



Sovereign Wealth Management

- Moderators: **Rawi E. Abdelal**, *Professor of Business Administration*
Richard H.K. Vietor, *Senator John Heinz Professor of Environmental Management*
- Panelists: **Manish Kejriwal**, *Senior Managing Director, Temasek Holdings Advisors India Pvt. Ltd.*
Knut N. Kjaer, *Former CEO, Norges Bank Investment Management*
William Miracky, *Senior Partner, Monitor Group*

Overview

Significant recent investments by sovereign wealth funds in troubled U.S. financial services firms have put sovereign wealth funds under the spotlight. Because these funds often lack transparency, many observers have wondered about the practices and intentions of these funds, expressing concern that sovereign wealth funds are using their investments for political purposes.

The consensus of this panel, supported by a detailed analysis of the investments made by sovereign wealth funds, is that sovereign wealth funds are run by professional investors. They don't have a political motivation; their interest is in maximizing their fund's long-term risk-adjusted returns.

Context

Professor Vietor provided a short history of sovereign wealth funds and Mr. Miracky shared data from research on them. The other two panelists, both of whom are involved in managing major sovereign wealth funds, offered their thoughts on the motivations and practices of these funds.

Key Takeaways

- **Sovereign wealth funds are not new in concept but are increasing in significance and number.**

Mr. Miracky offered the following definition of sovereign wealth funds, suggesting that they must:

- Be owned by a sovereign government.
- Be managed separately from the official reserves of the central bank or monetary authority.
- Invest in a range of asset classes, particularly foreign assets.

Mr. Miracky found 36 funds that met this definition. After assembling all publicly available information on these funds, his research concentrated on 17 of them.

Sovereign wealth funds feel like a recent concept because of how much they have been in the news in recent months related to investing more than \$50 billion in U.S. and Swiss banks.

But sovereign wealth funds aren't new. Professor Vietor explained that the first fund was the Kuwait Investment Authority, established in 1953. Other major funds and their year of inception include: Singapore's Temasek fund (1974); the sovereign wealth fund of Abu Dhabi (1975); and the Government Pension Fund of Norway (1993).

However, while not new, the number of sovereign wealth funds has increased significantly in recent years. Mr. Kejriwal said that since 2000, ten new funds have been founded, from countries like China and Russia. And Mr. Miracky said that half of the funds in existence today have been established since 2005.

Collectively, sovereign wealth funds manage about \$2.5 trillion dollars, with about 70% of the capital in sovereign wealth funds coming from oil and other natural resources. This \$2.5 trillion is a great deal of money, but it only represents about 2% of all the global equities and 5% of the total assets managed by the private sector.

- **The developed world worries about the motives of emerging market sovereign wealth funds.**

Mr. Kejriwal explained that concerns from the developed world about the sovereign wealth funds of developing countries typically center around:

- *Lack of transparency.* These funds are not required to disclose the quantity of their assets, their investments, or their results. While some funds choose to disclose this information, others do not, leading to a perception of secrecy.
- *The reversal of privatization.* Having huge amounts of assets managed by people who are working for the government is concerning to many.
- *Wealth transfer.* The developed world is concerned that through the assets sovereign wealth funds purchase from developing countries, wealth is being transferred.
- *Use of funds for political objectives.* The lack of transparency and perceptions of secrecy make some wonder whether these funds have been created to achieve political objectives rather than optimize returns. This concern is heightened by the fact that the new funds created in recent years are from countries like China and Russia where there have been geopolitical tensions with the West.

"Many people naturally assume that the intentions of these funds are to advance political objectives."

— Manish Kejriwal

- **Concern about the impact of sovereign wealth funds is overblown.**

Mr. Miracky's data show that fears about the political motives of sovereign wealth funds from developing markets are more hype than substance.

- *The investments are balanced.* Press coverage suggests that sovereign wealth funds are buying up assets in the developed world. The data disprove this.



Based on the number of transactions, two-thirds of the deals are in emerging markets. Based on the amount of dollars invested, 60% of the dollar value is in deals in the developed world, but 40% is in the sovereign wealth fund's region and 20% is actually in the home market.

After the investments in the financial sector, over the past six months there have been almost no investments by sovereign wealth funds in North America. (In the first quarter of 2008, sovereign wealth funds invested \$23 billion in North America; in the second quarter, it was down to \$1 billion.)

- *Control is not the primary goal.* While sovereign wealth funds take controlling stakes in about half of the deals that they do, most of the deals where a controlling stake occurs are smaller investments in developing markets. Few of the deals in developing markets have yielded a controlling interest. And, only 3% of the investments by sovereign wealth funds have resulted in a controlling stake of a company in the developed world in a politically sensitive industry such as telecom, utilities, aerospace, or defense.

"The concern over these funds was very overblown given what you see in actual deal activity."

— William Miracky

- *Responsible behavior is likely.* As these funds become more involved with the global economy, they have an increasing incentive to behave in a way that does not destabilize the global financial system.

Both Mr. Kjaer and Mr. Kejriwal were clear that the sole objective of their funds is to maximize the risk-adjusted returns. Their governments don't have political objectives related to their funds, just investment objectives.

"Sometimes we feel a bit misunderstood . . . but we've been doing this with one purpose in mind: Just to maximize returns."

— Manish Kejriwal

- **The governance and organizational structure of a sovereign wealth fund is critical to how it operates and the results it produces.**

In Norway, pension expenses for retirees are expected to double as a percentage of Norway's GDP as oil revenues decrease. Thus, the rationale for having a sovereign wealth fund is to mitigate the risks related to the country's oil revenues and to produce higher returns than are provided by oil. (\$1 invested in oil one hundred years ago would have returned \$2 over that time; \$1 invested in equities would have returned \$434.) So, taking revenues generated by oil and investing those actually lowers the country's risk and increases the returns. Key aspects of how Norway's sovereign wealth fund is managed include:

- *Clear governance.* The Minister of Finance and the Parliament set investment guidelines regarding the level of risk they are willing to take and establish benchmarks for performance.

- *Creation of a professional investment-management organization.* After the government officials set the guidelines, Norway's professional investment-management organization is given the autonomy to make day-to-day investment decisions without government interference. This organization, established from scratch by Mr. Kjaer in 1997, is a part of Norway's government, but it isn't a typical government entity. The autonomy, the culture of the organization, and a compensation structure based on performance help attract a highly professional team, which now manages 158 portfolios.

"You don't get professionals to join your organization when somebody else from outside is calling in and interfering in your investments."

— Knut N. Kjaer

- *Transparency.* Mr. Kjaer believes that sovereign wealth funds that provide transparency are rewarded with trust from both their government and citizens. In addition, transparency can mean that governments, rather than the funds themselves, can decide upon general diversification policy guidelines.

Singapore's Temasek fund has many similarities:

- *Separation of power.* The government of Singapore, which owns 100% of Temasek, wanted to separate the fund's role as wealth creator from the government's regulatory role. It did this by creating a completely separate entity.
- *Not technically a fund.* Officially, Temasek is a company, not a fund. At Temasek's formation, the equity of several different government-owned companies was put into Temasek based on the government's belief that this was the best way to maximize the value of these companies. Temasek's philosophy is that of any other company: to maximize profits and returns.
- *Independent board structure.* The board members of Temasek are independent from the government and are from all over the world. No one from the government is involved in or influences the investment decisions.
- *S&P and Moody's rated AAA.* Four years ago Temasek chose to open its books to get rated. As one of only about 12 corporations in Asia with an AAA rating, this showcased the company's transparency and accountability to bondholders; created a built-in market feedback mechanism; and gave Temasek an alternate way to raise investment money as a source of cash.

Both Norway's sovereign wealth fund and Temasek have generated outstanding results. Norway's assets have grown to \$400 billion and over its 35 years, Temasek has delivered an annual return of 18%.



Other Important Points

- **Essential reading.** Mr. Miracky is co-author of *Assessing the Risks*, a recently published Monitor Group report about sovereign wealth funds which Professors Abdelal and Vietor referred to as a seminal work.
- **Global rules.** Mr. Kejriwal explained that Temasek has been working closely with the International Monetary Fund to establish a set of consistent disclosure rules that would apply to all sovereign wealth funds. However, an audience member voiced a concern that regulating sovereign wealth funds while not regulating other types of investments, like hedge funds, might lead to even more problems in the global market.
- **Recipient transparency.** Mr. Miracky pointed out that not only are disclosure and transparency needed by sovereign wealth funds, but there should also be guidelines for disclosure of investments by recipients.
- **Economic development objectives.** While the panelists professed to not have political objectives associated with their investments, they acknowledged that some sovereign wealth funds invest part of their funds domestically and are pursuing both favorable returns and economic development objectives.
- **Real estate investments.** Of some surprise, the area that attracted the most capital from sovereign wealth funds in the second quarter of 2008 was real estate.



Speaker Biographies

Rawi E. Abdelal (Moderator)*Professor of Business Administration*

Rawi Abdelal is a professor at HBS in the Business, Government, and International Economy unit. His main area of expertise is the international political economy, and he is a faculty associate of Harvard's Davis Center for Russian and Eurasian Studies and Weatherhead Center for International Affairs.

Abdelal's first book, *National Purpose in the World Economy*, won the 2002 Shulman Prize as the outstanding book on the international relations of Eastern Europe and the former Soviet Union. His second book, *Capital Rules*, explains the evolution of the international financial system's social norms and legal rules. Abdelal is now at work on *The Price of Power*, a book that explores the relationships among political leadership, state-building, foreign investment, and geopolitics in the Russian energy sector.

In 1999 Abdelal earned a Ph.D. in government from Cornell University, where he had received an MA in 1997. At Cornell Abdelal's dissertation won the Kahin Prize in International Relations and the Esman Prize. He was a President's Scholar at the Georgia Institute of Technology, where he received a BS with highest honors in economics in 1993. His recent honors include HBS's Robert F. Greenhill Award and the Student Association's Faculty Award for outstanding teaching in the required curriculum.

Richard H.K. Vietor (Moderator)*Senator John Heinz Professor of Environmental Management, Senior Associate Dean*

Richard Vietor, the Senator John Heinz Professor of Environmental Management and senior associate dean at HBS, teaches courses on the regulation of business and the international political economy. He received a BA in economics from Union College (1967), an MA in history from Hofstra University (1971), and a Ph.D. in history from the University of Pittsburgh (1975). He was appointed professor in 1984.

Before coming to HBS in 1978, Vietor held faculty appointments at Virginia Polytechnic Institute and the University of Missouri. He is the recipient of a National Endowment for the Humanities Fellowship and Harvard's Newcomen Fellowship. In 1981 he received the Newcomen Award in business history. He serves on the editorial board of the *Business History Review*, the advisory board of IPADE in Mexico, and the Infrastructure Committee of the Competitiveness Policy Council. He was president of the Business History Conference for 1993–1994.

Vietor's research on business and government policy has been published in numerous journals and books. He has contributed chapters to *America versus Japan* (1986), *Wall Street and Regulation* (1981), *Future Competition in*

Telecommunications (1989), and *Government, Industries, and Markets* (1990). His books include *Environmental Politics and the Coal Coalition* (1980), *Energy Policy in America Since 1945* (1984), *Telecommunications in Transition* (1986), *Strategic Management in the Regulatory Environment* (1989), *Contrived Competition* (1994), *Business Management and the Natural Environment* (1996), *Globalization and Growth: Case Studies in National Economic Strategies* (2004), and *How Countries Compete* (2006).

For his courses in business-government relations and environmental management, Vietor has published more than three dozen case studies on international energy issues; on the regulation of natural gas, nuclear power, air pollution, and hazardous wastes; and on strategy and deregulation in airlines, railroads, telecommunications, and financial services. He has been a consultant to the Hudson Institute and the Energy Research and Development Administration and is a consultant to IBM, General Electric, Anglo American, and the government of Malaysia.

Vietor is married and lives in Wellesley, Massachusetts.

Manish Kejriwal, MBA 1995*Senior Managing Director, Temasek Holdings Advisors India Pvt. Ltd.*

As senior managing director of Temasek Holdings Advisors India Pvt. Ltd., Manish Kejriwal oversees the overall interests of Temasek Holdings in India. He is also a senior managing director of Temasek Holdings Singapore, where he is in charge of the financial-services portfolio and has oversight of Russia.

Temasek Holdings is an Asian investment firm with a diversified portfolio of over US\$100 billion. Established in 1974, Temasek holds and manages investments in companies involved in a wide range of business activities, from port, shipping and logistics, and banking and financial services to airlines, telecom and media, power and utilities, and rail. Many of these are leading companies in Asia such as Singapore Airlines, Singapore Telecom, Singapore Technologies, PSA Corporation, DBS Bank, ICICI Bank, and Standard Chartered Bank. Temasek is among the most active buy-side firms in Asia and has invested over \$20 billion in the last three years. It has delivered an 18% annual average compounded total return to its shareholder since its inception.

Before joining Temasek Holdings, Kejriwal was a partner at McKinsey & Company and had been part of its New York, Cleveland, and Mumbai offices. Before McKinsey, Kejriwal worked at the World Bank in Washington, D.C., and spent the summer between his two business school years with Goldman Sachs (principal investment and corporate finance) in Hong Kong.



Kejriwal received a BA from Dartmouth College, where he graduated magna cum laude with a major in economics and engineering sciences. He holds an MBA from HBS, where he graduated with high distinction as a Baker Scholar.

Kejriwal is a member of the boards of Fullerton Financial Holdings Pte. Ltd., Bajaj Auto Ltd., and Kejriwal Stationery Holdings Ltd. He is a member of the Young Presidents' Organization and was named a Young Global Leader by the World Economic Forum in 2006.

Knut N. Kjaer, AMP 165 (2003)

Former CEO, Norges Bank Investment Management

Knut Kjaer served as the CEO of Norges Bank Investment Management since its inception in 1997, stepping down on January 1, 2008. As CEO, he was responsible for managing the Norwegian Government Pension Fund (the Oil Fund) and managing Norway's foreign reserves. The total funds under his management were more than US\$400 billion by the end of 2007.

Kjaer has a master's degree in economics and a degree in political science from the University of Oslo. He attended the Advanced Management Program at HBS in 2003.

He has been a researcher in the Department of Economics at the University of Oslo and with Statistics Norway. In 1986 he cofounded and became a partner of the Economic Analysis Centre, ECON. From 1994 to 1997 he was EVP of Storebrand, a listed company within the financial sector. He has also been a member of the board and deputy chairman of the Oslo Stock Exchange and chairman of the board of the Centre for International Climate and Energy Research Oslo. In 1995–96 he was chairman of the board of Storebrand Bank.

William Miracky

Senior Partner, Monitor Group

Bill Miracky is a senior partner at the Monitor Group, working out of the Cambridge office. His responsibilities include client service and management in the firm's national economic development and security practice.

Since joining Monitor in 1993, Miracky has managed client relationships and projects in a variety of industries internationally in the firm's core strategy consulting practice. He has worked at the CEO and board levels of a number of Monitor's largest relationship clients. The work has included corporate portfolio strategy, business unit strategy, organization design and transformation, and marketing strategy. Miracky coauthored Monitor's June 2008 report *Assessing the Risks: The Behavior of Sovereign Wealth Funds in the Global Economy* and has spoken widely on the topic of SWFs.

Before joining Monitor, Miracky served in the economic research division of the Board of Governors of the Federal Reserve in Washington, D.C. He has done pro bono work for the Massachusetts Governor's Council on Economic Growth and Technology, on issues of regional macroeconomic growth. He also works with New Profit Inc. as a CEO coach to social entrepreneurs in their investment portfolios.

Miracky received his Ph.D. in economics from MIT, where his fields of study included industrial organization and econometrics. His studies were supported by NSF Graduate and Alfred P. Sloan Foundation fellowships. He graduated Phi Beta Kappa, with honors and distinction, from Stanford University with a dual major in economics and history.

Miracky resides in Newton, Massachusetts, with his wife and their three sons.