

2017

## »»» Responsible business – adding value

How DEG customers contribute to the global  
Sustainable Development Goals

# Foreword

DEG is committed to sustainably successful and effective private companies that comply with international environmental and social standards, promote local development and, by doing so, contribute to achieving the global development goals. In 2017, DEG was able to further expand its commitment, which not only includes its financial services, but also its advisory and promotional programmes that aim to increase sustainability.

In the 2017 business year, DEG entered into commitments totalling almost EUR 1.6 billion for 111 investments. DEG's portfolio amounts to around EUR 8.3 billion – financing for around 600 customers in 83 countries. A total of EUR 26.4 million for 154 customers was disbursed within the framework of DEG's promotional programmes, of which EUR 3.3 million were DEG's own funds and EUR 23.1 million were on behalf of other donors, including the Federal Ministry for Economic Cooperation and Development.

In 2016, DEG developed the Development Effectiveness Rating (DERa) to assess how private companies, financial institutions and funds contribute to development, and to identify how the impacts can be increased.

The DERa is guided by the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDGs), reflects 15 years of experience with the Corporate Policy Project Rating (GPR) and builds upon different indicator harmonisation initiatives.

DERa combines quantitative and qualitative indicators to measure development for each customer, which are summarised in five central development dimensions. Analysis of DEG's 2017 portfolio using DERa shows that responsible private investments have a measurable impact and make a significant contribution to the SDGs. Learn more in our yearly report.

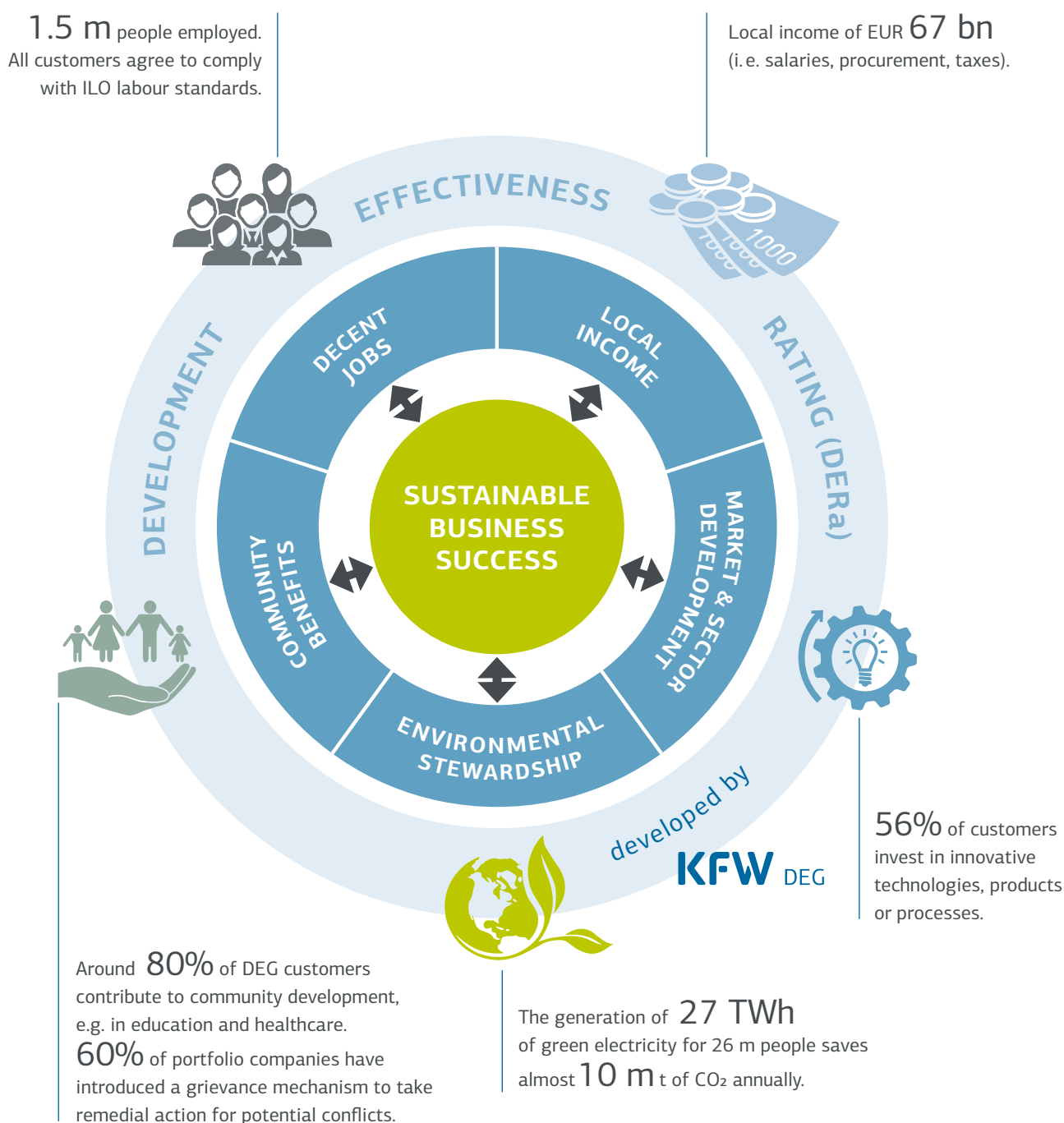
I hope you enjoy your reading.



Christiane Laibach  
Chair of the Management Board

# Development effects 2017

Analysis of DEG's 2017 portfolio using DERA outlines five central dimensions for development effectiveness of private sector investments: decent jobs, local income, market and sector development, environmental stewardship and community benefits.



## Decent jobs

Creating and safeguarding qualified jobs is of utmost importance, as vocational training and employment, in particular, pave the way out of poverty. Jobs provide more than monetary income; they are the cornerstone of development by improving living standards, raising productivity, and fostering social cohesion. This is also recognised in SDG 8 (Decent work).

The private sector is one of the most important employers worldwide. However, it is not the mere number of jobs that is relevant; ensuring that the work adheres to certain quality standards matters just as much. DEG's focus is therefore on creating and safeguarding formal employment in compliance with the core labour standards of the International Labour Organization (ILO), as well

as with ILO basic terms and conditions. Implementing better working conditions is also worthwhile for companies, as this increases motivation and productivity and lowers staff fluctuation and absenteeism.

- DEG's portfolio companies, amounting to around 600, employed more than 1.5 million people in 2017. The number of people employed by these customers has risen by almost 320,000 since DEG invested in them.

According to international statistics, more than 200 million people are looking for work, yet many companies complain that they are unable to fill vacant positions or to fill them with suitably qualified individuals. This gap between requirements and the qualifications offered by workers represents a major obstacle for the creation of productive employment and thus for economic growth and poverty reduction. DEG supports measures to close the skills gap and thus contributes towards increasing labour productivity, product quality and job security at companies.

- Nearly two-thirds of portfolio companies (excluding funds) invest in continued professional development for their staff and on average enabled 30% of their workforces to attend training courses.
- 35% of portfolio companies report that they provide further benefits for their employees, including healthcare, transport and the provision of food in staff canteens.



### How DEG measures employment effects

DEG's Development Effectiveness Rating (DERa) only assesses direct jobs in terms of a specific number. The indirect job potential of an investment – higher up the value chain – is categorised depending on the economic sector. An investment in the textile sector, for example, is assigned a higher job potential compared to investments in information services.

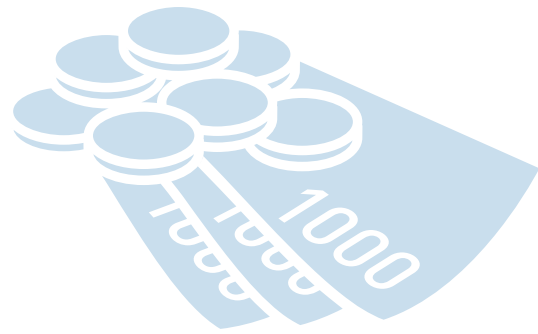
In recent years, DEG has discussed and examined various approaches with its international partners in order to measure the overall job impact of an investment. In the process, it found that conventional methods produce results that are difficult to compare over time and between different countries.

DEG now uses a model developed by Professor Löwenstein from the Institute of Development Research and Development Policy at the Ruhr-University Bochum to determine overall job impact. Using internationally available data for more than 70 developing and emerging-market countries, the "Löwenstein model" econometrically assesses the growth of the formal sector along a neo-classical production function. It is based on the assumption that equilibrium wages are not set in the formal labour market through supply and demand; instead, employment in the formal sector is determined by investment-driven labour demand from businesses. This implies a theoretical relationship between private finance and job creation.

Through their investments, DEG customers in the corporate and project-financing segments created more than 220,000 additional jobs in the previous year.

For a more detailed description of the Löwenstein model, see "What is our impact" at [www.deginvest.de](http://www.deginvest.de).





## Increasing local income

An increase in local income also means an increase in opportunities for people in developing countries to make self-determined decisions. The private sector is the main source of local income. Its contribution is even greater where a company's business model has closer links with the local area, i.e. if companies employ local staff, pay taxes locally and source goods from local suppliers.

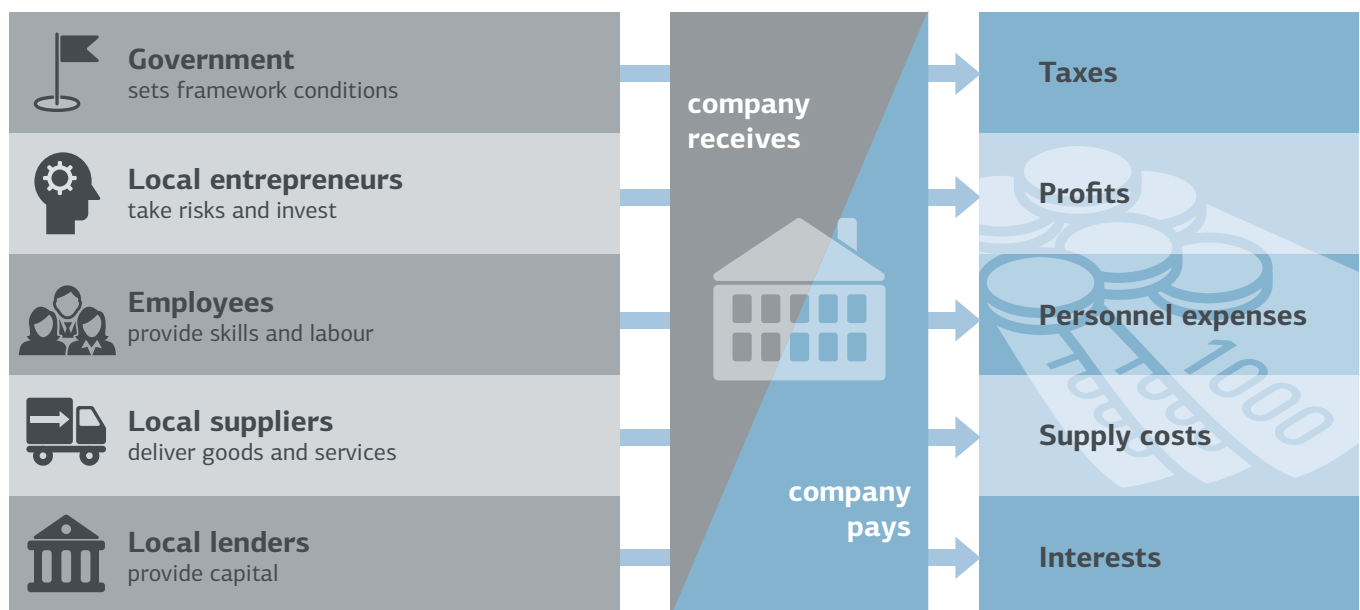
- Each year, the portfolio companies of DEG pay around EUR 14 billion in wages and salaries as well as EUR 4 billion in taxes.
- Around three-quarters of necessary supplies and almost half of capital goods are sourced locally, generating just under EUR 27 billion in income for local suppliers.

- Interest payments to local capital lenders and profits after taxes for local businesses create further annual income of EUR 22 billion. In total, DEG's portfolio companies generate local income of EUR 67 billion.

- For almost three-quarters of DEG customers, revenues have grown significantly since DEG's investment – by an average of 38% in the last reporting year.

The Agenda 2030 underscores that the mobilisation and effective use of domestic resources are central to achieving the Sustainable Development Goals. Increasing local income supports in particular SDGs 8 (Decent work and economic growth), 10 (Reduced inequalities) and 17 (Strengthen domestic resource mobilisation).

## Companies create local income



# »»» How an agriculture company contributes



Virú Group (“Virú”) is one of the three biggest agricultural exporters in Peru. In addition to its own cultivation, extending over 8,000 ha of farmland, Virú buys fruits and vegetables from smallholders. This products are processed at three processing plants and distributed worldwide. This includes asparagus, artichokes, avocados, peppers, mangoes and heart of palms, as well as value-added products such as pestos, bruschettas, and ready-to-eat meals. Its main customers are supermarket chains like REWE, Carrefour and EDEKA, as well as local retailers.

In 2013, DEG provided Virú with a long-term loan, thereby supporting its expansion plans. DEG also assisted Virú in improving its water efficiency, including the realisation of a water lily-based wastewater treatment plant as part of its Business Support Services (BSS).

DEG measured how the company contributes to sustainable development applying DERA and confirmed the findings in an on-site case study.

## **Permanent workforce of 7,500 – comprehensive training**

As a producer of agricultural products and Peru’s largest employer, Virú offers job opportunities especially for people in rural areas. Virú has a permanent workforce of more than 7,500 employees in eight processing plants and employs another 1,500 seasonal workers in peak season. The employees, 50% of whom are women, come mainly from surrounding communities. The number of employees has risen by 39% since DEG’s first investment in 2013.

Virú fully complies with the ILO core labour standards and international standards regarding, amongst others, remuneration, working hours and minimum age for employment as well as with respect to occupational health and safety requirements. By directly transferring salaries to its employees’ bank accounts and thus providing proof that salaries come regularly, Virú has contributed to increasing their creditworthiness. Virú offers hard and soft skill training for all its employees. The company cooperates closely with its 275 small suppliers to ensure,

for instance, that they comply with the ILO core labour standards and provides respective training, for example in occupational health and safety.

As part of its integrated CSR strategy, Virú provides, for example, free transportation, medical centres, childcare, a canteen service and products at reduced prices.

## **Local income of 130 million euros**

Agribusinesses such as Virú pay wages and salaries to their local employees; receive raw and packaging materials, water, biomass, fertilisers and land lease from local suppliers; invest in new land, buildings and machineries; pay interests to local banks and taxes and licence fees to local municipalities and central governments.

By doing so, Virú generated local income of EUR 130 million in 2017. The local population and their families benefit from this, as well the government, which invests this money to provide infrastructure.

# to Peru's sustainable development

## **Export and innovation – success factors for Peru**

Virú's export-oriented production has a positive effect on Peru's current account balance by generating export revenues and foreign exchange earnings. So far the company has been exporting to the USA and to Europe, with an export share of 45%, respectively. In future, Virú will sell its products also in Peru and Central America as well as China.

Following a clear diversification strategy, Virú is one of the most innovative agricultural companies in Peru with regards to product development, state-of-the-art production technologies, and effective logistics solutions.

## **Environmental stewardship in line with international standards**

Virú contributes to the global climate change goals by protecting biodiversity, reducing emissions, chemical fertilisers and pesticides, and committing to efficient water and wastewater management. Its E&S management is certified according to EU and US standards. Since Virú is operating in regions with relatively low precipitation, efficient water and wastewater management is of particular importance. It thus uses modern drip irrigation systems to reduce water usage and has installed computer-based groundwater level monitoring tools. Based on a feasibility study, co-financed by DEG, Virú built a wastewater treatment plant, put in operation at year-end 2017, in order to permanently comply with these standards.

## **Effective cooperation with local communities**

With an annual budget of EUR 1.2 million, Virú constantly improves the living condition of surrounding communities by supporting schools, sponsoring students, providing medical facilities and water pipes.

In addition, it supports its suppliers in terms of training programs and protective clothing.

For every production expansion, Virú assesses potential impacts and risks of the project to the local community and develops possible solutions together with the residents. In addition, it has implemented an anonymous grievance mechanism.

In the San Martín region, Virú supported the local population in obtaining legal titles for a total of more than 10,000 ha by registration in the land registry.



Details about how Virú's contribution to the SDGs and the effects are represented in DERA can be found here.



## Market and sector development

The business activities of companies can result in varying development outcomes, depending on the investment needs of the country and of the sector. In the DERA, DEG evaluates by means of country and sector indicators whether investment is being made where it is most urgently needed.

- DEG finances customers in developing and emerging countries around the world. Over 56% of its customers operate in difficult markets.
- More than 40% of DEG customers contribute, by means of their investments, to reducing country-specific bottlenecks in energy, transport, IT and communication technology or to creating access to financing.

The importance of innovation to market development is also reflected in SDG 9 (Industry, innovation and infrastructure). For industry to become more sustainable, more efficient technologies and industrial processes are needed. In order to make the economy more inclusive, small and medium-sized companies also need to have access to affordable financing.

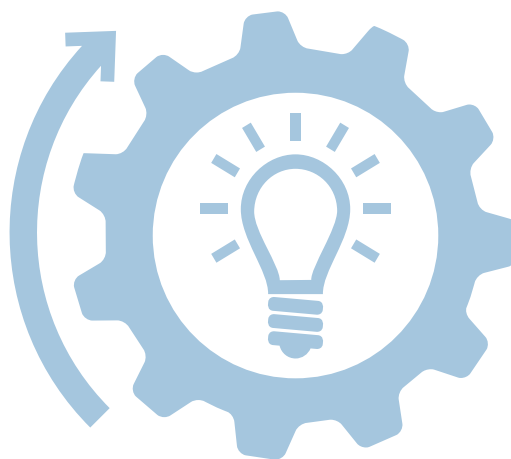
- 56% of DEG customers contribute to innovation by introducing new technology, developing new products or implementing new processes.
- The financial institutions financed by DEG facilitate access to finance for more than 2 million small and medium-sized enterprises (SMEs).



### Difficult markets and enabling sectors score points in the DERA

In the DERA, an investment country is categorised and evaluated on the basis of two indicators: average income and the ease of doing business. In low-income countries, an investment has a stronger impact on private sector growth than in middle-income countries. The investment volume and hence growth potential for the private sector depends, amongst other things, on the framework conditions for investment, such as macroeconomic stability (low inflation, stable exchange rates), reductions in corruption, and better infrastructure of the country in question. In markets where business conditions remain difficult, investment encourages other companies to get involved, further boosting local development. Both indicators carry equal weighting in the overall rating.

Further points are awarded in the DERA for so-called enabling sectors, which contribute to improving the business environment of a country and enable further growth in the private sector. For the purposes of the DERA, these have been identified as the energy, information and communication technology, transport and financial services sectors. Education and health are also considered to be enabling sectors, but are less relevant from the perspective of the private sector. The points awarded in the DERA are assessed based on the saturation level and business environment of the market concerned according to World Bank data.





## Environmental stewardship

Through the SDGs, the international community of states aims to substantially advance global environmental, climate and resource protection. These issues are also of key importance for DEG's customers. More than ever, companies are being required to manufacture in a manner that is as sustainable and efficient as possible. Large parts of the global private sector rely on natural resources either as part of their core business or in their supply chains. To be able to operate properly in the future as well, existing resources need to be preserved and harmful emissions into the environment need to be avoided. For development to be sustainable, global environmental and climate protection, as well as resource efficiency, are therefore decisive.

By complying with international environmental standards and implementing initiatives towards achieving more sustainable business operations, private enterprises are making their businesses more sustainable in line with Sustainable Development Goal 12 (Responsible consumption and production).

- All manufacturing companies and infrastructure investments in DEG's portfolio commit to implementing international environmental and social standards. During due diligence, a company's current status is assessed and – if necessary – an environmental and social action plan is drawn up.
- DEG expects banks and funds to implement their own environmental and social management systems (ESMS), and for them to also implement the relevant standards with their customers. As shown by a study published by DEG in 2017, this has a positive impact on financial institutions and their customers. It enables risks to be mitigated and investment opportunities to be identified, and enhances their reputations.
- In 2017, DEG assisted 15 customers with the implementation of environmental and social management systems by providing additional advisory aid through its Business Support Services (see also page 11). It supports them in this process and tracks implementation of the standards.

By generating renewable energy without CO<sub>2</sub> emissions, energy providers are playing a major role in achieving the goal to keep global warming to below two Celsius. The international community has set itself the target of doubling the share of renewable energy in overall energy consumption to 36% by 2030. This is the only way that Sustainable Development Goals 7 (Affordable and clean energy) and 13 (Climate action) can be achieved.

- On an annual basis, energy utilities co-financed directly by DEG produce 27 TWh of electricity from renewable energy and at current consumption levels can supply more than 26 million people. If this amount of power were to be produced using the current electricity mix in the respective countries, approximately 10 million tonnes of CO<sub>2</sub> would be emitted a year.



### A bank establishes environmental standards at its customers

TBC Bank in Georgia has helped to establish new standards among its customers through active environmental management. The results of this included reduced dust pollution at production plants, improved disposal of hazardous medical waste at hospitals, better storage of chemical materials at the processing plant of a mine, and the installation of a water treatment plant at a fishery.

With the financing provided by DEG, TBC Bank has committed to applying DEG's environmental and social standards to its entire portfolio. Previously, environmental and social issues had little relevance. In 2012, DEG's Business Support Services assisted TBC Bank with the introduction of an environmental and social management system. TBC is now regarded as the leading bank in Georgia for environmental and social risk management. The government of Georgia has also recognised TBC's expertise in this field, consulting the bank in environmental legislation questions.

The entire evaluation including further case studies can be found online.

## Community benefits

Entrepreneurs are active citizens who play an important role in society. As part of its environmental and social standards, DEG calls for good community health and safety management. In addition, increasing importance is being placed on the role of active interaction with local communities. This results in a win-win situation for all those involved: Companies encourage local social acceptance and support for their activities, while communities benefit from an increase in amenities and opportunities that would not otherwise exist.

- Almost 90% of the manufacturing companies and infrastructure projects in DEG's portfolio have implemented satisfactory community health and safety management.
- Around 80% of DEG's portfolio companies engage in community development activities. During the last reporting year, each company made an average amount equivalent to almost EUR 500,000 available for community development. The most common areas for investment were education and healthcare.

Where necessary, DEG advises its customers on how they can organise their community engagement, taking into account the needs of local communities.

For local communities, it is important that residents can contact the company directly. This enables any potential problems to be brought to the attention of the company so that it can take remedial action. Implementation of such a grievance mechanism is international best practice.

- 60% of portfolio companies have set up grievance management mechanisms.



### Grievance mechanism: a human right

The United Nations Guiding Principles on Business and Human Rights emphasise the need for companies to implement an effective and easily accessible grievance mechanism in order to identify and address any potential adverse effects at an early stage.

The establishment of a company grievance mechanism is stipulated in the IFC performance standards, which DEG agrees contractually with its customers. For customers that are classified in environmental and social category A, this is generally also incorporated in the environmental and social action plan. The DERA records whether a customer has a grievance mechanism and positively scores the set-up of such a procedure.

In the Virú example (see pages 6 and 7), the company established both an anonymous internal and an external complaints office. Employees and local residents are able to report a complaint by means of an "ethical hotline".

If an unexpected adverse impact should arise in relation to one of DEG's investments that cannot be addressed by the company's own grievance mechanism, DEG has an independent grievance mechanism. If the parties concerned are unable to resolve the situation locally, they can turn to this mechanism. More information on this can be found online at [www.deginvest.de/icm](http://www.deginvest.de/icm).



# »»» Promoting business in a targeted way

DEG is also enhancing the development impact of entrepreneurial activities through its promotional programmes. This enables the development of new markets, training of staff and suppliers, implementation of environmental and social standards, and improved corporate structures.

In 2017, a total of EUR 26.4 million was disbursed for such transactions, of which EUR 3.3 million were DEG's own funds and EUR 23.1 million were on behalf of various donors.

Initiatives with development impact by German and European companies are realised through the **develoPPP.de** programme sponsored by the German Federal Ministry for Economic Cooperation and Development (BMZ). Examples include pilot projects, qualifying measures for suppliers, training, developing innovative products and improving energy efficiency.

The so-called **Business Support Services (BSS)** assist companies with consulting services to solve challenges in the corporate environment. They are financed from BMZ funds and DEG's own funds and aim at improving the financial and management structures of companies, reducing project risks or promoting good business practices. An example is the newly developed advisory product "Working Capital Management". It contributes to further professionalisation and increases long-term liquidity of small and medium-sized enterprises.

The focus of the **Climate partnerships with the private sector** programme of the German Federal Ministry for the Environment, Nature Conservation, Building and Nuclear Safety (BMUB) is on promoting the transfer of technology and know-how to support the setting up of a climate-friendly economy.

By co-financing **feasibility studies**, DEG supports companies as they enter markets and the economic, technical and ecological due diligence of investments.

As part of its **Up-scaling** programme, DEG uses its own funds and, since 2017, also funds from the BMZ to promote investments of small and medium-sized enterprises that aim to expand innovative business models with development impact. The programme aims at making start-ups competitive, thereby strengthening the SME sector and creating new jobs.

In 2017, commitments were entered into for a total of 173 new projects, of which 98 were with German companies. These new commitments can be allocated to five topical priority areas:

**50** projects promote compliance with international environmental and social standards

**41** projects contribute to qualifying staff and suppliers

**41** projects serve to tap into new markets, for example through building up demonstration and pilot facilities

**27** projects contribute to improving production processes

**14** projects received access to venture capital



## Innovative packaging material made from plant waste

With its products, BIO-LUTIONS GmbH wants to contribute to tackling the plastic waste challenge in India. The company has developed an innovative and cost-effective technique to produce biodegradable packaging from plant waste without any chemical additives. The company integrates plant waste that has not yet been used in the value chain, thereby contributing towards a circular economy while avoiding waste of resources.

As part of its up-scaling programme, DEG is investing in the setting up of a turnkey production plant with a capacity of 2,000 tonnes per year.

# »»» Contribution to Sustainable Development Goals

Private enterprises that act responsibly and are successful over the long term make an important contribution to global sustainability targets. DEG reinforces the contributions of its customers by providing financing in conjunction with a broad range of advisory and support services as well as promoting environmental, social and corporate governance standards.

The 2030 Agenda for Sustainable Development adopted in September 2015 comprises 17 Sustainable Development Goals (SDGs), covering ecological, economic and social dimensions of sustainable development. The realisation of this ambitious agenda requires new players and active participation of the private sector.

Through their financial success and responsible operations, the companies supported by DEG are driving forward sustainable development in line with the 2030 Agenda. DERA records this contribution by means of direct links with selected indicators. The portfolio companies of DEG are contributing to the following Sustainable Development Goals:

Percentage of DEG portfolio customers actively contributing to the SDG in question.



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