DEFINING & MEASURING SUSTAINABLY SUCCESSFUL CLIENTS AND DEG'S CONTRIBUTIONS TO CLIENTS

Final Report for Publication

Prepared by Steward Redqueen BV

Authors: Krispijn Bertoen and Matthijs de Bruijn

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EXECUTIVE SUMMARY

Sustainably working, successful companies have great propensity to improve the living conditions of a local population economically, ecologically and socially. Contributing to the sustainable success of clients therefore is the major objective of DEG.

DEG is increasingly faced with the challenge to define what it considers sustainably successful clients[1]. DEG wants to know how it can best contribute to this success and how it can adequately monitor and measure both sustainable client success and its contributions to clients. Therefore DEG commissioned a study with two objectives:

1. define and assess the **sustainable success of DEG clients**;
2. research how **DEG contributes to this success**;

Sustainably successful clients – study results & recommendations

In this project a sustainably successful company is defined as *"a sustainably working and successful company that is operationally profitable, financially stable and competitive and that complies with relevant EHS standards, actively manages environmental and social issues and acts as a good corporate citizen".* This definition is further worked out in six sub-definitions with an underlying set of indicators to monitor and measure sustainable client success. However, due to data limitations measurement of sustainable client success has not yet been possible on the portfolio level. The planned quantitative analysis of two large samples of DEG's portfolio could therefore only be used to test the use of the designed model and its underlying indicators.

The study showed that the notion of 'sustainable client success' is not yet firmly embedded within DEG. Formulating a definition therefore triggers a discussion within DEG on how sustainable client success is perceived, how it should be measured and how specific data supports investment decision-making within DEG.

The following recommendations result from these findings:

1. The presented definition of a sustainably successful company serves as (i) a starting point for a discussion and further research on what sustainable client success means for DEG; (ii) how it can be used in company analysis, performance measurement and decision-making; and (iii) how this links to contributions that DEG makes to clients;
2. DEG could use the data analysis as a basis for further research into the data issues that surfaced during the analysis.

DEG contributions – study results & recommendations

Currently, DEG does not have a definition of its contribution to clients. The basis of this assignment is the following definition for contributions to clients: *"An intervention or action by DEG beyond the financing itself which adds value to a client's organisation."*

[1] A DEG client is a party that has received finance from DEG in the form of a loan, an equity investment or another financial product or a combination of these.

The study found that contributions to clients give DEG a competitive edge, are well-appreciated and considered useful by clients. Inherent collective contributions such as long-term relationships and personal contact between DEG and clients are qualifiers for trust and effective individual contributions. Yet despite the importance of contributions, the study found there is a lack of awareness within DEG on the possibilities of contributions to clients, no formal structured internal overview of and no approach for contributions. DEG investment staff is also not incentivised to contribute to clients.

All in all, there is an untapped potential to apply DEG contributions more often to tackle specific client challenges. A key reason for this is the fact that DEG lacks a 'menu of options' for potential contributions. This menu would help to bring alignment with the existing DEG investment process and give DEG staff insight in what situation which contributions could be applied. DEG contributions can be a great force in further building trust with clients, which, in turn, will help build sustainable DEG-client relationships and can lay the foundation for sustainably successful businesses.

The following recommendations result from these findings:

1. It is recommended to assign DEG staff as long as possible to clients and strengthen DEG's local offices;
2. In order to promote awareness and usage of DEG contributions that go beyond provision of finance and add value to clients, DEG is recommended to introduce a clear structure, a so-called 'menu of options' for contributions that can be recognised and used by every (client-facing) DEG staff member.

Links between contributions and sustainable client success

Looking forward, DEG needs to better understand potential links between on the one hand DEG's actions and inherent contributions and on the other hand sustainable client success. For this purpose DEG should work further on a holistic approach (see figure 1 below) in which it should try to link types of contributions with different aspects of sustainable client success.

A better understanding of links between contributions and sustainable client success will help DEG to move from the current ex-post analysis (measuring what happened with clients and how DEG contributed to this) to a strategic ex-ante analysis that estimates potential for sustainably successful clients. In case it is possible to establish interlinkages between contributions and sustainable client success, it might be possible to tailor contributions to help improving particular aspects of sustainable success at DEG's clients. As a next step, DEG can then start identifying and measuring how DEG contributes to development impact through the sustainable success of clients.

Please see Section 2.3.4 for more information on the possible link between sustainable client success and development impact.

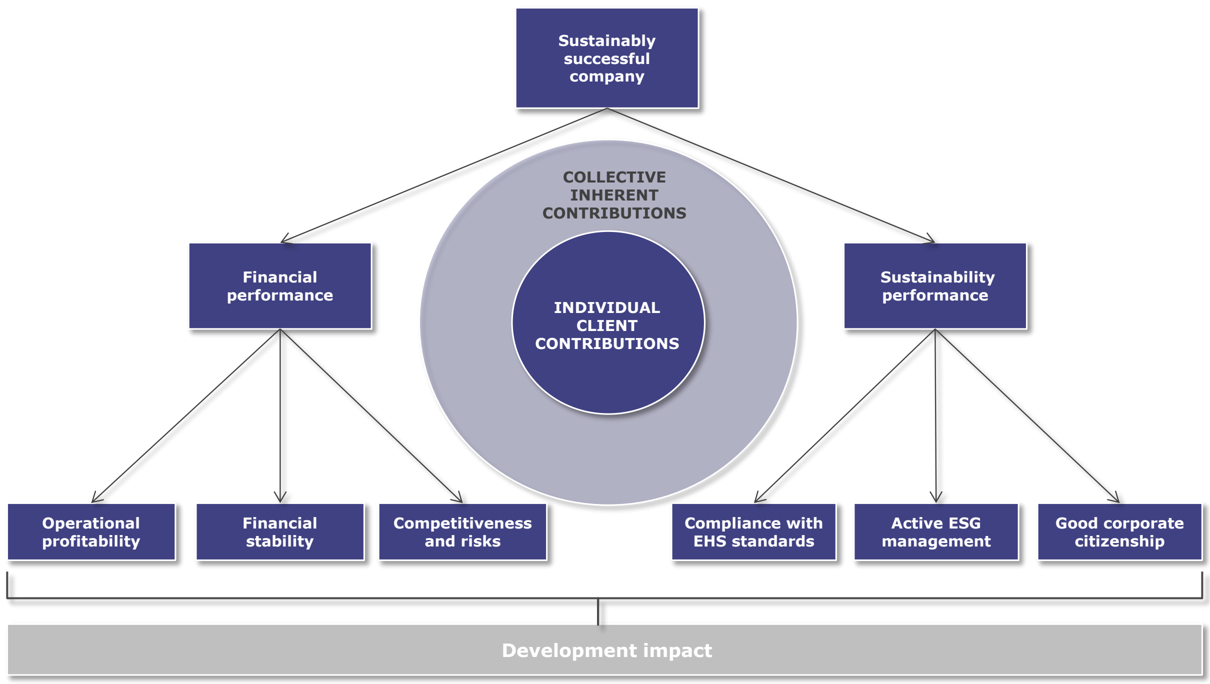

Figure 1: DEG contributions and sustainable client success

Methodology

The research methodologies used in this study include six layers of quantitative and qualitative analysis: data analysis, surveys, in-depth interviews, a peer review, three case studies and Steward Redqueen's own experience. These separate layers of analysis not only provided the required input, but also provided opportunities for cross-checks of data and opinions.

From the current portfolio, 59 companies were selected that received at least one form of DEG contributions as currently measured by DEG monitoring systems. These clients were requested to participate in a survey questionnaire. A tailored questionnaire was also sent to 48 DEG staff members. The peer review included 6 organisations, two of them commercial banks focussing on impact, three classical impact investors and one development finance institution, a direct DEG peer. Three clients were selected for in-depth case studies. These systematically selected case studies helped to i) test the feasibility and usefulness of the 'sustainable client success' concept developed in this study in practice; ii) identify DEG contributions and added value by DEG so far and iii) draft recommendations for DEG on potential areas of client support in the future (the case studies are included as stand-alone reports in Annex A, B and C).

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1. BACKGROUND AND SCOPE

1.1 BACKGROUND

Sustainably working, successful companies have great propensity to improve the living conditions of a local population economically, ecologically and socially. Contributing to the sustainable success of clients therefore is the major objective of DEG.

DEG is increasingly faced with the challenge to define what it considers sustainably successful clients. It also needs to determine how it can best contribute to the sustainable success of clients. And it wants to adequately monitor and measure the sustainable success of clients and DEG's contributions.

However, no clear-cut definition of sustainable success can be found and there is no standard measurement methodology for sustainable client success available. Further complexity is added by the (external and internal) pressure to make the contribution of DEG to the sustainable success of its clients more transparent.

DEG asked Steward Redqueen to address this challenge through a research and evaluation study, in close cooperation with DEG's Corporate Strategy and Development Policy Department. This final report presents the results of this research and evaluation study.

1.2 OBJECTIVE AND SCOPE

The objective of the study is twofold: (i) assess the sustainable success of DEG clients; (ii) research how DEG contributes to this success. For all elements the study was also expected to provide recommendations for DEG.

Five key questions were formulated around the focus areas:

1. How to define a sustainably successful client?
2. What are characteristics of sustainably successful clients in DEG's portfolio?
3. What are recommendations to further build upon the definition and analysis?
4. How does DEG contribute to the sustainable success of its clients?
5. What are recommendations to further improve contributions to clients?

The study is based on six layers of quantitative and qualitative research and analysis: data analysis, surveys, in-depth interviews, a peer review, case studies of three DEG clients and Steward Redqueen's own experience.

The data analysis includes two large samples of DEG clients: a selection of companies exited by DEG between 2010 and 2014 (171 companies) as well as a selection of DEG's current portfolio (265 companies)[2].

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[2] Investments and loans in financial institutions were excluded, as well as companies with insufficient data availability.

From the current portfolio, 59 companies were selected that received at least one form of DEG contributions. These clients were requested to participate in a survey questionnaire, to which 21 responded (36% response rate). A tailored questionnaire was also sent to 48 DEG staff members, answered by 27 of them (56% response rate). The peer review included 6 organisations, while 3 clients were selected for in-depth case studies (case studies included in Annex A, B and C).

1.3 DEG INVOLVEMENT AND RELEVANCE TO DEG

DEG was closely involved in the execution of the study. The Steward Redqueen team was in contact throughout the study with the Corporate Strategy and Development Policy Department. Several members of this same department were involved in the initial scoping phase of the project and during case studies.

In addition, DEG staff was involved in the study through the survey, in-depth interviews and case studies. Respondents and interviewees form a representative sample of DEG staff, consisting of investment managers (based in Cologne as well as the regional offices), members of the Sustainability Department and the Finance Department. Responsible investment managers were closely involved in the three case studies.

The study identifies issues and presents suggestions that affect DEG's core activities. It defines the concept of a sustainably successful client and performs an assessment of clients using a new evaluation model. It outlines the framework around DEG's ability to add value to clients and assesses the quality and usefulness of DEG's individual contributions. And it exposes serious flaws in DEG's data availability and quality in all monitoring systems, while it presents initial ideas to restructure the Corporate Policy Project Rating (GPR).

Given the wide array of results, the outcomes of the study should be seen as a starting point for potential further actions. Concrete recommendations for these follow-on activities are formulated throughout the report. It will be up to DEG to decide if it will actively pursue these actions and in which order of priority. The study should therefore be seen as a starting point for strategic discussion and a basis for decision-making.

In this regard it is important to highlight that introducing the concepts of sustainable client success and DEG's contributions have more strategic implications for DEG and the way the organisation analyses clients and DEG's role than initially foreseen. This is also due to the fact that the currently ongoing reorganisation project named "client centricity" focuses on DEG's perspective on and cooperation with its clients. There is an overlap with this research. Consequently, questions raised and recommendations made in this report are also relevant to the reorganisation project team.

1.4 CHALLENGES & RISKS

The overarching challenge of the study was to meet its ambitious objectives within a relatively short timeframe. In addition, Steward Redqueen and DEG identified three specific risks to be managed:

1. Too close involvement of too many internal stakeholders from DEG, affecting clear agreements on objectives and scope;
2. Below expectations data availability and/or quality, affecting the effectiveness, efficiency and results of the data analysis;
3. Below expectations response rate for the surveys, affecting the representativeness of survey results.

In order to complete the study within the set timeframe, Steward Redqueen and DEG agreed upon a detailed and strict work plan, defining responsibilities and deadlines. To manage the abovementioned specific risks, a number of concrete measures were identified and agreed upon:

1. The DEG project leader for this evaluation managed inputs from internal stakeholders and subsequently transferred these to Steward Redqueen as one voice. This was done well by DEG, leading to an effective and efficient process;
2. The data availability and quality indeed turned out to be partially below expectations. In addition, the data collection process turned out to be significantly more cumbersome than expected. Despite resolute actions by DEG , it led to a delay of about a month vis-à-vis the work plan;
3. Steward Redqueen and DEG identified measures to realise maximum response rates: the online survey was kept as short and simple as possible, while responsible DEG investment managers sent the questionnaire personally to clients. Both measures led to an acceptable level of responses for representative results.

2. EVALUATION METHODOLOGY AND PROCESS

2.1 METHODOLOGY

The study is based on 6 layers of quantitative and qualitative research and analysis: data analysis, surveys, in-depth interviews, a peer review, three case studies and Steward Redqueen's own experience. These separate layers of analysis not only provided the required input, but also provided opportunities for cross-checks of data and opinions.

2.1.1 Quantitative analysis

The first layer consists of a quantitative analysis of two samples of DEG clients: a selection of companies exited by DEG between 2010 and 2014 (171 companies) and a selection of DEG's current portfolio (265 companies). The analysis is based on an evaluation model specifically designed for this assignment, which draws upon data from all DEG's four main monitoring systems.

2.1.2 Client and DEG staff surveys

The second layer consists of two tailored surveys, one for clients and one for DEG staff. The survey focused on the client and staff experiences with extra-financial services provided by DEG and their views on what makes a company sustainably successful. The survey was filled out by 21 clients (36% response rate) and 27 DEG staff members (56% response rate). The selection process for clients receiving the survey is explained in Annex G, the survey results are included in Annex H and I.

2.1.3 In-depth client and DEG staff interviews

The third layer consists of interviews with clients and staff. The interviews with clients were conducted in phone calls in February and March 2015. The interviews with DEG staff members were conducted in two phases: during a visit to DEG's head office in November 2014 and subsequently during phone calls in March 2015. An overview of interviewees is included in Annex J.

2.1.4 Peer review

The fourth layer consists of a peer review. Six organisations were specifically selected as a best practice in a particular field, with potential learnings for DEG. The term 'peer' was broadly interpreted, as to not only include other development finance institutions (DFIs). The lessons drawn from the review were either directly included as recommendations in this study, used as hypothesis in interviews or discussed with the Corporate Strategy and Development Policy Department.

2.1.5 Three client case studies

The fifth layer consists of in-depth case studies of three DEG clients. The case studies included company visits and multiple interviews with different company representatives as well as the involved DEG staff members. The case studies were carefully selected in cooperation with DEG and based on the diversity of contributions received by DEG. They concerned Ohorongo Cement in Namibia, foliar fertiliser company Aminoagro in Brazil and textile manufacturer Texhong Renze in Vietnam. The three case studies are included in Annex A, B and C.

2.1.6 Steward Redqueen expertise and experience

The sixth layer consists of the consultants' expertise and experience. Steward Redqueen has worked on evaluation and strategy projects in the field of sustainability and impact for over 30 different financial institutions in emerging markets. These include major development finance institutions (DFIs), commercial banks, private equity funds and institutional investors.

2.2 PROCESS

The study was executed according to a five-phase approach. The corresponding tasks, subtasks, responsibilities and deadlines were described in detail in a work plan agreed between Steward Redqueen and DEG. The schematic project overview below summarises the inputs, the process and the outputs.

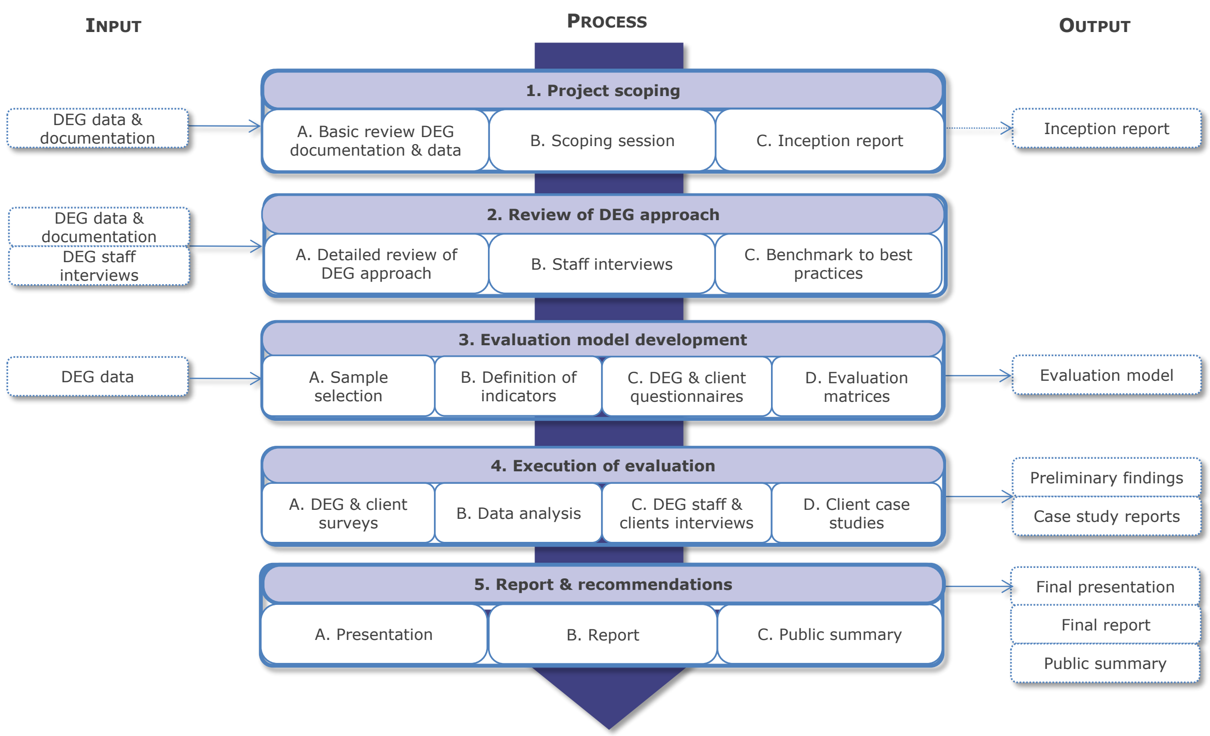


Figure 2: Schematic overview of the project approach

2.2.1 Project scoping

In the project scoping phase, Steward Redqueen and DEG defined in detail the objectives, methodology, work plan and expected results of the study. These were laid down in an Inception Report.

Steward Redqueen first conducted a review of relevant DEG documentation (e.g. strategic documents, manuals) and monitoring systems (GPR, BARS, the Environmental and Social Indicator, Corporate Rating), followed by several phone calls and a one-day scoping session with the Corporate Strategy and Development Policy Department at DEG's offices in Cologne.

During the scoping sessions, the initial proposed approach was altered to reflect DEG expectations, which included a stronger focus on DEG's contributions and a more strategic role for the study. At the end of the scoping phase Steward Redqueen delivered an Inception Report. A detailed work plan with tasks, subtasks, responsibilities and deadlines functioned as a roadmap during the project.

2.2.2 Review of DEG approach

The second phase consisted of a detailed review of DEG's current practices, a first round of staff interviews and a peer review. In the detailed review, an in-depth study was made of DEG's use of the sustainably successful client concept, the Theory of Change, contributions monitoring and the measurement tools.

With this knowledge in mind, the consultants conducted two days of interviews with investment managers, monitoring system representatives and special roles (e.g. sustainability, technical assistance) at DEG's head office in Cologne. The interviews focused on DEG staff views on the concept of sustainable client success, contributions to clients and measurement methodologies.

At the end of the second phase the consultants performed a peer review. Six of DEG's peers are reviewed on four aspects relevant to this research: organisation's mission, their view on sustainably successful companies, their contributions to clients and their measurement methodologies and/or impact reporting. The six peers were specifically selected by Steward Redqueen and DEG as a best practice in a particular field, with potential learnings for DEG.

2.2.3 Evaluation model development

The evaluation model phase consisted of indicator selection, the identification of a survey sample and the development of questionnaires and a scoring model for the quantitative evaluation.

Based on the review of DEG's monitoring systems, the interviews and the consultants' own experience with evaluations a set of indicators was selected for quantitative analysis of both sustainable client success and DEG's contributions. As it was crucial to have a pragmatic, focussed and manageable set of indicators, all were existing DEG indicators from one of the four main DEG monitoring systems. The indicators and evaluation model set-up was designed with close involvement of DEG. See section 2.3 for more details on the evaluation model and Annex E and F for the scoring methodology.

Steward Redqueen provided the data sheets for the quantitative analysis, which were subsequently filled with data by DEG. This process took substantially longer than expected, which was mostly due to a lack of data availability within DEG.

In order to ensure clients that would receive a survey with questions about DEG contributions actually had received any of these contributions, a sample of 82 current client companies who received most contributions was selected. See Annex G for an extensive explanation of the selection process for this sample.

Subsequently survey questionnaires were designed for clients (both debt and equity) and DEG staff. The client questionnaires focused on the clients':

- Understanding of what is a sustainably successful company;
- Experience with contributions by DEG;
- Perception of the extent to which its success is attributable to DEG's contribution.

The DEG staff questionnaire focused on the staff members':

- Understanding of what is a sustainably successful company;
- View on DEG's measurement methodologies;
- Experience with contributions by DEG in specific client projects;
- Perception of the extent to which its clients' success is attributable to DEG's contribution.

A part of the questions were formulated in such a way that client perceptions could be compared to DEG staff member perceptions. For a full overview of the (anonymised) outcomes of the survey questionnaires please see Annex H and I.

2.2.4 Execution of the evaluation

The execution phase consisted of analysis of the survey results, data analysis, DEG staff and client interviews and three case studies.

The survey questionnaires were first sent out to DEG staff and clients. DEG had an important role in this process, as the questionnaires to client were sent individually by the involved DEG investment manager. Once the responses came in Steward Redqueen analysed them and designed quantitative graphical outcomes, accompanied by qualitative observations and conclusions.

The consultants performed the data analysis of the current and exited portfolio samples in two steps. First a score was allocated to all individual companies for their performance on each individual indicator. The average of these scores determined the score for six performance areas as well as DEG's contributions, eventually resulting in one final score per company. On the basis of these scores the consultant was able to perform the second step, which concerned the core data analysis: a ranking of the sustainable success of companies, identifying common denominators, establishing correlations between performance areas and researching the potential effects of DEG contributions.

After the survey and data analysis Steward Redqueen conducted several in-depth interviews with DEG staff and clients, focusing on DEG's contribution to clients. These interview rounds also provided an opportunity to test the validity of potential conclusions derived from the survey.

In addition, three clients were visited as case studies to deep-dive into the performance aspects of sustainable success and DEG contributions. The visits were conducted jointly by a consultant and DEG staff member. The clients were carefully selected by Steward

Redqueen and DEG on several aspects, such as sector, size, geography and investment type. The three selected companies also concerned specific examples of different types of positive contributions by DEG with clients:

- *Ohorongo Cement*: example of DEG's financing of a German company expanding to an African market (Namibia);
- *Aminoagro*: example of DEG's option to invest direct as well as indirect (through a local fund manager) in the same company;
- *Texhong Renze*: example of DEG's long-term partnership with a client and effective technical assistance (E&S and production efficiency programme).

2.2.5 Presentation and report

Based on the findings of the data analysis, surveys, interviews, peer review and case studies, Steward Redqueen has written this final report. This report was preceded by a presentation of the key findings, conclusions and recommendations, which was presented and discussed during a workshop on 8 June in Cologne.

2.3 QUANTITATIVE EVALUATION MODEL

Part of the evaluation was the design of a quantitative model that would be able to quantify the extent to which a client can be labelled as a sustainably successful company. In parallel, the model will track the Role of DEG and how DEG can contribute to both core performance aspects of clients. The graph below summarises the resulting model.

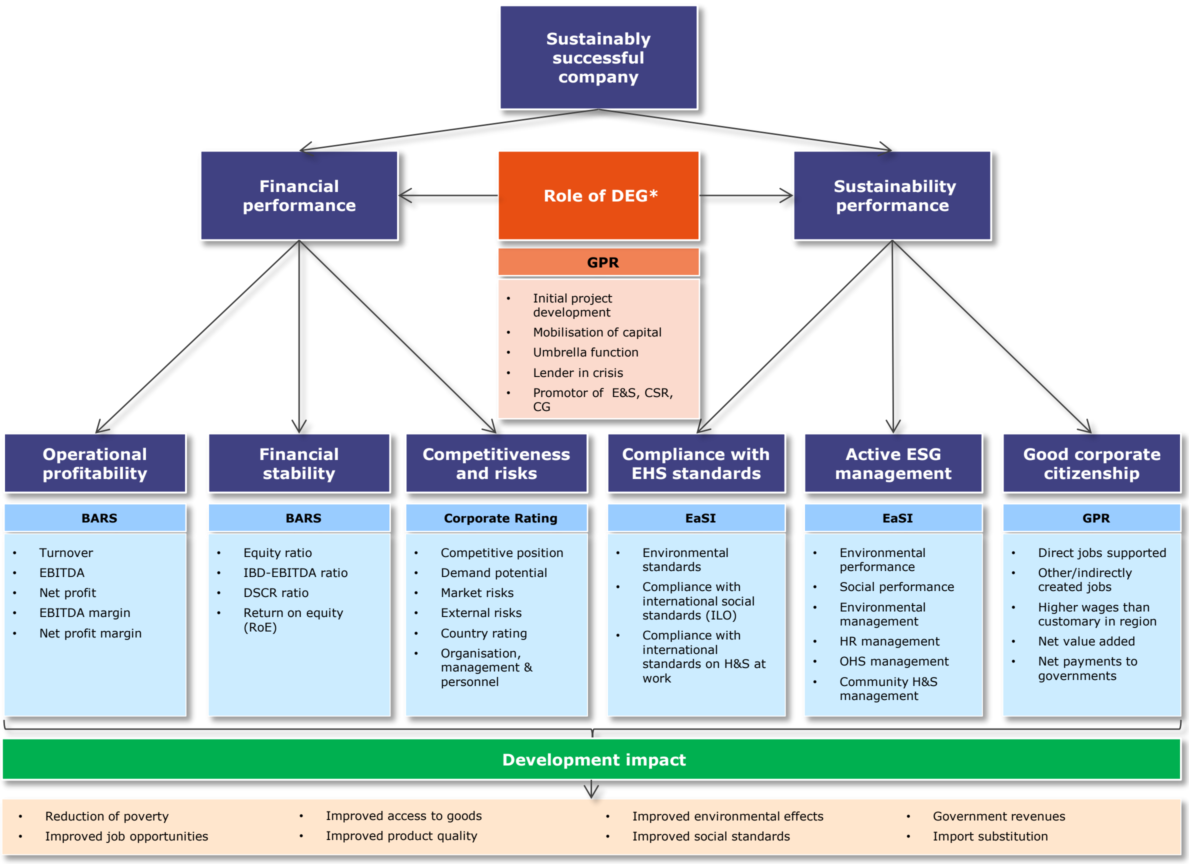


Figure 3: Schematic overview of the evaluation model

2.3.1 Concept

In order to design the model, it first was necessary to anatomise the concept of a sustainably successful company. Below the basic steps in the design of the model are explained.

Two questions were core in the analysis of the concept of a sustainably successful company: (i) what is sustainable success and (ii) what are its core performance aspects? It was determined that following the etymology of the word *sustainable*, sustainably successful client defines a sustainably working, successful company. Herein "successful" focuses on the long-term financial performance and competitiveness while "sustainably working" includes compliance to EHS standards, active management of environmental and social issues and acting as a good corporate citizen.

Without financial success and without sustainably working also named sustainable operations, the long-term business continuity might be in danger and the prospects for long-term growth are limited. Therefore the financial performance and the sustainability performance are the two core performance areas on which the model is based.

To further work out subareas that substantiate the two core performance areas two questions were leading: (i) what are the drivers of a successful financial performance and (ii) what are the drivers of a successful sustainability performance?

Three aspects were identified that determine a successful long-term financial performance:

- *Operational profitability*: a company with profitable operations, which enable the business to maintain and grown in the long run;
- *Financial stability*: a company with a strong balance sheet, mainly reflected in solvency and liquidity;
- *Competitiveness and risks*: a company that constantly works to maintain and improve its competitive position and manages risks appropriately.

Three aspects were identified that determine a successful long-term sustainability performance:

- *Compliance with EHS standards*: a company that is in compliance with relevant environmental, social and health & safety standards;
- *Active ESG management*: a company that works towards maximising its positive impact and minimising its negative impact on society and the environment;
- *Good corporate citizenship*: a company that demonstrates value to all stakeholders and acts transparently.

These six performance subareas and their link with sustainable client success are further discussed in section 3.2.

2.3.2 Indicator selection

The next step was to identify indicators that substantiate these performance areas. The aim was to select a set of indicators that is representative, focussed, manageable and easily retrievable, both during the study and in the future. Therefore 29 existing DEG indicators or indices were selected as a source for six performance subareas and 7 indicators for DEG's contribution. The indicators were drawn from all four main DEG monitoring/ measurement systems.

For operational profitability five indicators were selected, with data derived from BARS:

- *Turnover, Earnings before Interest, Taxes Depreciation and Amortization (EBITDA) and net profits*: main indicators for absolute financial performance, used to measure progress during the time in DEG's portfolio;
- *EBITDA margin and net profit margin*: indicators for relative financial performance, largely determining the operational profitability score.

For financial stability four indicators were selected, with data derived from BARS:

- *Equity ratio*: the amount of assets financed by equity, the higher this ratio the better financial stability;
- *IBD-EBITDA ratio*: indicates the amount of years it would take a company to repay its interest-bearing debt (IBD) out of its operational profits, the lower this ratio the better the financial stability;
- *DSCR ratio*: the debt service coverage ratio (DSCR) shows whether the net income of a company is high enough to service a company's debt. The higher this ratio the better the financial stability;
- *Return on equity*: indicates the relation between the net income and shareholder's equity, the higher this ratio the better the financial stability.

For competitiveness and risks six indicators were selected, with qualitative assessments (very weak to very good) derived from the Corporate Rating:

- *Competitive position*: a company's competitive position in the market;
- *Demand potential*: the potential demand for a company's products in the market;
- *Market risks*: market risks affecting the company;
- *External risks*: external risks affecting the company;
- *Organisational quality*: quality of the company's organisation and management.

For environmental, social and health & safety (EHS) compliance three indicators were selected, derived from the Environmental and Social Indicator (EaSI) and based on qualitative assessments by DEG staff on the adherence to standards:

- *Environmental standards*: the environmental standards a company adheres to (from local to World Bank standards);
- *Compliance with ILO standards*: whether a company complies with ILO standards;
- *Compliance with international H&S standards*: whether a company complies with international H&S standards.

For active ESG management six indicators were selected, all derived from the EaSI and all indices formed by several indicators combined into a single measure:

- *Environmental performance*: quantitative score of the environmental performance of a company;
- *Social performance*: quantitative score of the social performance of a company;
- *Environmental management*: quality of the environmental management system of a company (varying from none in place to internationally certified by ISO 14000)

- *HR management*: quality of the Human Resource (HR) management system of a company (varying from none in place to internationally certified by SA 8000)
- *OHS management*: quality of the Occupational Health and Safety (OHS) management system of a company (varying from none in place to internationally certified by OHSAS 18001)
- *Community H&S management*: quality of the community Health & Safety (H&S) management of a company (varying from none in place to international standards)

For good corporate citizenship five indicators were selected, all derived from the GPR:

- *Direct jobs supported per EUR 1 million turnover*: the more jobs supported relative to a company's turnover, the better the offering of jobs in a local society and the stronger the embedment in a local society;
- *Other/indirectly created jobs*: the more indirectly created jobs, the more embedded the company is in a society;
- *Higher wages than customary in region*: the higher the wages, the higher the likeliness of decent jobs and the higher the contribution to individual income generation in a local society;
- *Net value added as % of turnover*: the higher national income generated relative to a company's turnover, the higher the relative financial contribution from a company to (local) society;
- *Net payments to government as % of turnover*: the higher the payments to government through taxes relative to its turnover, the higher the contribution to government and the higher the likeliness of responsible tax practices.

For DEG's contributions 6 indicators were selected that represent DEG's contribution, all derived from the GPR:

- *Initial project development*: active adoption of (parts of) the project concept by DEG, going beyond financial consultancy or restructuring;
- *Mobilisation of capital*: if DEG acts as an active arranger in the project and mobilizes at least one private or public lender or other funds;
- *Consulting/Board seat*: consultancy services by DEG which have made project "bankable" (e.g. by introducing risk procedures, accounting standards and/or minority rights for shareholders).
- *Umbrella function*: if DEG accompanies a German or European partner to a politically difficult country;
- *Lender in crisis*: if DEG acts as a lender in times of crisis and/or provides capital to companies in distress owing to third-party fault (e.g. owing to a national crisis);
- *Promoter of E&S, CSR, CG*: significant added value by DEG in the project in terms of (i) environmental and social issues, (ii) Corporate Social Responsibility (CSR) and/or (iii) Corporate Governance (CG).

2.3.3 Scoring methodology

The next step was to assign a score to the data for all indicators. As indicators are different in nature, scoring models are tailored per individual indicator with a number from 0 (worst) to 10 (best). The individual indicator scoring models are designed in such a way that there is a relatively normal spread of scores. See Annex F for a complete overview of the scoring model per individual indicator.

The average scores per individual indicator determine the six performance subareas, two performance areas, the role of DEG and the sustainably successful client score. See Annex E for a schematic overview of the scoring methodology.

2.3.4 Development impact in the definition and methodology

Finally, it is important to note that the definition and methodology do not include the (potential) development impact generated by a company. This is because there is no direct *causal* link between sustainable business success and development impact. A company that improves access to healthcare or improves the environment may have high development impact, but may not necessarily be a sustainably successful company, as it may have weak operational profitability, financial stability or competitive position. Development impact therefore is not part of the definition and methodology. However, a sustainably successful company is more likely to generate long-term, positive development impacts. Development impact is therefore included in the schematic overview of the methodology in exhibit 2 (please note that the 8 development effects are randomly selected examples).

3. SUSTAINABLY SUCCESSFUL CLIENTS

3.1 INTRODUCTION

DEG is increasingly faced with the challenge to define and measure the sustainable success of its clients. DEG currently publicly describes several expectations of what:

- is considered a successful private company;
- it considers environmentally and socially responsible operations.

DEG indicates successful private companies:

- are of long-term financial viability
- generate economic growth
- create skilled jobs
- generate income
- improve local production
- boost added value within a country
- expand range of goods and services
- contribute to public revenue (tax payments)
- enhance foreign exchange earnings (export)
- invest in employees (education, training)

DEG indicates E&S responsible companies:

- comply with E&S standards
- apply and promote international E&S standards
- protect life, health and economic livelihood
- provide decent working conditions
- preserve ecological, social and cultural environment
- make sustainable use of natural resources

Figure 4: Overview of current aspects DEG considers for successful companies and responsible companies in the field of E&S

Nevertheless, DEG currently does not have a holistic view laid down in a definition on what it considers to be a 'sustainably successful client'.

This section provides a definition of a sustainably successful client and corresponding sub-definitions methodology for the analysis of clients in line with this definition. In addition, the section provides a first attempt to measure if a client is a sustainably successful one. The results of this data exercise are based on two data samples: DEG's current portfolio and the clients exited between 2010-2014.

3.2 DEFINING SUSTAINABLY SUCCESSFUL CLIENTS

Based on surveys and interviews with clients and DEG staff, a peer review, three case studies and the Steward Redqueen expertise, a definition of sustainably successful client has been drafted comprising of five elements. The process was as follows:

1. Draft of assumptions based on our own experience in working with DFIs and commercial FIs in emerging markets;
2. Execution of a peer analysis to identify how DEG's peers define this notion;
3. Discussion on these assumptions with DEG staff;
4. Discussion on the draft definition with DEG's Corporate Strategy and Development Policy Team;
5. Test of these definitions through DEG and client interviews, surveys and the case studies.

Based on this process the following definition for sustainably successful companies was formulated:

"A sustainably working and successful company that is operationally profitable, financially stable and competitive and that complies with relevant EHS standards, actively manages environmental and social issues and acts as a good corporate citizen".

In this definition, six different elements can be identified. The study further explains these sub-definitions of a sustainably successful client in the paragraphs below.

3.2.1 Operational profitability

The first element is operational profitability, which is defined as '*a company that is able to improve both the top line and bottom line of its profit and loss statement (P&L*). Operational profitability is crucial to sustainable success, as profitable operations provide room to grow the business in the long run. Without profits, business continuity is in danger.

3.2.2 Financial stability

The second element is financial stability, which is defined as '*a company with a strong balance sheet, mainly reflected in solvency and liquidity levels*'. Together with operational profitability, a strong balance sheet is the basis for sustainable future growth of the company. A weak balance sheet (low solvency and liquidity levels) threatens business continuity.

3.2.3 Competitiveness

The third element is competitiveness, which is defined as '*a company that constantly works to maintain and improve its competitive position and manages risks appropriately'*. A thorough understanding of the competitive environment, innovation and proper risk management increases the chances of survival in the long run and contributes to sustainable future growth of the company in both its existing and future markets.

3.2.4 EHS compliance

The fourth element is compliance with environmental, health and safety (EHS) standards, which is simply defined as '*a company that is in compliance with relevant EHS standards*'. Compliance with EHS standards is both a hygiene and an enabling factor. Non-compliance with EHS standards may result in bad publicity, fines, interruption of business or even closure. This all negatively influences the financial performance and business continuity. In addition, EHS compliance forms a basis for companies to start working on ESG management pro-actively.

3.2.5 Active ESG management

A fifth element is active ESG management, which is defined as *'a company that (pro-) actively manages the environmental, social and corporate governance aspects of its operations*'. By pro-actively managing ESG, companies can run their operations in a more sustainable manner and consequently work towards maximising its positive impact and minimising its negative impact on society and the environment, while in the meantime maximizing productivity of employees and production resources. Contrary to EHS Compliance (previous paragraph), corporate governance is included in this definition of active ESG management because corporate governance is much less driven by compliance of standards and much more by active engagement between company management and investors.

3.2.6 Good corporate citizenship

The sixth element is good corporate citizenship, which is defined as '*a company that demonstrates value to all stakeholders and acts transparently'*. Despite being less tangible than the other five elements, it is a fundamental aspect of sustainable success. Good corporate citizenship entails issues as offering decent jobs and adding value in a local society, responsible tax practices and transparency. If a company performs well on these aspects it safeguards its 'licence to operate' and contributes towards maximisation of value for all company stakeholders.

3.2.7 Balance between financial success and sustainable operations

An often heard assumption is that financial aspects prevail over non-financial aspects. If valid, this would imply that more weight should be allocated to financial success performance of a company than to the sustainable operations performance in the model. However, the client and staff surveys indicate that both DEG clients and staff do not structurally prioritise financial over non-financial aspects.

Figure 5 below indicates the importance clients and staff attach to different company objectives. It shows a mix, with no clear priority for all financial, E&S or corporate citizenship objectives. This finding was confirmed in our interviews with both clients and staff and the case studies. Hence DEG staff and clients take a holistic view to company performance, which is in line with the proposed definition.

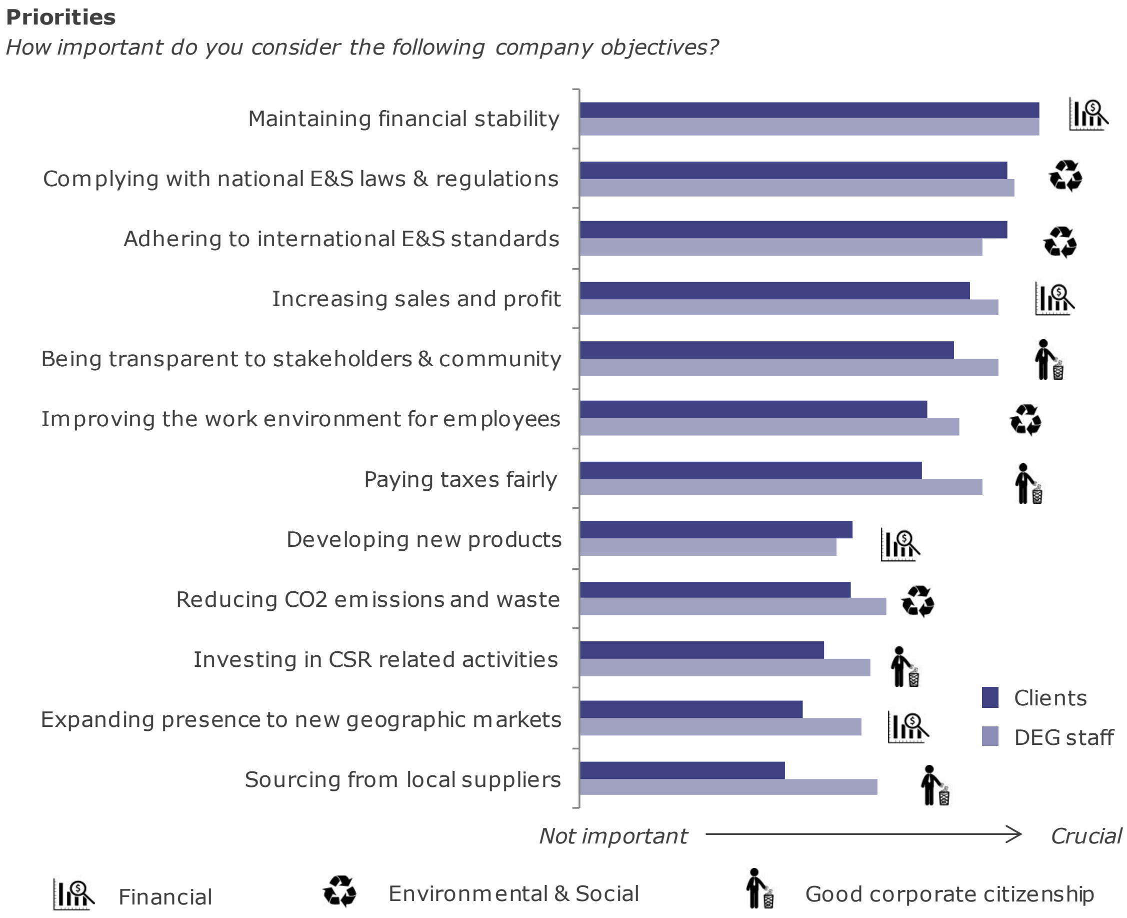


Figure 5: Importance of business objectives according to clients and DEG staff

3.2.8 Use of the definition

The definition of sustainably successful companies can serve as a backbone for improved analysis, measurement and contributions. Using the definition may benefit DEG:

- It serves a *purpose*: it creates internal (and potentially external) clarity on which companies DEG considers to support;
- It can be used as a basis for *analysis*: the sub-definitions and corresponding indicators enable DEG to structurally analyse aspects of the 'DNA' of portfolio companies;
- The definition allows for improved *measurement*: with this analysis, DEG will be better able to measure the progress towards sustainable success for clients. Improved measurement in turn enables DEG to better allocate its *contributions* and help steer a company towards sustainable success.

Finally, please note that the definition is not meant to substitute common sense and qualitative, individual company analysis, which should always prevail. The definition and corresponding company analysis methodology do not sufficiently capture unique individual company aspects, nor does it take into account specific market circumstances. However, the definition and methodology do allow comparison of companies according to a set methodology, while it allows for portfolio-wide aggregation of performances.

3.3 ANALYSIS OF DATA SAMPLES

To assess the sustainable success of DEG client companies, a quantitative analysis of two samples of clients was executed. The samples consisted of a selection of DEG's current portfolio and a selection of companies exited between 2010 and 2014. The methodology of the quantitative analysis is described in detail in section 2.3. Based on the methodology, every company was assigned a score for its sustainable success. For both samples the company scores were plotted in a graph (see figure 6 below).

It should be noted from the outset that the quantitative analysis revealed serious gaps in data availability in DEG's monitoring systems. In addition, several data quality issues surfaced. Due to these data limitations, the correlations between indicators were calculated only to test the designed model and its underlying indicators. Due to the uncertainty around the quality of data input, these results were excluded from the public version of this report.

3.3 CONCLUSIONS

Based on input from clients and DEG staff, the following definition for a sustainably successful client was formulated: *"A sustainably successful company is an operationally profitable, financially stable and competitive company that complies with relevant EHS standards, actively manages environmental and social issues and acts as a good corporate citizen"*.

The definition contains six performance areas for which sub-definitions are formulated. The survey showed that DEG staff and clients already take a holistic view to company performance, in line with the proposed definition.

Due to data unavailability and data quality issues within the provided DEG data set common characteristics and correlations should be seen as potential trends rather than a representative conclusion. Nevertheless, the application of the quantitative evaluation model underlines its practical feasibility and use and further provides a basis for further testing.

3.4 RECOMMENDATIONS

There are two main recommendations for DEG:

1. Consider using the definition in DEG's policy, analysis, performance measurement and contributions:
    a. The definition creates clarity, can improve structural company analysis and measurement and can enable DEG to better focus and allocate its contributions.
    b. The definition should not substitute common sense and qualitative, individual company analysis (which should always prevail).

2. Use the data analysis as a basis for further quantitative and qualitative research:
    a. Address the data unavailability and data quality issues which the data collection process exposed;

b. Use the data samples as a source for further quantitative analysis (samples are a deliverable in itself);
c. Perform further qualitative research, such as deep-dives of best or worst performing companies;
d. Test the main conclusions through further research.

4. DEG CONTRIBUTIONS

4.1 INTRODUCTION

DEG's mission is to promote business initiative in developing and emerging markets. To this end, DEG makes available long-term financing and advice. In this section the focus lies on the latter: the advice to clients. The sections below address the importance of this advice to clients, how the provision of this advice is structured within DEG and what clients think about different types of advice.

In this report *'advice'* is referred to as a *'contribution'* to a client's organisation. Apart from tangible contributions, like E&S advice, less tangible, so-called hidden or collective inherent contributions are also discussed. These are contributions that clients recognise as an added value to their organisation, but that DEG does not always (fully) recognise as such.

Our findings, conclusions and recommendations are based on a survey[3] among 21 clients (36% response rate) and 27 DEG staff members (56% response rate), in-depth interviews with 7 clients and 20 DEG staff and 3 client case studies, including local company visits.

4.2 DEFINING DEG CONTRIBUTIONS

Currently, DEG does not have a definition of its contribution to clients. The basis of this assignment is the following definition for contributions to clients: *"An intervention or action by DEG beyond the financing itself which adds value to a client's organisation"*

The initial main focus of this study was to look into different types of contributions tailored to individual clients. Concrete examples are E&S advice or an energy efficiency check. However, in interviews several clients mentioned contributions that are not individually targeted, but the result of DEG's infrastructure or work approach. It was decided to include these contributions within the scope and refer to them as 'collective inherent contributions'.

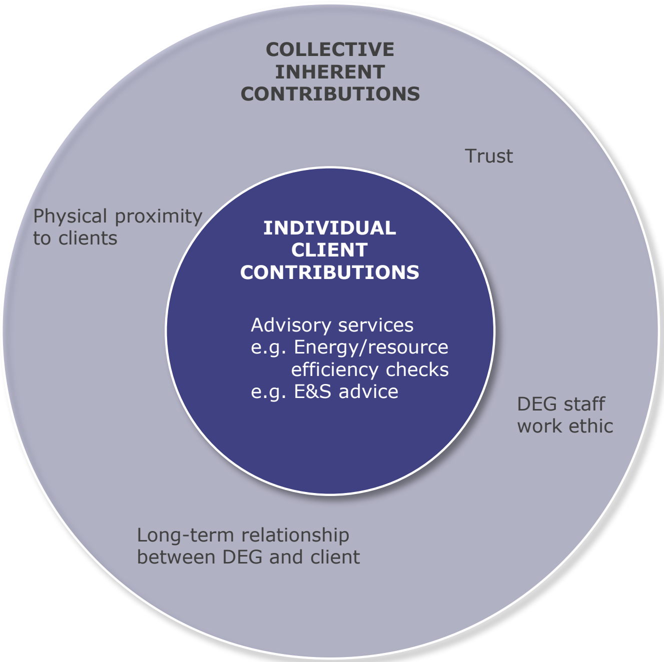


Figure 10: Schematic overview of contributions

[3] It should be noted that the survey actively targeted and therefore preselected clients which had received services beyond financing from DEG.

Therefore we see DEG's contributions as having two layers:

- *Collective inherent contributions*: contributions are not specifically targeted at individual clients that enable the successful delivery of individual contributions;
- *Individual client contributions*: interventions or actions by DEG beyond the financing itself which add value to individual clients.

4.3 THE IMPORTANCE OF CONTRIBUTIONS

Contributions that go beyond financing form a core part of DEG's services to clients, and the customer survey carried out by DEG in 2014 showed that the demand for value adding contributions is increasing. Several clients and DEG staff indicated in interviews that competition in the offering of financing is increasing in DEG's target markets, while DEG does not necessarily offer lower interest rates than other DFIs or local financiers. DEG's loan appraisal process is characterised by several clients as prudent yet conservative and slow, taking more time than average from a client.

At the same time, the survey, interviews and visits showed that clients generally are positive about DEG's services, because DEG takes the long-term view in client relationships and offers additional value adding services to them beyond financing (see figure 11) As one client put it: "*From major commercial banks I receive offers for similar or lower interest rates compared to DEG and the loan is paid out in three instead of nine months. Yet, I still choose working with DEG because of our long-standing, trusted relationship and their advice that goes beyond mere financing*".

This view is echoed in the survey, as 75% of surveyed clients indicate they actually prefer working with DEG because of their ability and willingness to provide value adding services that go beyond financing. This means that contributions provide DEG a competitive edge over other financiers.

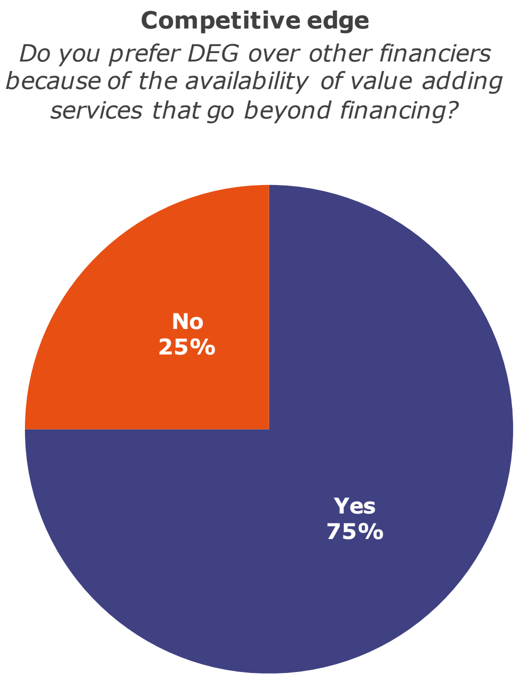


Figure 11: Competitive edge

4.4 COLLECTIVE INHERENT CONTRIBUTIONS

Numerous interviews (both with DEG staff and clients), the client- and DEG surveys and our three case studies confirmed our assumption that building long-term relationships and trust between DEG and clients makes clients more susceptible for contributions. Trust is the fuel for client acceptance and a qualifier for contributions DEG intends to provide. A financier or shareholder can gain most trust and make a real difference for a client at moments when clients are most vulnerable or uncertain, for example by giving assistance during times of crisis or resolving an (ESG) issue that should have been solved much earlier (according to an ESG Action Plan). This trust is further build up through direct personal contact with the client. DEG has a unique local offices network which also helps enabling this personal contact.

4.4.1 Long-term relationship

DEG is generally lauded for its long-term view and described as a loyal partner. Working together for a long period of time leads to trust which in turn leads to a more sustainable relationship, more business for DEG and better chance to add value through higher receptiveness of feedback. Several clients mentioned these aspects even as the most important inherent contributions DEG makes. However, several clients also indicated DEG relationship managers change too often. Like one client asked: *"I have had five different contacts since 2007, how is somebody then able to truly understand my business and my needs?"* Therefore a key recommendation, especially in the current restructuring process, is to actively ensure clients keep the same contact point within DEG as long as possible.

4.4.2 Personal client contact

DEG is equally lauded for its physical proximity to clients through its local offices, which is a differentiator vis-a-vis some of DEG's DFIs peers. Several clients mentioned the personal attendance of DEG investment officers in their board meetings as a sign of genuine interest, commitment and dedication by DEG and the input by board members as the most important contribution. Like one client noted: *"I know DEG has its offices in Cologne, but through DEG's physical presence in my country I consider them as a local financier and partner."* Like long-term commitment, personal client contact also builds trust and hence a more sustainable relationship, more potential business for DEG and higher receptiveness of feedback. Therefore a key recommendation, especially in the current restructuring process, is to consider ways to further strengthen and leverage DEG's local offices.

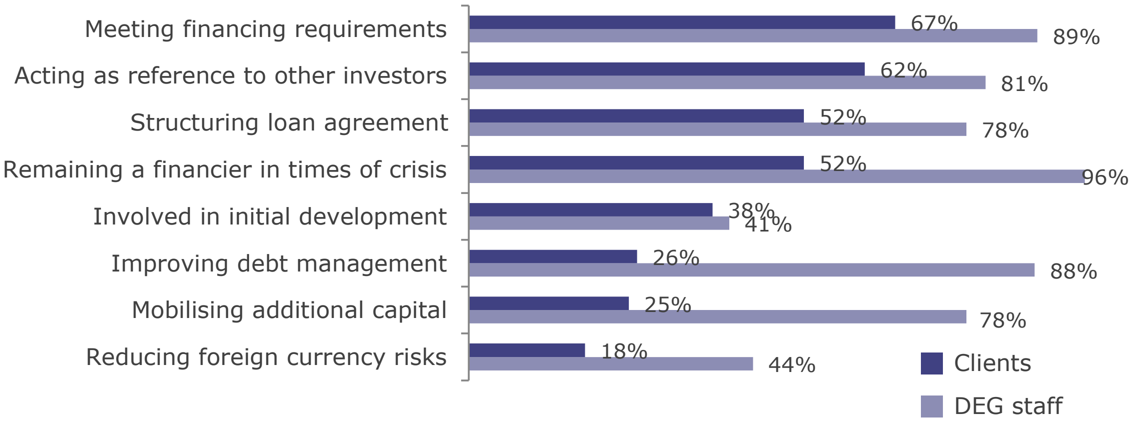
4.5 INDIVIDUAL CLIENT CONTRIBUTIONS

4.5.1 Frequency of contributions

As can be seen in the graphs below, contributions that are closely linked to the initial deal negotiations are the most common financing-related contributions. This also holds true for extra-financial contributions, where E&S advice is most common. Contributions in the portfolio management phase are less common which gives an opportunity for DEG to become more pro-active in this phase. In interviews it became clear that contributions in this phase largely depend on the initiative of individual DEG investment officers.

Financing-related contributions

Do you have experience with the following financing-related services?



Extra-financial contributions

Do you have experience with the following financing-related services?

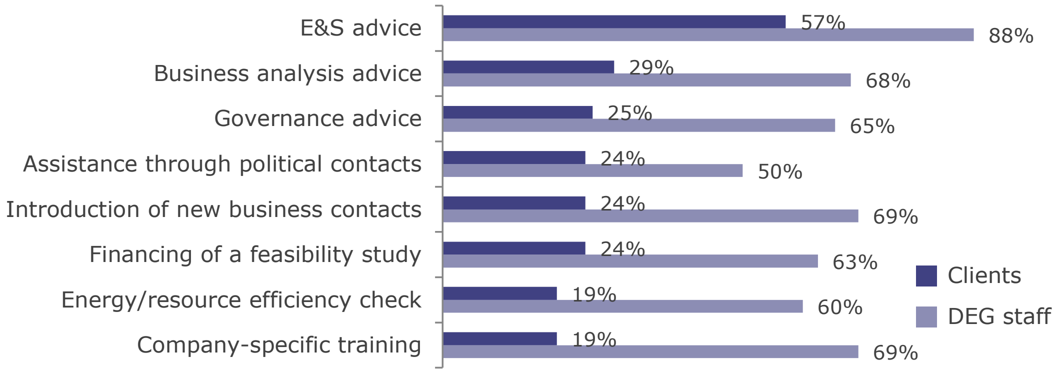


Figure 12: Frequency of contributions

4.5.2 Usefulness of contributions

Surveyed clients consider all DEG contributions helpful, and some even crucial for their business. E&S advice is in general perceived as helpful, but some also identified it as a burden for the company, in case the E&S advice is not sufficiently tailored to their needs. The largest discrepancy between DEG and client perception is around the usefulness of energy efficiency checks. Interviews showed that operational follow-up of these checks is a bottleneck: there is no specific funding to implement recommended measures.

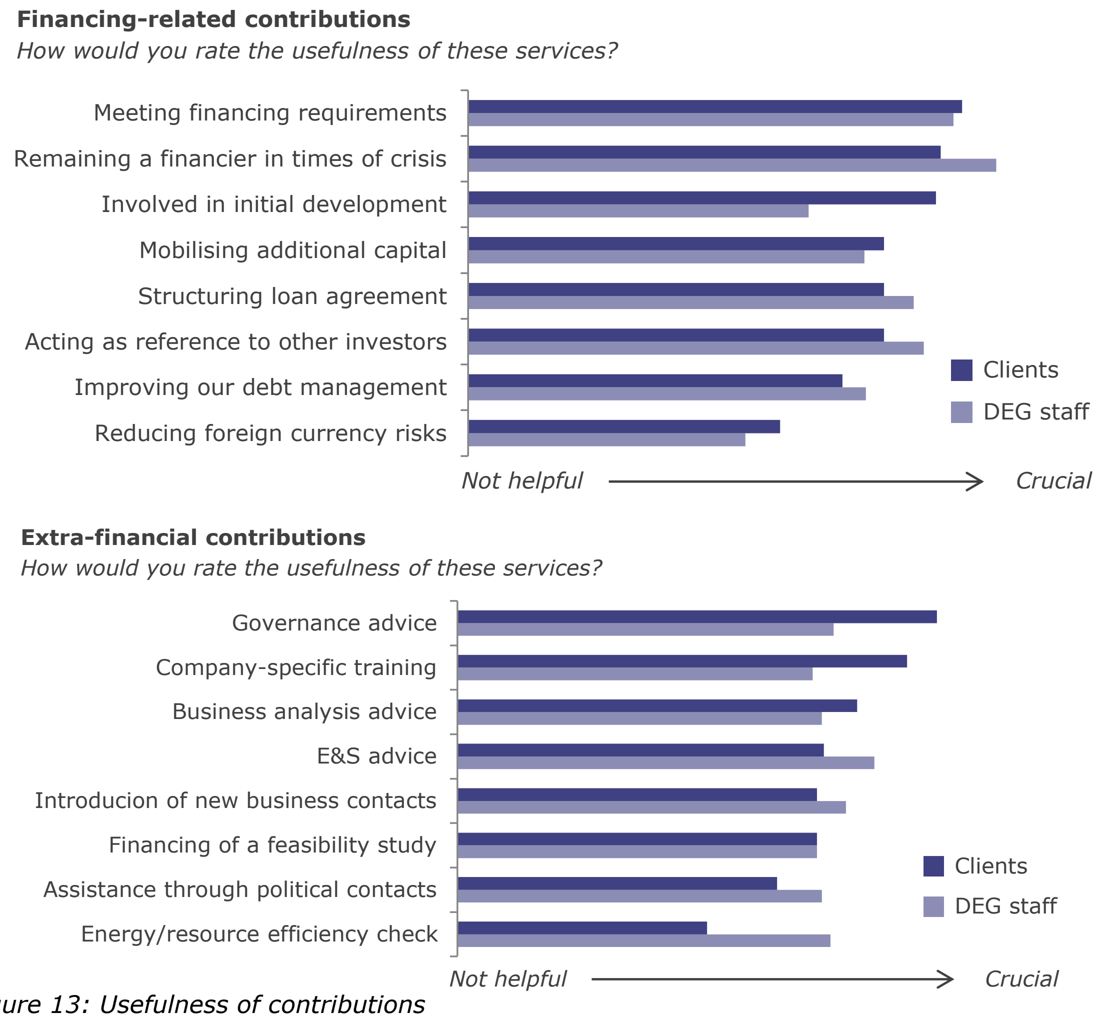


Figure 13: Usefulness of contributions

4.5.3 Quality of contributions

A slight majority of clients consider DEG's contributions better than other financiers' contributions and only 10% rate DEG worse than those from other financiers. The other financiers include local commercial banks and investment funds as well as DFIs. These survey findings were backed up in the interviews, as most clients interviewed rank DEG either at the top position or in the top-2 of their financiers/investors in terms of quality of contributions that go beyond financing. From the different client and DEG interviews and market experience it is concluded that DEG, compared to other DFIs, is perceived as being highly professional in executing services beyond financing.

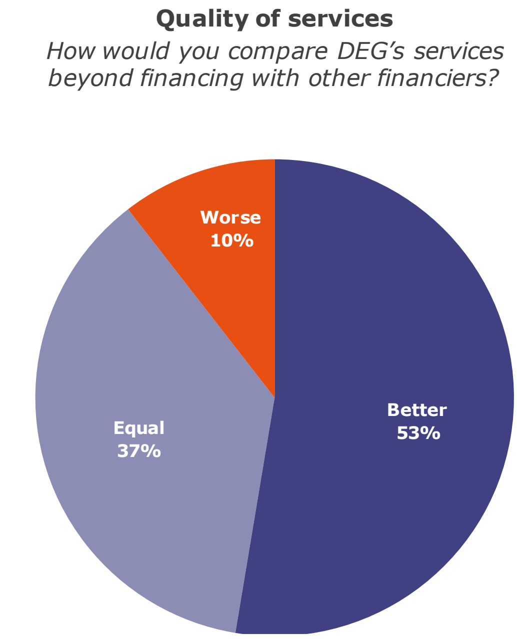


Figure 14: Quality of contributions

4.5.4 Effect on business performance

As shown in the graph below, client respondents directly see a link between DEG's contributions and five important business performance aspects. In interviews, clients indicated that DEG helps attract financing in three ways:

- Active mobilisation;
- Referencing;
- DEG's financing as 'seal of approval' for other potential investors/stakeholders.

Many clients also noted that DEG raised their awareness on the importance of E&S aspects to their business performance.

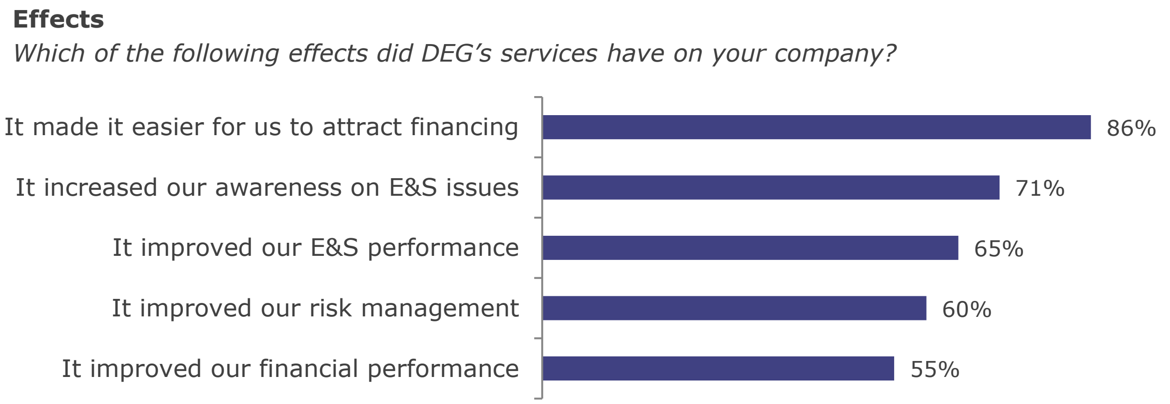


Figure 15: Effects of contributions

The graph below shows the extent to which the effects are attributable to DEG. Although DEG attribution levels differ, for all aspects the improved performance is at least partly attributable to DEG according to at least two thirds of clients.

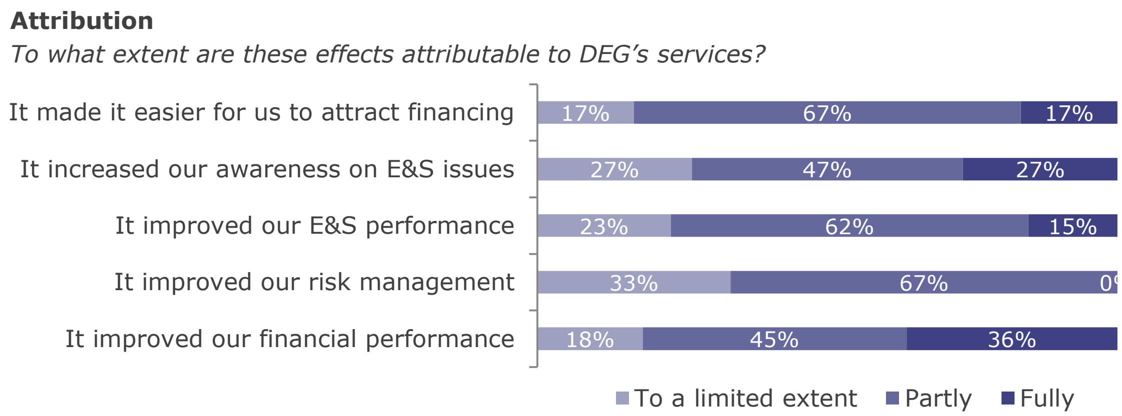


Figure 16: Attribution of effects to DEG contributions

4.6 OPPORTUNITIES FOR IMPROVEMENT

Despite the aforementioned positive responses from clients, there is ample room for improvement in awareness among clients and DEG staff on potential DEG contributions.

4.6.1 Awareness among clients

Roughly 50-60% of surveyed clients who received one or more forms of value adding contributions is not fully aware of the contributions DEG could potentially offer (see Annex H, question 3). This means DEG can and should be more transparent about their potential contributions. And at the same time it is crucial to manage client expectations by explaining that not all types of contributions fit all clients. Matching a potential contribution (in the form of and advice or service) with a particular client in a particular situation needs a customised approach.

4.6.2 Awareness among DEG staff

Whereas all DEG staff members were expected to know all about DEG's potential contributions, in interviews this turned out not to be the case. Several reasons can be identified:

- Lack of formal internal 'menu of options';
- No structured approach to identification of opportunities at clients;
- No formal incentive in personal targets.

4.6.3 Lack of structured approach to contributions

Despite the major importance of value adding contributions for DEG, it is observed that there is no formalised and structured overview of contributions. DEG started to map its contributions in last year's Strategy Review. It is recommended that DEG further refines these efforts in order to come to a 'menu of options' for contributions that can be recognised and used by every (client-facing) DEG staff member. Once completed, the delivery of training workshops on options for contributions would help integrate this practical concept within DEG's operations. By explaining this menu through client case studies, DEG staff will better understand how they can best serve clients with the means and tools that DEG already has in-house.

Interviews and case studies with clients showed that DEG's contributions at clients were initiated on an ad-hoc basis, mostly through the initiative of individual DEG investment officers. Clients also perceived DEG's communication on potential contributions as not always clear. DEG staff confirmed in interviews that contributions are initiated by individual investment officers, mostly during due diligence or during client visits. But DEG staff indicated communication on potential opportunities for contributions were not consistently and clearly communicated between the different departments working with a client (acquisition, structuring, portfolio management). As opportunities are lost here, it is highly recommended to formalise lines of communication on potential contributions between acquisition, transaction and portfolio management departments. A concrete measure can be to add identified opportunities for contributions at clients in the credit proposal.

DEG staff described their most important incentive as to generate the highest possible volume of deals. In general, there are no incentives or performance review aspects on contributions to clients. Introducing incentives to actively identify opportunities to contribute to clients beyond financing would be a clear signal from top management. Thereby, DEG underlines that it takes adding value to clients beyond financing seriously.

This will help to change the mind-set of DEG staff. Therefore the aim of contributing to clients beyond finance should be embedded stronger in DEG's strategy and individual personal performance targets.

	Contribution type	Financing-related contributions	Extra-financial contributions
Individual	**Visible**	• Advice through Board seat • Arranging and/or structuring financing • Mobilisation of third party capital • Umbrella function • Involvement in initial development of company • Taking over of foreign current risks • Improving debt management	• Advice through Board seat • E&S advice • Governance advice • Feasibility studies • Energy/resource efficiency checks • Tailored training • Other technical assistance • Advice on measuring (social) impact • Industry (agri) or theme-related (HR) knowledge sharing
Individual	**Hidden**	• Advice in meeting DEG demands (increasing 'bankability') • Remaining a financier in crisis • Acting as reference to other investors • DEG's financing as seal of approval • Simplification of contracts	• Networking / introduction of new business contacts • Support through political contacts • Business analysis advice • More tailored E&S requirements
	Inherent	• Proximity to clients through DEG's local offices network • Long-term relationship between DEG investment officer and client leading to trust • DEG staff work ethic (e.g. meeting deadlines agreed with clients) • The pro-active stance of DEG staff • DEG's structure in thinking and acting	

Figure 18: Suggestion for mapping of contributions

Here, the recommendation is to simplify the structure of the mapping and recognise collective inherent contributions as a separate category. In figure 18 above a suggestion of this structure is provided in which the following key elements are defined as follows:

- *Visible*: Contributions to individual client through formal or informal agreements such as contracts or TA agreements;
- *Hidden*: Contributions to individual clients that are made on an ad-hoc basis and not formally or informally laid down with the client;
- *Inherent*: Contributions that enable the successful delivery of individual contributions. These contributions are the result of DEG infrastructure or work approach and are not specifically targeted at individual clients.

The contributions in red are opportunities for additional contributions that are not yet provided by DEG. Examples are advice on measuring (social) impact, a field that is emerging rapidly and gaining in importance for companies. Another opportunity is better sharing of the specific sector knowledge built up within DEG. Concrete examples of knowledge sharing could be a newsletter on developments at DEG clients in a particular sector, which may stimulate networking among DEG clients. DEG could look at an FI like Rabobank for inspiration on how to communicate more clearly on specific in-house sector experience.

When asked about potential additional contributions, clients indicated simplification and tailoring of processes would also be major contributions. DEG processes are perceived as thorough, but sometimes also overly onerous or complicated. Clients consider shorter and simpler processes 'contributions' in itself as they would save time and costs for clients. Examples of thorough/complicated processes:

- Due to DEG’s (and other DFIs) strict credit/investment processes the time to complete a deal is perceived by clients as long compared to commercial financiers;
- DEG’s contracts, including its conditions precedent and conditions subsequent, are perceived as a heavy administrative burden;
- E&S requirements are sometimes perceived as insufficiently tailored to clients, potentially leading to higher consultancy costs.

4.7 CONCLUSIONS

Contributions to clients by DEG consist of two layers: collective inherent contributions and individual client contributions. The most important collective inherent contributions are long term relationships and personal contact between DEG and clients. These are a qualifier for trust and a trustful relationship makes clients more susceptible for individual contributions.

The research results shows the major importance clients attach to these contributions:

- Contributions give DEG a competitive edge over local financiers;
- All different types of individual contributions are well-appreciated and generally considered better than peers;
- A majority of clients directly links DEG’s contributions to improved performance aspects.

The customer survey carried out by DEG in 2014 showed that the demand for value adding contributions is increasing.

Despite the crucial role of contributions, there is ample room for improvement in DEG’s approach to these contributions:

- There is a lack of full awareness about DEG’s contributions among most clients and some DEG staff;
- There is no formal structured internal overview of different types of contributions;
- There is no structured approach to identify opportunities for contributions at clients;
- There are no formal incentives for DEG staff to actively assist clients.

These points hamper DEG’s ability to provide value adding contributions to clients.

4.8 RECOMMENDATIONS

There are two main recommendations and several concrete actions that would improve DEG’s value adding contributions to clients.

1. DEG should preserve and cherish long-term client relationships and personal client contact. Concrete actions to accomplish this are to:
   a. Assign DEG investment officers as long as possible to individual clients;
   b. Further strengthen and leverage DEG’s network of local offices for face-to-face client contacts.

2. The introduction of a more structured internal approach to contributions would help DEG to make better use of their potential added value to clients. Concrete actions to structure the approach are:
   c. Introduce an internal 'menu of options' for contributions;
   d. Organise workshops/training on options for contributions with successful case studies;
   e. Formalise identification of opportunities for contributions (e.g. inclusion section in credit proposal);
   f. Formalise lines of communication on potential contributions between acquisition, transaction and portfolio management departments;
   g. Formalise incentives to contribute beyond financing in personal performance targets.

5. CONCLUSIONS

DEG is increasingly faced with the challenge to define what it considers sustainably successful clients[4]. DEG wants to know how it can best contribute to this success and how it can adequately monitor and measure both sustainable client success and its contributions to clients. Therefore DEG commissioned a study with two objectives:

1. define and assess the sustainable success of DEG clients;
2. research how DEG contributes to this success;

Based on six layers of quantitative and qualitative analysis, this study provides findings, conclusions and recommendations for DEG in these fields.

The study showed that the notion of ‘sustainable client success’ is not yet firmly embedded within DEG. Formulating a definition therefore triggers a discussion within DEG on how sustainable client success is perceived, how it should be measured and how specific data supports investment decision-making within DEG. The application of a model that quantifies the extent to which a client can be labelled as a sustainably successful company showed that data unavailability and quality within DEG are serious constraints for reliable decision-making based on data.

The study also found that DEG contributions to clients are perceived by both clients and DEG staff as value additions, but that there is an untapped potential to apply DEG contributions more often to tackle specific client challenges. A key reason for this is the fact that DEG lacks a ‘menu of options’ for potential contributions. This menu would help to bring alignment with the existing DEG investment process and give DEG staff insight in what situation which contributions could be applied. DEG contributions can be a great force in further building trust with clients, which, in turn, will help build sustainable DEG-client relationships and can lay the foundation for sustainably successful businesses.

Please note that detailed conclusions can be found in chapters 3 and 4.

[4] A DEG client is a party that has received finance from DEG in the form of a loan, an equity investment or another financial product or a combination of these.

6. RECOMMENDATIONS

Looking forward, DEG needs to better understand potential links between on the one hand DEG's actions and inherent contributions and on the other hand sustainable client success. For this purpose DEG should work further on a holistic approach (see figure below) in which it tries to link types of contributions with aspects of sustainable client success.

A better understanding of links between contributions and sustainable client success will help DEG to move from the current ex-post analysis (measuring what happened with clients and how DEG contributed to this) to an ex-ante analysis that estimates potential for sustainably successful clients. In case it is possible to establish interlinkages between contributions and sustainable client success it might be possible to tailor contributions to help improving particular aspects of sustainable success at DEG's clients. As a next step, DEG can then start identifying and measuring how DEG contributes to development impact through the sustainable success of clients.

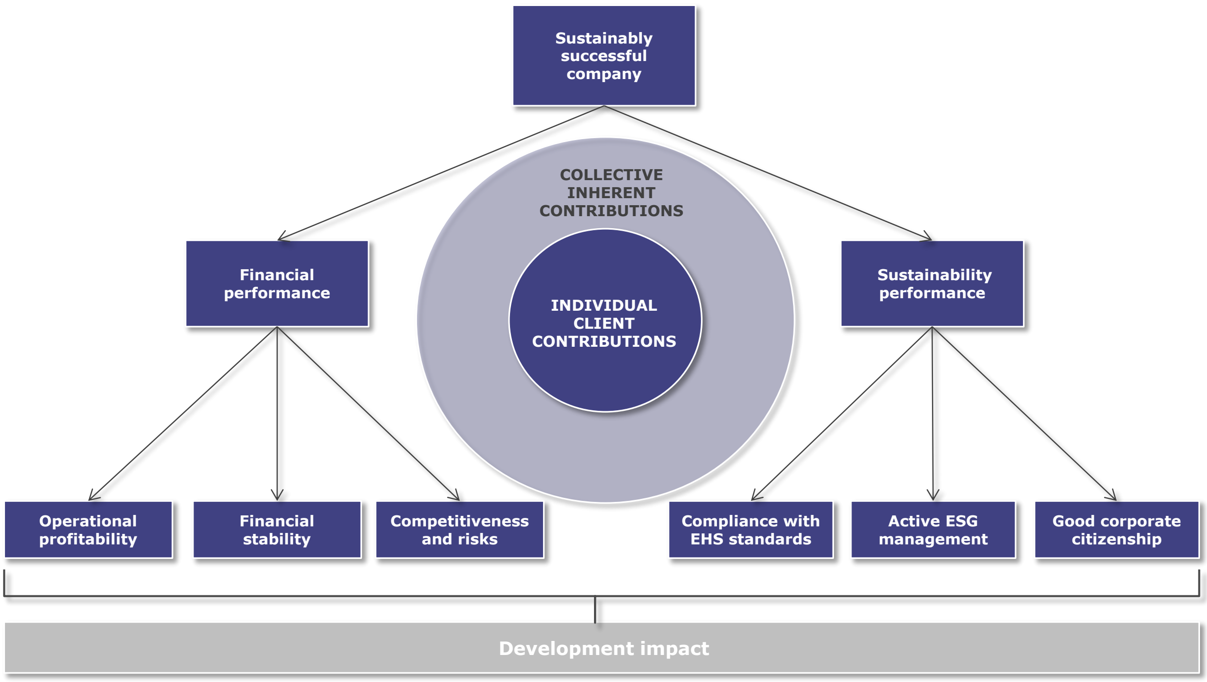


Figure 27: DEG contributions and sustainable client success

Please note that detailed recommendations can be found in chapters 3 and 4.

ANNEX A: CASE STUDY OHORONGO CEMENT (NAMIBIA)

EXECUTIVE SUMMARY

Ohorongo Cement provides a good example of DEG's contribution to the successful expansion of a German company (Schwenk Zement), while at the same time supporting the establishment of a new African company. It also exemplifies DEG's long-term partnership with clients, as DEG remains financing partner of Ohorongo, providing a portion of the corporate loan which was agreed in 2015 to replace the first project-based funding. From its state-of-the-art plant in northern Namibia, Ohorongo Cement has within four years established itself as a major producer and reliable supplier of high quality cement to Namibia. Ohorongo has considerable development effects, notably by providing direct and indirect jobs in a structurally weak region and by offering nationally produced high quality cement. It is also pioneering through the use of woodchips as fuel for its production process.

INTRODUCTION

Company background

Ohorongo Cement (PTY) Ltd. ("Ohorongo") is a cement manufacturing company located near Otavi in northern Namibia. It is the first and currently only cement producer in Namibia. All raw materials required for the production process are sourced in Namibia and the entire value chain takes place within the country. Ohorongo holds a significant market share in Namibia and also produces for export to clients in the southern Africa region.

Overview of the Ohorongo production plant

Ohorongo was initiated and founded by Schwenk Zement KG ("Schwenk"). Schwenk is a family-owned business with 160 years of experience in cement production. It currently is one of the large cement producers in the German market, operating four plants. Schwenk also holds stakes in plants in Hungary and Bosnia-Herzegovina and is a leader in the use of alternative fuels.

Local sourcing of limestone, shale and marl next to the Ohorongo plant

In 2008, Schwenk decided to invest in Namibia. The construction of the plant started in 2009 and was completed in a record period of less than two years, with the first cement produced in December 2010. The plant was developed and constructed by German company Polysius (today ThyssenKrupp Industrial Solutions) with which Schwenk has a long-standing relationship. A value of approximately 12% of the total investment was spent on infrastructure (buildings, roads, etc.), constructed by local, Namibian companies.

The location of the plant was chosen due to the deposits of limestone, shale and marl which are adjacent to the production site. Under the current production capacity, the limestone deposit yields sufficient raw material to produce cement in this factory for another for 300 years. The plant is directly connected with a railroad track, offering the opportunity to transport cement within Namibia but also to the port city Walvis Bay for export.

With the construction of the plant, Schwenk took a long-term view. It ensured that Best Available Technology was used, despite the fact that this increased construction cost. As a result, the Ohorongo plant is now considered one of the most modern cement plants in Africa. In addition, it has a pioneering programme to use alternative fuel for thermal energy in the production process.

THE INVESTMENT

Background

The total investment sum for development and erection of the plant was EUR 249.8 million, of which EUR 131.8 million was earmarked to be financed with long-term bank loans. The rest of the financing was arranged through shareholder equity and a subordinated construction facility loan by the shareholders to cover start-up costs and as contingency.

Schwenk initially was the sole shareholder, but sold part of the shares to international, but also regional and national development banks to give local shareholders the opportunity to participate. The shareholding structure now is the following: Schwenk (70%), the Industrial Development Cooperation (IDC, 16%), the Development Bank of Namibia (DBN, 9%) and the Development Bank of Southern Africa (DBSA, 5%).

While Schwenk also spoke to commercial banks for the long-term financing, it had a preference to acquire finance from development banks due to the political support they could provide as well as their experience in doing business in Africa. After a first meeting between the chairmen of DEG and Schwenk in 2007 there was a lengthy negotiation process, and it took almost two years until the loan agreement was completed and the first disbursement took place.

The deal

In 2009, DEG provided EUR 31.5 million financing in conjunction with EIB (EUR 82.3 million) and DBSA (EUR 18 million). The loan had a maturity of 10 years plus 3 years of capital grace. As part of the deal, Ohorongo was obliged to employ 50% of excess cash flow for mandatory prepayment of the long-term loans. The security package was solid and included mortgages/pledges on shares, land, buildings, the plant, all movable and non-movable assets, the mining licence as well as guarantees by the shareholder (Schwenk). DEG was mandated to coordinate the consortium of long-term lenders as facility agent.

The Ohorongo head office at the plant

At the end of 2013, Ohorongo repaid a substantial part of the initial project finance loan by EIB, DEG and DBSA to provide the basis for a corporate loan that would better suit the operating challenges compared to the previous rigid project loan funding. In 2015, DEG agreed on a new corporate loan with Ohorongo, replacing the first project finance loan. Through this loan, DEG provides EUR 30 million with a maturity of 7 years and remains a long-term lender to Ohorongo, alongside Namibian Banks.

Rationale for investment

DEG decided to finance the project as it matched several of DEG's strategic goals. Through its financing, DEG supported a medium-sized German company in its international expansion, while at the same time enabling the establishment of a new African company. With regard to Ohorongo's role in development, DEG's planning data listed the following development effects:

- *Create jobs*: 300 direct jobs and another 300 indirect jobs (realized were 2,700) in a structurally weak region of Namibia;
- *Import substitution*: conversion of Namibia from a cement importing into a cement exporting country;
- *Macro-economic effects*: being the largest industrial investment in Namibia outside the mining sector, positive effects are visible for the state budget and the trade balance;
- *Technology transfer*: transfer of Best Available Technology.

This case study shows that Ohorongo achieved or exceeded these planning data.

COMPANY PERFORMANCE

As a result of the state-of-the-art facilities and quality raw materials, Ohorongo was able to produce cement of consistently high quality. It also proved to be a reliable and rapid supplier. The excellent feedback from individual customers and industry associations helped to establish a good reputation for Ohorongo right from the start. A challenging start-up phase from a sales point of view, especially during the first two years, could be resolved. Missing export markets could be offset by higher sales within the Namibian market.

Domestic market

Prior to the establishment of Ohorongo, the Namibian cement market was mainly supplied by South African cement producers and imports from overseas (Asia). A large proportion of the demand is generated in the greater Windhoek area, Walvis Bay, Swakopmund and northern parts of the country. Given the distance from production plants, it was challenging for the producers in Asia and South Africa to deliver cement to these markets.

Cement production at Ohorongo

Ohorongo's cement quality and competitive prices forced the South African cement producers to gradually retreat from the Namibian market. However, other importers increasingly targeted the Namibian market, offering cement at lower prices. In the beginning, Ohorongo expected to be protected against imports through the Infant Industry Protection Act (IIP), a tariff agreement by the Namibian authorities to support domestic industries. However, although the IIP was confirmed for the Namibian Industry (that Ohorongo is part of) and an import duty was imposed, it has until now not been enforced due to a pending court case.

Three main types of cement are available in bags and bulk

A strong growth of the domestic market supported the economic development of Ohorongo, as the demand for cement increased by more than 60% from 2010 to 2014. The increase resulted from a stable political and economic climate (5% annual GDP growth since 2010), increased government spending on infrastructure (e.g. new port development near Walvis Bay), rapid growth of commercial real estate and major industrial investments (e.g. development of a new gold mine near Ohorongo's plant).

Export market

Ohorongo's business plan also relied on export markets, of which southern Angola was the main one. Other potential export markets include north-western Botswana, south-western Zambia and exports to markets further away through the port of Walvis Bay. Whereas the domestic market developed favourably, Ohorongo faced unanticipated severe difficulties in penetrating international markets.

This was particularly the case in Angola, where cement production almost tripled since Ohorongo became operational, predominantly as a result of a new production line of the China International Fund (CIF) cement plant in Luanda that became operational in 2014. Therefore, compared to the original business model, exports to Angola were much lower than planned.

Export is possible by road and railroad

While there is some export to other countries (Botswana, Zambia and the new airport on St. Helena), the situation in Angola has a significantly negative impact on Ohorongo's export business. Instead of an anticipated 55% export quote, Ohorongo now exports only around 10% of its cement.

Environmental and social aspects

Raw materials being burned to clinker

Ohorongo is classified within DEG as B+ (environment), B+ (social) and G0 (gender) based on an external environmental and social impact assessment. An action plan has been agreed with the company. Ohorongo obtained ISO 9001:2008 (quality management system) and ISO 14001:2009 (environmental management system) certifications in October 2013. Different regular internal and external audits are performed to ensure adherence to the standards as well as to identify opportunities for improving the company systems and processes. As the cement sector alone is responsible for 5% of worldwide carbon emissions resulting from human activity, it is crucial that plants are built as environmentally-friendly as possible. The Ohorongo plant is designed with several features of Best Available Technology:

- *Mills*: the use of roller mills instead of ball mills leads to a higher efficiency of the grinding process (up to 30% electricity savings compared to ball mills);
- *Precalciner*: air staging and meal splitting in the precalciner reduces

The use of a roller mill saves energy

mono-nitrogen oxides (NOx) emissions by up to 50% compared to traditional cement plants;

- *Cooling process*: the use of air quenching instead of water conditioning to cool down the waste gas saves up to 220m³ water per day;
- *Filters*: the most modern bag house filter technology minimizes dust emissions;
- *Clinker cooler:* a better efficiency of heat recovery is realized with the installation of a roller crusher between the recuperation and cooling zone.

Ohorongo applied for carbon credits (CERs) for the emission reductions achieved through the construction of the cement plant. Up to today, the applications were rejected following the argumentation that there had been no baseline for the improvement. This argument has been irritating to Ohorongo, as the company provided best available technology right from the start of operations, including the use of alternative fuels (see next section on woodchips).

Energy for Future Programme

Ohorongo is pioneering with a unique alternative fuel initiative. Under the name Energy for Future (EFF), the company is running a programme to use woodchips as alternative fuel for the kiln. Generally, the plant is equipped to replace up to 80% of coal, the original provider of thermal energy for the kiln. EFF is set up as a separate company and has raised attention in different parts of the world. A notable example was the invitation to present EFF at the Rio+20 conference held in Brazil in 2012.

The rotary kiln at the Ohorongo plant

As alternative fuel, woodchips from bushes of farms within an economically reasonable distance of the plant are used. This scheme offers shared value for Ohorongo, the environment and local farmers. For Ohorongo, it presents an alternative fuel for its kiln. At the same time, using woodchips is beneficial for the environment, as it replaces coal, which emits more CO2.

In addition, it increases the productivity of land for farmers. The woodchips are made from encroacher bushes. These bushes are a major problem in Namibian agriculture, as their presence leads to a drastic fall in the agricultural potential of the land. Debushing increases the productivity of rangeland by restoring grazing potential, increasing ground water availability and thereby improves beef production. There are strict rules to keep larger

Coal and woodchip supplies at the Ohorongo plant. EFF enables Ohorongo to replace coal by woodchips

bushes/trees intact in order to provide natural protection for animals.

CHALLENGES

Ohorongo faces five main challenges in consolidating and expanding its success:

Ohorongo's production process requires qualified workers

- *Retaining a leading position in the domestic market*: Ohorongo established itself as a reliable producer and supplier of high quality cement in Namibia. However, if importers are able to further lower their prices, this might pose a threat to the company. The upcoming court case on the Infant Industry Protection Act will be important in this regard;

- *Expanding exports*: cement demand is currently at a high level in Namibia, but it is uncertain if it will remain at this level. Ohorongo's dependence on the Namibian market is risky and the company's current priority, therefore, is to expand its exports;

- *Retaining workforce*: due to the large mining industry and relatively low level of education in Namibia, there is a high demand for qualified technical workers. It is therefore challenging to retain the workforce in this competitive environment;

- *Power supply:* even if an emergency power supply was installed, a continuous and sufficient power supply at adequate prices is essential;

- *Optimising debt*: the long-term loan with DEG, EIB and DBSA was a heavy burden for Ohorongo. The relatively high margins and obligation to use excess cash flow for repayment restrained the further development of the company. The main shareholder therefore decided to repay a substantial part of the loan and replace the project finance loan by a corporate loan which better reflects Ohorongo's going-concern situation.

DEVELOPMENT IMPACT

Ohorongo has substantial positive development effects, with a particularly large impact on the Otavi region and additional benefits for Namibia and the wider southern Africa region.

99% of the Ohorongo employees are Namibian

Otavi region

The Otavi region is one of the structurally weak regions in Namibia, with a lack of employment opportunities and infrastructure. The establishment of Ohorongo has realised several important development effects:

- *Direct jobs*: Ohorongo directly created 331 permanent jobs, 286 of which are located at the plant and 45 at the headquarters in Windhoek (excluding the EFF programme);
- *Indirect jobs*: the company estimates that it supports around 2.700 additional jobs in third companies. Ohorongo has actively helped to establish several SMEs as suppliers, for example a pallet business, a personal protective equipment (PPE) manufacturer and a gypsum producer;

Local businesses benefit from Ohorongo's presence

- *Income*: both the direct and indirect jobs have increased the purchasing power in the region, substantially improving the local economy;
- *Technology transfer*: only new equipment was installed and together with the use of Best Available Technology at the cement plant, Ohorongo can be considered one of the reference projects within the whole Southern African region. In addition, there was an employee training programme at Ohorongo in which the company invested heavily, for instance by arranging internships for 60 workers at one of the four Schwenk plants in Germany during the construction phase of the plant. During operation, a well-established employee training programme remains in place;
- *Healthcare*: Ohorongo has an own doctor on-site and financially supports a hospital;
- *Ohorongo Otavi Community Trust*: the company established a trust fund with the purpose of contributing towards the wellbeing of the community of Otavi. Concrete examples of activities include a sports development programme, exchange of medical knowledge, training of teachers and support for people with disabilities;
- *Debushing*: the EFF assists local farmers in increasing the productivity of their land.

Namibia

The project is the largest industrial investment in Namibia outside the mining sector and realised substantial positive development effects for the country:

- *Macro-economic*: Ohorongo is estimated to contribute at least 1% to the Namibian GDP;

- *Import substitution*: the company changed Namibia's 100% reliance on cement imports to become an almost self-sufficient producer of cement;

- *Whole added value process within the country:* not only raw material production but also the whole manufacturing process takes place within Namibia, with all corresponding positive effects for the country.

DEG's CONTRIBUTION

Contribution to/during first investment

DEG had an important role in the establishment of Ohorongo, as it provided part of the funding required to construct the plant in a risky market just after the 2008 financial crisis. However, the long arrangement phase and the financing terms in the end proved to be rather strict and a heavy burden on the development of the company. Despite the securitisation of all its assets and the corporate guarantee by Schwenk, the consortium of lenders demanded a margin which Ohorongo considers too high. The company felt it was forced to accept the terms, as the construction contract with Polysius was already signed and it was a difficult lending climate (right after the collapse of Lehman Brothers in 2008). DEG did fulfil an important role as facility agent on behalf of the consortium of long-term lenders.

Second loan

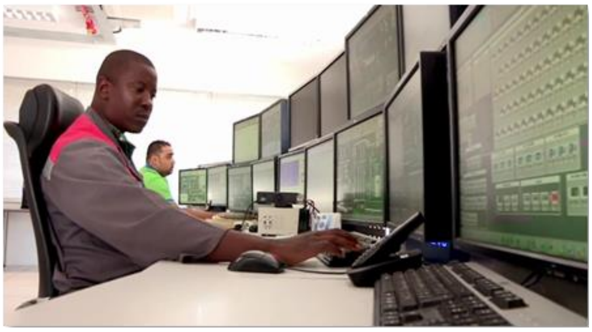
DEG played an active role in facilitating the transition from a project loan to a corporate loan. These efforts, along with DEG's signalling function and ability to provide technical assistance led Ohorongo to conclude a portion of the new corporate loan with DEG in 2015. This means that DEG remains a provider of long-term finance to the company.

DEG's added value

DEG provided two important contributions to Ohorongo:

- *Network:* DEG was able to support through its connections and the long lasting relationship with Namibian institutions;

- *Technical assistance*: DEG currently finances up to 50% of the construction and establishment of a simulation and training centre. The training of supervisors and control room operators is a major challenge, as Ohorongo is currently the only cement producer in Namibia, and the skills and knowledge – also needed by other companies like mines – can only come from a combination of simulation


Control room operators at the Ohorongo plant

and on-the-job training. The training programme helps the company tackle one of its most pressing challenges, while also transferring knowhow to local workers.

Less tangible, but also important to note is that Ohorongo's management sensed that DEG on several occasions put in efforts to soften the strict position that its co-lenders held on the terms and conditions of the project finance loan.

ANNEX B: CASE STUDY AMINOAGRO (BRAZIL)

EXECUTIVE SUMMARY

In August 2013 DEG invested in Aminoagro, a Brazilian micronutrient fertiliser company. The case of Aminoagro exemplifies DEG's ability to co-invest alongside a local private equity fund, Brazilian agribusiness-focused fund Aqua Capital in this case. DEG holds a direct and an indirect stake in Aminoagro: directly through its joint investment with Aqua and indirectly through DEG's commitment to the fund. In addition, Aminoagro provides a clear case example of the transformation process a company has to go through from being a family-owned business to a formally run company. Driven by Aqua, a professionalization plan was rolled out right after investment and is implemented at a high pace. The roll-out of the plan changed the company in many aspects. While positive results are clearly visible, the process also has its challenges. DEG holds a Board seat in Aminoagro, and actively contributes to the company with boardroom advice and technical assistance in the field of E&S.

INTRODUCTION

Aminoagro

Founded in 2001, Brazilian company Aminoagro is a manufacturer of micronutrient fertilisers. Micronutrients are essential for plant growth and play an important role in balanced crop protection. Micronutrients can be applied through soil application (by mixing them with regular fertilisers) or through foliar sprays. Aminoagro specialises in higher value foliar fertilisers. Its foliar fertilisers are applied across grains, oilseeds, vegetables and fruits, and it is a leading producer of bio-stimulants.

Aminoagro has one of the most complete product ranges in Brazil's foliar fertiliser market, which is estimated at around BRL 1.800m (USD 600m) in annual sales. In addition to diversified micronutrients (such as boron, copper, iron and manganese), it specializes in biostimulants such as amino acids and seaweed extracts, which are combined according to innovative formulas developed by the company. While revenues in this high value added part of this segment have grown in double digits annually over the past decade, the market is still emerging. Penetration is estimated to be just over a quarter of the potential market size.

A soy field with Aminoagro's foliar fertlisers

The foliar fertiliser segment within the micronutrient market is highly fragmented. There are over 50 registered foliar fertilisers companies, but fewer than 20 have certified products, rigorous product development and integrated manufacturing processes. Aminoagro currently has a 3% market share, and the objective is to become a top-3 player in the market through organic growth and/or acquisitions. Aminoagro established its current production plant in 2007 in Cidade Ocidental, located just south of Brasilia in the state of Goiás. The location provides easy access to the growing Central West, North and Northeast agricultural regions of Brazil, and benefits from a lower tax regime. Recently it established a new head office in Idaiatuba (near Sao Paulo), close to Brazil's main R&D centers for micronutrients.


Aminoagro's production plant in Cidade Ociental

The plant is fully vertically integrated. Its activities range from chemical processing and mixing to packaging and transportation (the company has an own fleet of 12 trucks). This enables the company to capture value along the entire production and distribution chain, deliver faster than competitors – especially useful during peak harvest – and have full control over the production process.

Aqua Capital

DEG co-invested in Aminoagro with Aqua Capital, a Sao Paulo-based private equity fund. Aqua targets mid-sized, often family owned companies in the secondary agribusiness and food value chain. This means that the fund does not invest in primary agribusiness such as farmland, but sectors such as food processing, logistics, agri equipment, animal nutrition, crop protection or seeds. These sectors show high growth potential but are fragmented and have insufficient access to equity or quasi equity finance. Its geographic focus is primarily on Brazil, but also includes neighbouring countries.

DEG is an anchor investor in Aqua, having committed USD 12.5m at first close in May 2012 (total fund size USD 173.4m). Within DEG's portfolio, Aqua is the only agribusiness fund in Latin America, a sector with strategic importance to global food production. Other LPs in the fund include Latin America-focused development banks IDB and CAF. DEG expected Aqua to grow and professionalise companies (including improvement of ESG standards), consolidate markets and create jobs.

DEG also committed to Aqua in order to gain access to mid-market companies that otherwise would be hard to reach. It therefore secured preferential co-investment rights. DEG also holds an observer seat in Aqua's investment committee, which is actively used by an investment manager of DEG's local office in Sao Paulo.

THE INVESTMENT

Background

Aminoagro was 83.5% owned by a family (consisting of nine siblings) and for 16.5% by Ricardo Carreon, founder and the company's current CEO. The family did not actively focus on Aminoagro and used the company's balance sheet for financing other businesses. This withheld Aminoagro from using its positive cash flow for investment in new products, despite concrete plans (e.g. for products in the biotechnological space) and available land for expansion of the plant.

The deal

This situation of suppressed growth potential was frustrating for CEO Ricardo Carreon and Aminoagro as a whole. He therefore persuaded the family to sell its stake in the company, to which it reluctantly agreed. Through an external advisor appropriate investors were sought and an Aqua-led consortium (which included DEG) proved to be a good fit, alongside two other serious candidates. The consortium was selected as a result of its know-how and ambition for the company, despite not offering the highest investment amount.

The investment was made through an SPV consisting of Aqua, DEG and a third co-investor (Quilvest, also a fund LP). Together they form a holding company that controls 86% of Aminoagro. CEO Ricardo Carreon holds the remaining 14% stake in the company. DEG committed BRL 16.9m (equivalent USD 5.6m), through which it de facto holds a 24% stake in Aminoagro (albeit indirectly through the holding). Aqua has control over the holding company, but DEG has customary minority rights.

Rationale for investment

DEG decided to invest as the investment would enable the company to grow and have a more efficient management. Together with Aqua and Quilvest, DEG was able to provide scarce equity funds to a local, medium-sized business with a large client base in less developed regions of Brazil. DEG also had the opportunity to actively contribute to the company with financial, commercial and sector know-how.

Aminoagro stand at an exhibition

In addition, DEG expected Aminoagro to have positive development effects:

- *Improve food security*: Aminoagro's fertilisers increase agricultural productivity;
- *Create jobs*: it was expected that the company would double its employment;
- *ESG*: DEG had the opportunity to add value to the company by improving ESG standards.

PROFESSIONALISATION PROCESS

Before investment, Aminoagro already was a stable, steadily growing and relatively well-run company. However, most management processes were executed in an informal way. Therefore the investors laid down a professionalization plan, for which implementation started right after investment. Most measures were implemented in the second half of 2013 and 2014, under a combined 180-day plan, which was followed by an annual business plan based on a long-term value creation plan. The professionalization process entails changes in management and organisation, commercial operations, finance and control, supply chain management and environmental and social management.

Three zones of the Aminoagro plant: mixing, packaging and storage

Management and organisation

Aminoagro was managed relatively well, albeit rather informally from its plant in Cidade Ocidental. There was a heavy reliance on the company's CEO, as there was no CFO, COO or dedicated R&D function. There were no formal board meetings and no formal business planning. After investment, the following operational measures were taken:

- *Senior management*: the investors recruited a new CFO, National Sales Manager and R&D manager, while one of the Directors at Aqua became Aminoagro's COO;
- *Head office*: a new head office was established for Aminoagro in Indaiatuba, a city around 100 km northwest of Sao Paulo. Senior management, sales, business development and part of administration were moved there. There were several reasons for the move: better ability to attract and develop talent, greater proximity to Brazil's R&D centres for micronutrients as well as financial institutions and easy access to Campinas airport;
- *Board meetings*: bi-weekly executive team meetings, monthly finance meetings and formal board meetings were introduced;
- *Business planning*: a first formal business plan was written and a new enterprise resource system (ERP) was developed, which is currently being implemented;
- *Human resources*: a people management system was rolled out with objectives for key persons which are linked to performance-related compensation;
- *Formalization*: all functions were formally contracted (as opposed to informal labor contracts prone to litigation and low employee loyalty). Through careful implementation under a profit-sharing mechanism, a lower tax basis was obtained.

- *Cultural transformation*: Aqua implemented, with support from an external consultancy, a management system which broke down the company's objectives into team and individual goals for all three top management team levels. The program went as far as aligning compensation at the individual level, and generating an on-going methodology to communicate progress, correct issues and improve performance.
- *Risk management*: an external consultant reviewed all major operational risks.

Commercial operations

A well-trained and geographically spread salesforce is crucial to the success of Aminoagro. The salesforce forms the bridge between the company, its distributors (e.g. specialised agri equipment stores) and clients directly. The sale of Aminoagro's products is highly technical and clients first like to test the effects of the fertilisers on crops through field trials, which takes time. Therefore the members of the salesforce need to be highly skilled agronomists. The salesforce is spread out throughout Brazil, in order to be close to clients. Ramping up this salesforce was a key action after investment:

- *Salesforce*: the salesforce was expanded from 2013 to 2015 from 21 to 70 members and changes were made to the structure, composition and compensation. The salesforce now consists of a National Sales Manager, five Regional Sales Managers, 43 Technical Sales Representatives and 21 Assistant Technical Representatives;
- *Field trials*: the (free) field trials are key to converting farmers into customers over successive crop cycles. The number of field trials was dramatically increased from around 200 to a total of 782 in 2014, and their quality improved through careful planning, results measurement and accountability;
- *Distribution*: the distribution network was increased from 70 to over 90 independent distributors throughout Brazil. Underperforming channels were cut and the profile of the new channels consists of larger, more professional firms;
- *Education*: in order to ensure quality of the sales team, the "Aminoagro School" was established, delivering over 60 hours of lectures to salesforce members.

Map of the salesforce throughout Brazil

Supply chain management

Aminoagro sources 80-90% of its basic raw materials such as manganese and potassium from China. The remainder is imported from countries including Canada (seaweed), Germany (boron), the United States, Russia, Argentina and Brazil itself. As most of the company's working capital is required for sourcing materials, several

Examples of raw materials: potassium from China and seaweed from Canada measures were taken to optimise supply chain management:

- *Credit terms*: credit of 90+ days was negotiated with most suppliers;
- *Inventory*: more tight inventory management was put in place;
- *Logistics*: increased focus on most economic logistics and port of entry.

Finance and control

In the field of finance and control the company had to transform from a family business with informal financial controls and no third party audits to an organisation with a fully professional finance department. The following measures were taken:

- *Financial management*: under a new CFO better cash flow tracking and more formal and consistent financial reporting were introduced;
- *Financial audit*: Deloitte was selected as auditor, the first full-year audit is currently being finished;
- *Debt optimisation*: the debt tied to the previous owners was paid off and credit lines were finalised with leading banks (e.g. Santander, Citibank), reducing net debt levels as well as average cost of debt;
- *Fiscal optimisation*: the company's tax benefit plan with the state of Goias (Plano Produzir) was extended until 2040. With the aim of supporting Goias-based businesses, Plano Produzir reduces sales tax from 20% to 4%.

Storage tanks at ESDD: without containment wall

Storage tanks during visit: with containment wall

Environmental and social

Aminoagro is categorised by DEG as B+ (environmental), B (social) and G0 (gender). DEG assisted Aminoagro with its E&S management by financing part of the environmental and social due diligence (ESDD). The main environmental and social (E&S) aspects identified are related to hazardous chemicals, air and wastewater emissions, water consumption, fire risks and possible soil contaminations. Other E&S aspects are energy and resource efficiency, OHS, solid waste management, labour and transportation risks.

Before investment, there was a lack of some environmental and social permits, while there were improvement opportunities in the treatment of wastewater. Aminoagro only had basic environmental, human resource and OHS management systems, although its dedicated plant manager controlled most aspects in an appropriate manner. Following up on recommendations of the ESDD (which was initiated and funded for 50% by DEG), Aminoagro took the following measures:

- *Responsibility*: the plant manager was formally assigned as E&S manager;
- *Management systems*: the company used the ISO 14001 and SA 8000 standards as guidance to the formalisation of an environmental and social management system which complies with the IFC Performance Standards. The company committed itself to get ISO 14001 certified by latest 2017;
- *Wastewater*: an external consultant was hired to analyse wastewater. Pollutants were found to be within national regulatory limits. The company also improved its wastewater treatment, as water used to clean reactors was stored and re-used, while other used wastewater goes through a filter;
- *Soil analysis*: a soil analysis was performed in the area where effluents and rinsates were discharged;
- *Spill prevention*: a containment wall was constructed around the solutions storage tanks;
- *Emergency prevention*: an Internal Commission for Prevention of Accidents (CIPA) was established, which includes training on issues such as fire safety, regular meetings and posters with emergency contacts;
- *Employee grievance*; a complaints and suggestions box was introduced;
- *Procurement*: a policy for key suppliers was adopted.

CIPA notices are visible throughout the plant

CHALLENGES

The professionalization process, which started almost two years ago, is still ongoing. The process has transformed many aspects of the company. The resulting more professional, structured and meritocratic working environment of the company is seen as a positive development by most employees. This was critical in generating industry-leading growth in 2013-15. However, the process put severe pressure on the company and its staff, posing several challenges:

- *Pace:* the pace of the changes was a constant point of discussion between the investors and CEO. The investors pushed management to implement proposed plans as quickly as possible, while the CEO wanted to ensure the transformation was done in a more moderate way. This put severe pressure on certain parts of the company;
- *Structure:* the more structural approach of working, such as through regular financial reporting, required a change in the mind-set and working structure of employees.
- *Personnel:* it was challenging to find and integrate the new senior management members and large amount of new salesforce members. At the same time, around 20% of personnel left, both forced (due to underperformance) and voluntarily (due to inability to adapt to new working environment);

- *Communication*: The overall most challenging part was for the CEO and plant manager to properly communicate all changes to employees, both in terms of rationale for change and implications.

The changes mostly affected Aminoagro employees in management and administrative functions. On the production side change has been less intensive: the number of workers at the plant has remained the same and the formalisation process has had a limited effect on their day-to-day activities. This also underscores the untapped potential of the company under the previous owners.

DEVELOPMENT IMPACT

DEG targeted three main types of development effects for Aminoagro, which all materialised:

- *Improve food security*: the increased yields contribute to improving food security in Brazil, as Aminoagro's fertilisers increase agricultural productivity between 3% and 15% (depending on crop and product use);
- *Create (decent) jobs*: the investment in Aminoagro led to the creation of around 50 additional jobs through the hiring of agronomists for the company's salesforce. These concern high skilled jobs, as the agronomists in the salesforce often are university graduates;
- *ESG*: Aminoagro significantly strengthened its ESG management practise on multiple aspects (as described in more detail above), which was to a large extent driven by DEG's initiative and financial backing of the ESDD;
- *Additional income*: Increased crop yield generate additional revenues for farmers.


Foliar fertiliser being mixed for spraying

CONTRIBUTION BY DEG

Role of DEG at investment

DEG had a crucial role in the deal. The requested investment amount was above the envisaged individual company investment size for Aqua, and the fund therefore needed co-investors to be able to put in a qualifying offer. As a result of DEG's decision to invest, the Aqua-led consortium was able to offer the required investment amount. In addition, DEG's good reputation as well as its ability to add value (notably in the field of ESG) substantially strengthened the extra-financial aspects of the offer.


Foliar fertiliser being sprayed on crops

Added value by DEG

DEG is an investor with a significant minority stake (i.e. 24% de facto through holding company) and a Board seat in the company. In practice, the Board seat is actively used by DEG's regional office. DEG added value to Aminoagro in several ways:

- *Strategic and operational advice:* through its Board seat, DEG provides useful strategic and operational advice to the company. Both senior management as well as Aqua Capital regard DEG as a well-respected sparring partner, asking the right questions and providing constructive criticism. This includes challenging Aqua's push for the fast-paced professionalization measures at Aminoagro within the holding company and providing on-going analysis and feedback of potential bolt-on acquisitions;
- *Financial advice:* DEG advises Aminoagro on how to communicate with banks in the rearrangement of its debt;
- *Signalling function*: the shareholding of a major financial institution as DEG in Aminoagro signals confidence to the market;
- *E&S*: DEG funded 50% of the E&S due diligence (ESDD) through a technical assistance programme. The ESDD resulted in an action plan with clear activities and timetables, which has resulted in several improvements. Aminoagro's CEO indicated that without DEG the company would not have approached E&S issues in a formal and thorough manner.

ANNEX C: CASE STUDY TEXHONG RENZE (VIETNAM)

EXECUTIVE SUMMARY

Texhong Renze, a Vietnamese subsidiary of China-based Texhong Group, is a professionally run, financially sound and responsibly-managed company. It has a strong position in the market and is well-positioned to be successful in the long run. Since 2005, when DEG provided the first of three loans to Texhong Times, a Chinese subsidiary of Texhong Group, the company and DEG have built a strong and trustful relationship, which is recognised by both parties. In 2011, DEG provided a separate long-term loan to Texhong Renze in Vietnam. Alongside this loan, DEG successfully stimulated the improvement of environmental and social (E&S) practices within the Vietnamese subsidiary and also initiated a technical assistance (TA) project in production efficiency. Especially the latter is much appreciated by Texhong Renze and is recognised as a source of value creation. However, from DEG’s perspective the TA project is not fully successful so far, as the project’s social targets to reduce working hours have so far not been adopted by Texhong Renze.

Whereas, initially, the lack of providers of long-term finance in the local market was a reason for Texhong Group to reach out to DEG, the group is much more independent from its financiers today. It now chooses to work with DEG mostly because of the trust and strength of the relationship. Effectively, DEG has become a back-up financier that can further add value to the company through its specific knowledge in ESG management and its TA programs. The only client’s criticism is about DEG’s rather long through-time of due diligence processes for loan requests.

INTRODUCTION

TEXHONG

DEG financed an expansion project for operations of Texhong Renze, a Texhong Group subsidiary in Vietnam. The holding company, Texhong Group, is responsible for all sourcing and sales within the group, whereas the subsidiary in Vietnam is a pure cost centre that buys and sells products from and to the holding. Therefore, this study will introduce both the holding company Texhong Group and the subsidiary Texhong Renze in order to better present their respective roles. Yet, the case study’s fully focuses on Texhong Renze and its production location near Ho Chi Minh City, as Texhong Renze is the counterparty to the loan DEG provided for the expansion.

Texhong Group

Texhong Group is China’s largest manufacturer of stretch yarn, a core-spun cotton yarn with elastin filaments (spandex) and denim yarns. In the Chinese market, Texhong Group is one of the largest core-spun cotton textile manufacturers. This market is highly differentiated and stretch yarn comprises only a small part of the overall cotton yarn production. This market fragmentation becomes evident as, according to the company’s figures, the total Chinese yarn production capacity is around 100 million spindles, and Texhong Group's total production capacity is 2.2 million spindles.

Since Texhong Group's foundation in 1997, the group has been growing rapidly and today it is successfully operating twelve production plants in mainland China - in the Yangtze Delta and Shandong Province - and three plants in Vietnam. As per the end of 2014, the Group employed more than 20,576 people, up from 13,700 people in 2010. Each of the subsidiaries is an independent legal entity and run as cost centre, whereas treasury, financing, controlling, purchasing, product R&D, sales and marketing are centralised.

The spinning process

Stretch yarn and denim yarn are sold to a variety of clients in the textile industry. The Group's current customer base is diversified with over 3,000 customers in China and overseas. Its sales network spans China, Brazil, Turkey, Bangladesh, Japan and South Korea. In 2010, 90% of the sales were generated in the Chinese domestic market while 10% came from exports. Current figures are unknown. Customers range from weaving mills, denim manufacturers, printing and dyeing factories to trading agents.

Texhong Group is in the top five of the largest cotton textile firms in China and the largest supplier of core-spun cotton textiles worldwide. While Texhong Group operates in a very competitive environment, it is still a successful niche player in the high-grade yarn segment. To avoid competitors entering the high-grade core-spun yarn segment, Texhong Group has established a solid and close cooperation with its up- and downstream partners (e.g. exclusive cooperation agreement with Dow Chemical). Another market entry barrier for potential competitors is the huge investment amount (around USD 100m) necessary to realise economies of scale with the spinning technology for high- grade denim yarn.

Texhong Group currently faces most competition from some of the medium and small core-spun yarn producers in Jiangsu province with production capacities of around 50,000-100,000 spindles and a few cotton yarn producers in India and Bangladesh.

Texhong Renze

Texhong Renze Factory (Ho Chi Minh City)

Texhong Renze is a 100% subsidiary of Texhong Group. It is a pure production site of the group and focuses on the production of core-spun spandex yarns and denim yarns with a capacity of 400,000 spindles. The expansion project (Phase III), financed amongst others by DEG and completed in 2011, was the last phase of the original plan for the establishment of Texhong Renze's plant in Ho Chi Minh City. Phase I, comprising the installation of 70,000 spindles, was completed in December 2007 and Phase II, comprising 140,000 spindles, was completed in September 2008. DEG, FMO and Citibank financed Phase III, which consisted of the construction of new factory buildings on existing available land. In the newly developed facilities a total of 190,000 additional spindles were installed.

Texhong Renze is located approximately 60 km from Ho Chi Minh City. The company currently employs 3,959 people.

The supplied cotton is processed to usable material

Investing in Vietnam has proven to be a strategic success for Texhong Group. Running at full capacity, the Vietnam operations are now the biggest profit generator of the whole group. This is a result of the following key success factors:

- Access to low-cost and duty-free cotton imports from the US. This is the key competitive advantage for the Vietnamese subsidiaries compared to the China-based yarn production sites, which are subject to cotton import quota mechanisms as well as higher cotton prices (regardless of whether it is sourced from domestic or offshore suppliers);
- Lower local expenses in Vietnam for land, labour and utilities and more favourable tax treatment (full tax exemption for the first 4 years of Texhong Renze generating a taxable income; 50% tax rate reduction during the subsequent 9 years);
- No import and export tariffs for trade between ASEAN country and China since 2009.

Cotton, ready to be processed to yarn

Currently, all final products of Texhong Renze are sold to its related parties and independent customers worldwide at a sales pricing system set on arm's-length basis. Purchasing of raw materials is centralised in another subsidiary of Texhong Group, Sunray in Macao. However, inventory is held on the balance sheet of Texhong Renze. The cotton for Vietnam is sourced from a range of suppliers, with Allenberg from the USA being the biggest.

From a general point of view, Texhong Renze is purely treated as a manufacturing site as sales are all handled via Sunray Macao. Using this channel, Texhong Renze sells its products to its related parties and independent customers worldwide with a reasonable margin that enables to serve its obligation on DEG's loan.

THE INVESTMENT IN TEXHONG RENZE

Background

Since 2005 DEG, has been building a steady and good client relationship with Texhong Group. Before discussions started in 2010 on the Texhong Renze deal, DEG had already provided three loans to Texhong Group's Chinese subsidiary Texhong Times. In 2005, DEG provided a USD 9m long term loan (Loan I) to finance a greenfield investment. In April 2010, DEG committed another USD 15m long term loan to the same entity for capacity expansion (Loan II). Finally, in September 2013, DEG provided a third loan for the expansion of business of USD 20m loan, also to Texhong Times.

The deal

Although Texhong Group initially negotiated only with Citibank, DEG and FMO were later approached to participate in the financing of the USD 85m Phase III capacity development of the production facilities of Texhong Renze. This total amount of USD 85m consisted of USD 60m in senior loans in a club deal by Citibank, FMO and DEG, an equipment supplier credit via Texhong Group and a small amount of additional equity from Texhong Renze (USD 2m).

Spinning process

Overview of one of the Texhong Renze facilities

In 2010, Citibank, FMO and DEG provided the USD 60m, 7-year loan (including 1 year grace period). The security package was solid and included corporate guarantees from Texhong Group, Texhong Renze Investment Ltd., Sunray International Holdings Ltd., Sunray Macau Commercial Offshore Ltd., and a first ranking pledge over moveable equipment and machinery of Texhong Renze related to the Phase III project, of which the book value was to cover at least 73% of the senior loans. Citibank was assigned the role of facility agent to coordinate the consortium of long-term lenders.

Rationale for the deal

DEG decided to provide the loan to Texhong Renze for the following reasons:

- Support expansion strategy: The expansion in Vietnam would assist Texhong Group to further expand its production capacity and market share to consolidate its position in the international market of core-spun yarns;
- Contribution to development: Texhong Renze has a considerable development impact in Vietnam by providing jobs and on-the job training;
- ESG improvement: DEG believed it was well-positioned to support Texhong Renze in improving its ESG management, particularly regarding social matters like working conditions and occupational health and safety.
- Good management: Texhong Group already was a well-managed company, particularly in terms of risk and liquidity management;
- Strong project sponsor: Between 2005 and 2010 Texhong Group proved to be a profitable and financially sound partner and sponsor that has the necessary strength to provide DEG with a trustworthy and strong guarantee;

COMPANY PERFORMANCE

Before investment, Texhong Group had already been a stable, steadily growing and well-run company. Its listing on the stock exchange of Hong Kong in 2007 further contributed to the professionalisation and formalisation of corporate governance and internal processes.

As a result of its state-of-the-art facilities and well-trained employees Texhong Renze was able to produce high-quality yarn right from the start. It also proved to be a reliable and rapid supplier.

Texhong Renze production

Financial performance

Texhong Renze steadily increased its internal sales from USD 369m in 2013 to USD 388m in 2014. It is currently producing at the maximum capacity of 400.000 spindles.

The main risk factor that influences Texhong Group's performance is the price of cotton. Texhong Renze is important for the Texhong Group in terms of supplier risk mitigation and support, as the group buys most of their cotton from the US market, whereas Texhong Group's Chinese subsidiaries are dependent on the Chinese cotton price. In 2014, the cotton price on the Chinese market developed negatively for Texhong Group and this influenced the Group's net profit. While the world cotton price was stable, the domestic Chinese cotton price dropped by 30% during that time. This was due to a couple of factors including a reform in the Chinese governments' cotton policy and the fall in the sales price of the Chinese cotton reserve. As the Chinese yarn price correlates with the domestic cotton price, the price drop negatively impacted Texhong Group's Chinese subsidiaries.

Environmental and social performance

Texhong Renze is classified as 'medium' environmental risk and 'medium to high' social risk. As there is no dyeing included in the production process, environmental impacts are limited to dust, energy consumption and waste management. The community health and safety impacts are also limited. The company is situated in a new industrial park established by the local authorities where it occupies 300,000 sqm. The higher social relevance is due to labour issues in general. At the due diligence stage and at the request of DEG, an external labour audit indicated a number of potential improvements, especially with regard to non-discrimination, overtime, occupational health and safety, working conditions of young, and pregnant workers. Over the years, significant improvements in the working conditions have been implemented in line with local and international standards. Regular internal and external audits are performed to ensure adherence to the standards as well as to identify opportunities for improving the company systems and processes. During a short case study site visit of Texhong Renze in March 2015, two points for improvement could be identified in terms of occupational health and safety: First, very few machine operators used ear protection, although this is particularly important for the vortex machines due to their high noise levels. Second, some employees or suppliers loading and unloading small trucks were not wearing footwear.

Cotton yarn ready to be shipped

Production efficiency and social improvements

Recently, specific attention has been given to the issue of overtime as this was one of the few open issues in the E&S Action Plan. DEG funded 80% of the E&S management project and also arranged advisory services on how to set up a production efficiency project. DEG's objectives with this project were twofold: first of all, DEG wished to ensure that the number of instances machine operators work overtime is very limited. Texhong Renze indicated that actual average daily overtime was recorded as 0.90 hours per each worker (assuming 6 working days per week) and 291.60 hours per year per worker, which was lower than the statutory requirement imposed by the local Vietnamese government, i.e. not exceeding 4 hours per day per worker and 300 hours per year per worker. More efficient production would, theoretically, lead to a more organised way of working, fewer instances of malfunctioning machines and production targets being met more frequently. In the respective report, the consultant even suggested to Texhong Renze to split the benefits of the production efficiency improvements evenly between employer and employees: 50% of the cost reduction would directly impact the company's operational profit and 50% would benefit employees by decreasing their working hours while receiving the same salary as before. DEG had hoped that this external mapping of the production process would also help to provide recommendations on production efficiency in general in order to streamline production, become more energy efficient and reduce costs.

Spandex yarn, the main final product of Texhong Renze

Texhong Renze showed great appreciation of DEG's idea, the efficiency results and the actual support to realise production efficiency improvements with the help of a consultant. However, the company focused solely on the efficiency gains and not on the overtime reduction effects. Although this is not clear yet, it could well be that overtime is automatically reduced through a more efficient production (as explained above). But for Texhong Renze this is a side-effect and not something that management focuses on. Also, it seems that the suggestion from the consultant to reduce the standard working hours is not being considered by Texhong Renze.

DEVELOPMENT IMPACT

DEG indicated that, despite the legally accepted tax-optimizing structure within the Group, Texhong Renze contributes strongly to development effects in Vietnam.

The investment in Texhong Renze has three main development effects:

1. *Employment effects:* in addition to the then existing staff of approximately 3,000 employees, the expansion investment of Texhong Renze created approximately 959 additional jobs including significant employee training. To create and secure jobs was considered to be one major development effect of this project.
2. *Social effects:* DEG supported an improvement of the working conditions of about 4,000 workers in a growing sector in Vietnam. After a labour audit was carried out at due diligence stage, it was agreed with Texhong Renze to develop a social action plan in order to support improvement measures by Texhong Renze's management and establish an integrated E&S management system. For this project, 80% of costs were financed by DEG's TA funding. Apart from the issues regarding overtime and the number of shifts, the execution of the social action plan was largely successful. Although attribution to DEG's TA to improve E&S management is difficult to establish, the following observations during this case study underpin the fact that social practices of the company are good:
    - Texhong Renze claims that, compared to peers, its staff retention rate is high at 94.25%;
    - On-the-job training and vocational training is well-organised and structured. For example, Texhong Renze has been carrying out a Mentoring System since the start of operations, in which senior technicians from other subsidiaries of Texhong Group train Vietnamese technicians in handling routine production duties. Their expertise is also used for other aspects of the professional on-the-job training;
    - Texhong Renze claims to pay the highest wages in this sector in Vietnam;
    - Workers are directly benefiting from the increased productivity as a small portion of their salary is based on the production efficiency level they can realise.

3. *Technology & know-how transfer:* Texhong Group, a large Chinese corporation, expands its production activities in Vietnam and hence transfers technology and know-how to this country. In addition, Texhong Renze's Chinese middle-management is step-by-step being replaced by Vietnamese staff: until 2014, 23 Chinese middle-management staff members were replaced by Vietnamese staff. All of the key job roles and responsibilities have been systematically shifted to those newly-trained Vietnamese managers.

DEG'S CONTRIBUTION

DEG's role at investment

DEG had an important and positive role in preparing the deal. Especially the general 'ease of doing business' that Texhong Group experienced while negotiating with DEG, helped Texhong Group to close the deal more easily compared to the processes with other financiers. Texhong Group believes the long-standing and trustful relationship with DEG, which had developed over the years, was an important factor in completing the negotiation phase smoothly. The continuity and stability of DEG staff working with Texhong Group over the years played a central role in building this trust, according to the company.

Added value by DEG

At the time of investment it was still hardly possible to obtain long term financing in Vietnam. Hence, DEG and FMO ensured long term financing and therefore helped stabilise the company's financial structure. Nevertheless, DEG's role has become less crucial to the Texhong Group as it grew bigger. DEG has effectively become a back-up financier, who provides long-term and reliable financing, and who especially adds value to the company through its specific knowledge in ESG management and its TA programs.

DEG added value to Texhong Renze and Texhong Group in several ways:

- Long standing relationship and trust: Texhong Group clearly indicated that the long-standing relationship DEG has built with Texhong Group over the years and the resulting trust between parties has been one of the main reasons for them to keep working with DEG as a business partner. As the company grew quickly over the years, was listed at the Hong Kong Stock Exchange and gained access to the bond markets, it has become much less dependent on specific financiers and the company is thus able to choose their own mix of finance providers. Still, Texhong Renze and the group continued working with DEG despite some disadvantages compared to other finance providers: "with major commercial banks we can get a loan with the same or lower interest rates, and I get it in three instead of nine months. Yet, I still choose to work with DEG because of our long-standing, trusted relationship and their advice that goes beyond mere financing". Even though processes might be cumbersome at times, Texhong Group feels that a trustful relationship, like the one with DEG, adds value to the company, especially in case the company would be in trouble or a quick decision is needed.

- E&S: the ESDD resulted in an action plan with clear activities and timetables, and in several improvements. Texhong Renze indicated that without DEG the company would not have approached E&S issues in the formal and thorough manner it currently applies. Texhong Renze and the Texhong Group have learned a lot from DEG in terms of proper E&S management and in terms of E&S improvements like fire safety.
- Technical assistance for the improvement of an integrated management of E&S matters and advisory services for production efficiency improvements:
  DEG funded 80% of the E&S management project through a TA grant and also arranged advisory services on how to set up the production efficiency project. The production efficiency improvements were recognised by Texhong Renze as a particularly important DEG contribution.