million dollars through private investments and other sources. In the case of the Polish American Enterprise Fund, $328 million in private capital was raised "through a combination of outside investment partners for individual deals and helping establish separate private equity funds that attracted outside investors."[5]

While the Enterprise Funds have been successful in both encouraging private enterprise and attracting private investment, they have also helped strengthen financial institutions, encouraged economic reforms, and provided technical assistance. "Most funds have . . . used funding to provide technical assistance to businesses in which they invest," and have "taken measures to help strengthen financial institutions and provide 'demonstrable effect' that encourages economic reforms"[6] Over $70 million of technical assistance has been funded by Enterprise Funds to strengthen the private sector. Enterprise Funds have provided employee training, upgraded management information and financial reporting systems, and provided advice and technical support in a variety of other areas to such firms. Examples of some additional benefits of the Enterprise Funds include:

- Establishment of banks;
- Creation of residential and home mortgage lending programs;
- Creation of micro loan funds;
- Establishment of innovative technological funds;
- Provision of capital for housing developers;
- Training for bankers in the loan application development process;
- Training employees and managers;
- Updated financial reporting systems; and
- Training bank personnel in credit risk evaluation.

In addition, Enterprise Funds have invested or reinvested in over 500 small and medium sized enterprises in host countries. Every dollar invested in these businesses has helped attract an additional two dollars from local and foreign investors for new technologies and development capital and has created employment opportunities for approximately 250,000 people.

THE CUBAN ENTERPRISE FUND

Building on the success of the Enterprise Funds and the precedent of public funding for such initiatives, the Cuba Study Group proposes the creation of the Cuban Enterprise Fund (the "Fund") to assist in the creation of private enterprise in Cuba as soon as law permits. The Fund would follow a similar institutional structure as previous Enterprise Funds while drawing on additional sources of capital funding.

The Fund would be incorporated as a not-for-profit corporation with no shareholders. A Board of Directors would be appointed by the donor institutions and in accordance with their contributions to the Fund. Directors would be selected for their knowledge and experience in venture capital investment and not for political considerations. The Board would consist of five members from donor nations (or regions) as well as four members from within Cuba.

The Cuba Study Group recognizes the obstacles in both United States and Cuban legislation that would make the implementation of the Fund impossible at this time. However, recognizing that the transfer of

5. Ibid, p. 7.
6. Ibid, pp 5–6.

power in Cuba represents a genuine window of opportunity and, given the Cuba Study Group's belief in the importance of laying options on the table for the consideration of possible reformers within the government, we propose that the groundwork be laid in anticipation of the inevitable change that will occur in Cuba. By preparing this important initiative in anticipation of change, we better serve the Cuban people and their chances of success and prosperity following a transition.

A Cuba in transition will face a number of challenges, including obstacles in the development of a vibrant private sector. The lack of a civil society, the need for government deregulation, poor infrastructure, and issues regarding property rights will be some of the obstacles that Cuban entrepreneurs will face as they attempt to start or expand their own businesses. An important obstacle, however, will be the availability of capital, a problem that will not be remedied only by the large amount of foreign investment expected into the island. Just as was the case in the former communist nations of Eastern Europe as well: "Despite private and international donor investments in these countries, the overall need for foreign investment capital and western business expertise…continues unabated."[7]

The most dynamic sector in the former communist nations of Europe, the former Soviet Union, Vietnam, and China have been small and medium sized businesses which have been responsible for generating approximately 60% of their gross domestic product. It is generally the case in nations in transition that neither the former banking system, which had primarily served large corporations, nor the new private domestic and foreign banks, serve the small enterprise market. This is due in great part to the fact that these new, domestic small and medium sized businesses present a greater perceived risk and higher transactional costs due to the small size of their loans and lack of collateral. Inevitably, this will be the case in Cuba as well. The Cuban Enterprise Fund would service this segment of the Cuban economy that ultimately will be underserved, yet is so important for the economic success of Cuba.

The Role of the United States Government

In addition to the United States Government's initiative in financing the Enterprise Funds of Europe and Asia, it has specifically recognized the importance of assisting in the development of private enterprise in Cuba. Chapter IV of the Second Report of the Commission for Assistance to a Free Cuba presented to the President in July 2006[8] clearly states the important role the United States, the international community, and Cubans abroad can play in assisting in the economic development of Cuba. More specifically, the section titled "Encourage Small Business Development" sets out specific ways in which the United States could assist in encouraging private enterprise in Cuba. Furthermore, the report highlights the importance of preparing "well in advance" to assist the Cuban Transitional Government so as to be in a position "to offer assistance immediately."[9] Finally, the report highlights the importance of building "a broader international effort starting now, in the planning phase."[10] The Cuba Study Group believes that this proposal builds on this commitment by the United States government through the implementation of foreign assistance programs with a proven track record within the United States government, principally the Enterprise Fund model.

The Role of the International Community

Just as the various Enterprise Funds have had to adapt their methods and strategies to the realities inside those countries, Cuba presents some unique conditions that will require careful considerations when designing the Cuban Enterprise Fund. Mainly, important historical and political considerations must be taken into account so as to address the inevitable

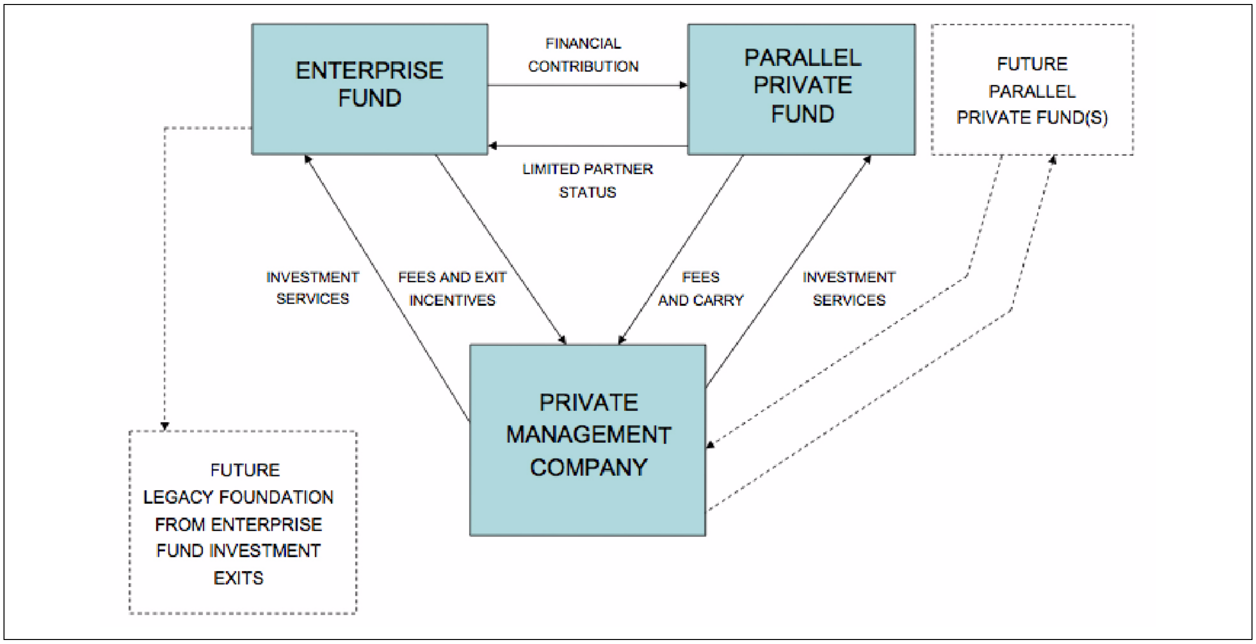
7. Ibid, p. 3.

8. Commission for Assistance to a Free Cuba, *Report to the President*, July 2006.

9. Ibid, p. 87.

10. Ibid, pp. 80–81, 87.

Figure 1. Model for Management of Private Investment Funds



skepticism surrounding efforts by the United States, or its citizens, to invest in Cuba. Therefore, careful thought must be given to the selection of board members and donors to ensure the greatest possible participation by foreign entities and international financial institutions. The following institutions would be ideal donors to the Fund:

- Inter-American Development Bank, IDB;
- International Finance Corporation, World Bank;
- Hungary, Poland, the Czech Republic and other European nations.

Cuba has a very small private sector and a very primitive financial sector with a total lack of financing for small and medium sized enterprises; however, there are plenty of investment opportunities, especially in the service sector (retail trade, services to tourism, personal and commercial services, etc.). This is in contrast to some Eastern European nations where there was a small, yet significant, private sector accounting for approximately 10% of the economy in some instances. This fact highlights the challenges Cuba will face and the importance of making training, technical assistance, and mentorship available to Cuban entrepreneurs, in addition to making capital available to start or expand small and medium sized businesses.

Eastern European nations such as Poland, Hungary, and the Czech Republic that saw the benefits of the United States Enterprise Funds, and that continue to do so today, are in a unique position to understand the important role that the Cuban Enterprise Fund could play during Cuba's transition. The Fund represents a unique opportunity for these nations to now take on a leadership role and assist a country that will face many of the same challenges they once did.

The Role of Private Investments

While this proposal relies mainly on the support and financing of governments and international financial institutions, it recognizes the important role of private investments. The Cuban Enterprise Fund will be called upon to leverage itself with parallel private investments. The Polish-American Enterprise Fund provides a highly successful model for managing and attracting private investments. It established an investment management company which attracted private institutional money to invest alongside the Polish Enterprise Fund (See Figure 1). Over time, the Polish Fund was re-paid and the investment company continues to invest funds from private sources. The Cuban-American community is a natural source of private investment in this case. In addition, Cuban-American investment would send an important message to Cubans on the island, that the exile community is interested in being a transitional asset, not a transitional obstacle.

OUR PROPOSAL

The Cuba Study Group proposes the creation of the Cuban Enterprise Fund in the amount of $300 million to assist in the development of small and medium sized businesses in Cuba and provide Cuban entrepreneurs and financial institutions with training, technical assistance, and mentorship assistance during a process of transition. The Fund would draw from contributions from the United States Government, International Financial Institutions, and European nations, with a lesser percentage coming from private funds. Below is an outline of our proposed funding:

U.S. Government Funds	$100 million
International Financial Institutions	$100 million
European Nations	$100 million
Total	$300 million[a]

a. The Polish and Hungarian Funds were $300M in 1990

The Board of the Fund would have complete autonomy to decide where and when to make investments, separate from political considerations or pressures from the Cuba Study Group, governments, or donor institutions. The Board would approve investments in private enterprises in Cuba and direct the profit of such activities back into the Fund for further investment; no dividends will be paid out. This will ensure that the operation is truly not-for-profit and that any profits will be used to further the mission of the Fund.

Upon the liquidation of the Fund, all monies should be directed toward the creation of an endowment to continue to assist the Cuban people in a manner directed by the Board of the Fund. The creation of the Polish-American Freedom Foundation out of the liquidation of the Polish American Enterprise Fund can serve as a good example of the way in which this can be managed.

Technical Assistance

The Cuban Enterprise Fund would also provide technical assistance to directly support Fund investments. This technical assistance would focus on training and educating management and employees of invested companies to provide them with the skills necessary to ensure the success of their businesses. Technical assistance costs would be managed from a separate account other than the Fund's investment capital.

The Cuba Study Group recommends that funding institutions allocate an additional $15–$20 million, separate from the Fund's investment capital to fund technical assistance programs.

Role of the Cuba Study Group

The role of the Cuba Study Group would be to prepare the proposal and seek the cooperation and commitment of the prospective donors, as well as lend the experience and expertise of the Cuba Executive Corps (the mentorship initiative created for the Cuba Study Group Micro-loan initiative) for future training and mentoring of Cuban entrepreneurs. The Cuba Study Group would not be responsible for funding, managing, or staffing the Cuban Enterprise Fund or directing the type of investments the Fund directors make, nor will any of the Cuba Study Group's members or staff profit in any way from the Fund.