Development Effectiveness Rating 2.0

Brief description

KFW DEG

Measuring impact

Private enterprises that are financially successful and acting responsibly promote local development. By providing reliable financing and targeted advisory to the private sector in developing and emerging markets, DEG strengthens its clients' overall performance and thus contributes to development.

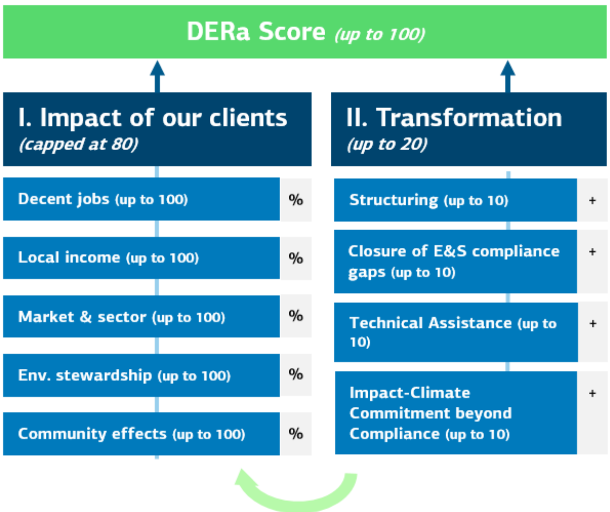
Guided by the 2030 Agenda for Sustainable Development and the SDGs, reflecting 15 years of experience with the Corporate Policy Project Rating (GPR)© and seven years with the **Development Effectiveness Rating (DERa)**©, DEG refined its multidimensional index-based development assessment by introducing the **DERa 2.0**.

The DERa is based on a so-called *theory of change*, a methodology used to explain the process towards desired change by mapping causal linkages from initial activities of DEG's clients through their outputs towards one or multiple targeted outcomes and finally impacts. In a separate step, the theory of change includes the role of DEG in supporting a positive transformation of its clients.

What DEG wants to achieve is for its clients to provide more and better jobs, increase local income and support transformation in developing markets while acting within planetary boundaries and creating benefits for local communities.

For this purpose, DEG actively supports its clients in their transformation.

The DERa rates individual clients' positive and negative effects on sustainable development, follows up on changes in performance since DEG's investment and describes DEG's transformative role. Based on the DERa assessments, DEG can build its impact reporting and steer the overall development quality of its portfolio.



A higher transformation strength is likely to increase impact strength

Structure of DERa 2.0

DERa 2.0 looks at two pillars, one reflecting the impact contribution of the DEG client, the other recording the client's transformation processes supported by DEG.

Pillar I: Impact of our clients

To assess the impact of DEG's clients, five key outcome categories were identified. Each category consists of a set of outcome fields with indicators that capture a client's contribution to that specific category. These indicators are mostly quantitative in nature or are qualitative expert judgements.

This pillar takes a net-perspective, meaning that outcome fields, outcome categories and the pillar score can become negative. This is achieved by including indicators that track either positive or negative impacts, or impacts that can work in both positive and negative directions.

1. Decent jobs

Creating more jobs is an urgent priority as jobs are the main pathway out of poverty. However, not all jobs help people out of poverty. DEG needs to ensure that the jobs supported and created are "quality jobs" that enable people to improve their living standards, increase their well-being and support social cohesion. Better job quality is also good for business success: it contributes to increased staff motivation, helps to attract and retain workers and thus reduces absenteeism and staff turnover. Therefore, DEG focuses on both the creation and safeguarding of formal employment in compliance with ILO labour and IFC performance standards, and the promotion of additional topics regarding job quality beyond compliance, thus contributing to SDG 8 (decent work).

This category consists of four outcome fields:
- Jobs supported
- Compliance with labour standards
- Equal opportunities
- Job quality beyond compliance

2. Local income

An increase in local income provides an increase in opportunities for self-determined decisions of individuals and institutions in developing countries. Within the SDG framework, there are thus important synergies between SDG 1 (targeting no poverty) and SDG 8 (focusing on economic growth through higher levels of productivity and high value added). The private sector is one of the main sources of local income. This contribution is stronger if the respective business model is strongly linked to the local context, i.e. if a company employs local personnel, pays taxes locally and sources from local suppliers. Local income generation can also be indirect by sourcing from local suppliers and contracting local service providers to achieve the SDGs.

This category consists of two outcome fields:
- Direct contribution to GDP
- Indirect contribution to GDP

3. Market and sector development

Similar business activities can result in very different development outcomes. This depends on whether an investment is going to a country or sector in which it is still particularly necessary and will potentially have a particularly positive development effect. Some clients directly contribute to the SDGs by their core business, such as educational institutions, hospitals, renewable energies or fintech companies that focus on financial inclusion. In addition, there are other relevant aspects for market development. Enhancing competition is one such aspect, as it is fostering innovation, which contributes to SDG 9 (innovation).

This category consists of five outcome fields:
- Solutions for sustainable development
- Going where we need to go
- Innovation
- Competition
- Responsible finance

4. Environmental stewardship

Large parts of the global private sector rely on natural resources either as part of their core business or in their supply chains. For economic development to be sustainable, economic activities need to take place within planetary boundaries. Private sector operations need to be designed in such a way to minimize their ecological footprint by reducing not only their GHG emissions, but environmental impacts in general, e.g., on biodiversity. At the same time, the private sector can develop solutions to counteract overshooting of the ecological ceiling, e.g., through sequestering GHG emissions.

This category consists of three outcome fields:
- Environmental responsible practice
- Climate
- Biodiversity

5. Community effects

Companies can boost or damage communities through their business activities. Not only should businesses "do no harm", but they can "do good" and contribute to development by actively engaging with local communities. By avoiding negative impact and proactively contributing to community development, businesses secure their local licence to operate and communities can see a rise in amenities and opportunities.

This category consists of two outcome fields:
- Mitigate negative effects
- Pro-active positive contribution

Pillar II: Transformation promoted by DEG

Recognising the need for a tailored approach, DEG commits to working with its clients to achieve sustainable transformation and climate resilient business in line with the SDGs. The focus lies on value-additionality and the transformation can be economic, social, or environmental.

This pillar considers four possible mechanisms through which DEG supports the transformation of its clients. For those mechanisms, DERa 2.0 documents transformation milestones/targets that DEG has agreed upon with its clients and tracks the implementation progress.

a. Structuring

The structuring stage of an investment involves an assessment of the organisational, legal and equity participation structure of the company in order to obtain a comprehensive understanding of its corporate management and its effects on financial performance. Transformations proposed and contractually agreed at this stage, such as increasing transparency through audited annual financial statements and an improved corporate governance structure, put the company in a much better position and secure the impact contributions achieved.

b. Closure of E&S compliance gaps

DEG's comprehensive environmental and social assessment concerns the potential effects and risks of the financing. This approach assesses the transformation resulting from the contractual agreement of environmental and social action, such as in action plans, and implementation by the client with the aim of offsetting the risks and significantly improving environmental and social performance.

c. Technical Assistance

DEG can also offer supplementary developmental financial and advisory services to help implement action plans and increase the impact contributions of its clients through its promotional programmes (e.g. BSS). It thereby actively supports its clients' transformations.

d. Impact-Climate Commitment beyond compliance

Some DEG clients are prepared to start their impact and/or climate transformation journey with DEG and work together via a formal commitment that extends beyond the minimum requirements. This form of cooperation is currently in the pilot stage and will be assessed at a later point.

The DERa score

The DERa produces a cumulative score with a minimum of -65 and maximum of 100 points. Up to 80 points can be scored in pillar I (Impact of our clients), and up to 20 points can be scored in pillar II (Transformation promoted by DEG). Due to the multidimensional nature and the implemented net-approach of DERa 2.0, no type of investment can achieve the maximum of 100 points. To aid the interpretation of client scores, they are linked to the qualitative categorisation below.

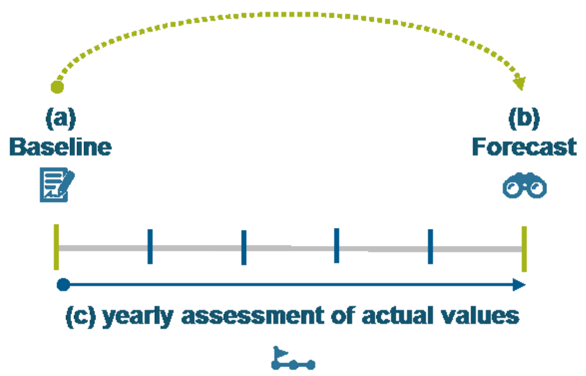
Qualitative Categorisation:

≥ 60 points:	Exceptional
45 – 59 points:	Very good
30 – 44 points:	Good
15 – 29 points:	Satisfactory
0 – 14 points:	Poor
≤ -1 points:	Insufficient

In pillar I, up to 100 points can be achieved, which are capped at 80. The results for each outcome category are weighed differently for each clients cluster. While Environmental Stewardship is deemed to have equal relevance in terms of impact contribution across the DERa types, the impact relevance of the other outcome categories varies. For each cluster, the main category/categories were identified that lie at the core of the impact financing rationale for the cluster. These are weighed more strongly than the others. The score for each outcome category is derived from 2-4 specific outcome fields, which combine a set of relevant indicators.

In pillar II, a range of 0 to 20 points can be achieved which is added to pillar I's score to form the overall DERa 2.0 score. For each of the mechanisms, a maximum of 10 points can be achieved. These are added up and capped at 20 to reach the pillar II score.

Application of the DERa



DERa is applied throughout the project cycle

The DERa is applied throughout the project cycle of each transaction. Prior to approval of a transaction, the first DERa is filled in. It consists of (a) a baseline with actual values prior to investment and (b) a forecast of expected effects with the investment on a 5-year horizon. After commitment, the DERa is updated annually with actual values (c). This allows us to analyse changes in the clients' contribution to development since DEG's investment.

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