››› DEG evaluation results

Impact in times of COVID-19

A series of insights regarding development impact at risk

This report is a result of assessments made by DEG's impact monitoring and evaluating team to understand the extent to which the development impact of DEGs clients is at risk

The insights were prepared by Dr. Julian Frede, Elleke Maliepaard, Dr. Clemens Domnick, Daniela Jann, Christiane Rudolph and Leoni Kaup.

We thank our colleagues for contributing their knowledge while writing these insights.

Front page picture: AdobeStock/MACLEG

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Introduction

DEG customers have been hit hard by COVID-19. Helping our customers through the crisis is about a lot more than merely protecting our own interests or those of our customers: the private sector creates income and jobs for millions of people.

"Impact in times of COVID-19" is a loose series of brief insights into the development impact that is at stake as a result of COVID-19.

The series is structured along the lines of DEG's Development Effectiveness Rating (DERa). DERa rates customer performance in five key outcome categories. For each outcome category, DEG has assessed the extent to which the development impacts of DEG's portfolio (as per 31.12.2019) are at risk because of COVID-19.

1. decent jobs
2. local income
3. market and sector development
4. environmental stewardship[1]
5. community benefits.

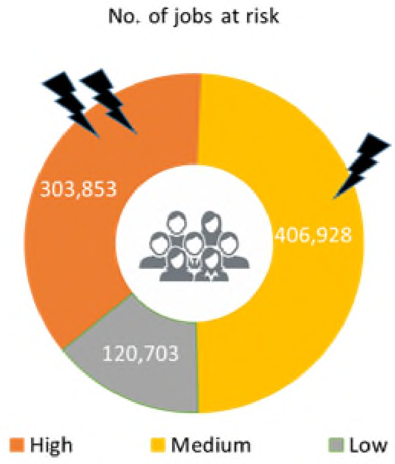
[1] We have broadened the scope of the Insight for the DERa outcome category "environmental stewardship" to encompass both environmental and social management.

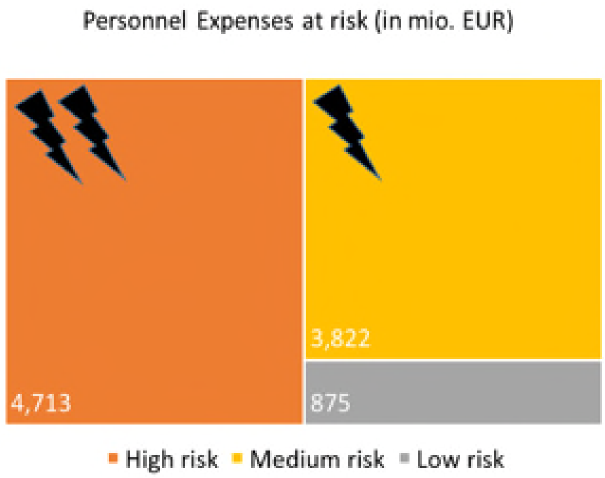
Impact in times of COVID-19: Jobs at risk

DR. JULIAN FREDE & DANIELA JANN | 22.05.2020

Globally, the International Labor Organizations sees 2.7 billion workers affected by COVID-19, representing around 81% of the world's workforce. At DEG, 35% of the 830,000 jobs of our corporate, project finance and financial institution clients are at high risk according to the KfW country/sector COVID-19 risk classification – while 35% are facing high risks, 50% also face medium risks.

The region with the highest risk exposure of is Africa: 44% of all jobs are at high risk and 51% at medium risk. This is no surprise as risk exposure correlates with low GDP and weak health systems.





The potential jobs at risk have far reaching consequences: Lay-offs will not only have huge impacts on the livelihoods of employees and their families, they will also lead to a substantial reduction of consumer spending with knock-on effects on already weak economies. For DEG clients alone, there are 4.7 billion EUR of local personnel expenses at high risk. This is almost the GDP of Togo.

Besides affecting people, society and economies, retrenchments also come at a direct cost for business as skills and labor are valuable company resources.

Supporting our clients to find creative alternatives to lay-offs whenever possible can help them to maintain a competitive edge beyond the crisis and to recover quickly and effectively. Caroline Kremer, deputy chairwomen of the works council and sustainability expert, reports of a DEG client:

> *"A well-known Bangladeshi entrepreneur decided to continued to pay wages even though the factory was shut down. The money disbursement itself became, however, a security risk as thousands of people came on payday in order to secure funds for their most basic needs. The more than three million textile workers in the country are mostly unprotected by labor law, many of them currently dismissed and unpaid and they couldn't travel back to the country-side to their families' safeguard as transport was shut down."*

In Bangladesh, DEG's 10 clients employ 40,000 people, who support around 140,000 family members (avg. family size 4.5). 1.9bn EUR are annually paid personnel expenses.

To repeat where we have started: DEG's clients are hit hard by COVID-19. Helping our clients to weather this crisis goes well beyond our own or our clients' interest: the private sector is critical to safeguard millions of people.

Impact Profile Bangladesh
(Client data based on DERa, 31-12-2019)

Decent jobs	
No. of jobs	39,808
thereof newly created jobs	16,275
Female employees	9,353
Job decency rating	68%
Local income	
Local income created	1.9 Mrd. EUR
Tax payments	0.3 Mrd. EUR
Local personnel expenses	0.2 Mrd. EUR
Market & sector	
% of clients in difficult markets	100%
% of clients reducing bottlenecks in enabling sectors	60%
% of clients with business innovations*	80%
Environmental stewardship	
Environmentally responsible practices - % of all points reached	74%
% of clients with avoidance and savings	30%
Community benefits	
Community developments contributions	4.6 Mio EUR
% of clients with external grievance mechanism*	70%

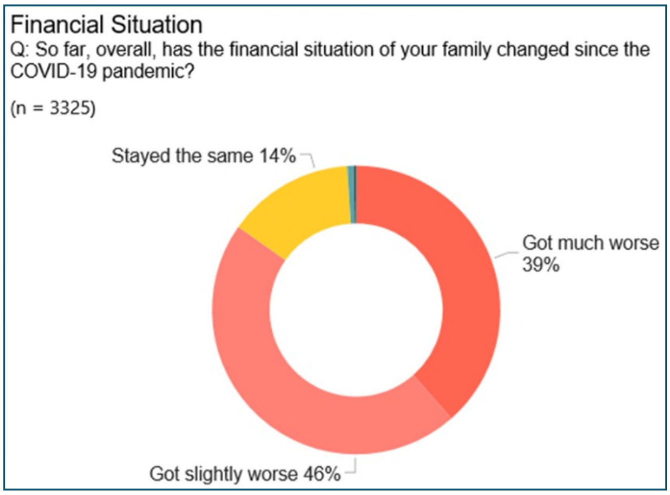
References and further information

- IFC (2020): Interim Advice for IFC Clients on Supporting Workers in the Context of COVID-19
- CDC / ERGON (2020): COVID-19 Guidance for investors and financial institutions on job protection

Impact in times of COVID-19: local incomes at risk

DR. JULIAN FREDE & LEONI KAUP | 22.06.2020

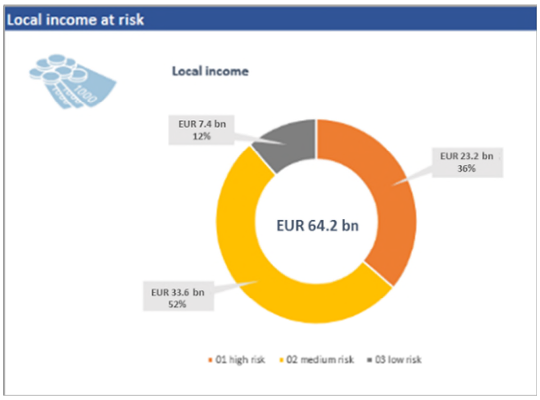
Local income generated by the private sector supports development: An increase in local income provides an increase in opportunities for self-determined decisions of individuals and institutions in developing countries. The private sector is one of the main sources of local income. This contribution 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.

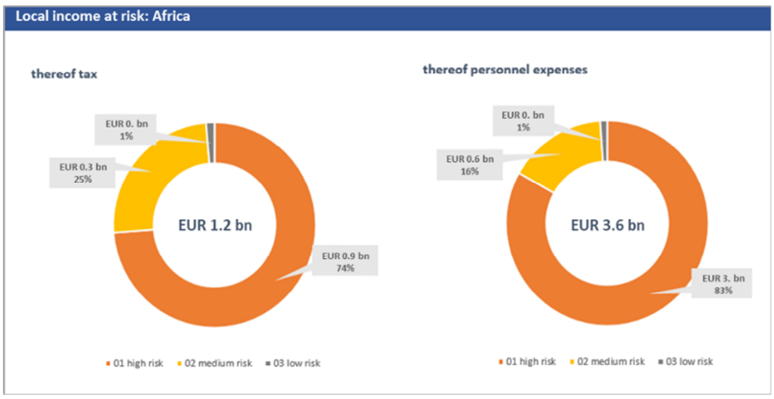


Even a short dry-up of this income stream heavily affect economies and by this societies. Poor populations are affected the most as they depend more on daily or monthly income. One of the most current data from 60decibels, an impact measurement and consultancy company shows based on more than 4,000 phone interviews in developing countries across continents that family income is not only at risk but already decreases.

The local income gerenerated by DEG's customers is under stress because of COVID-19. DEG's Development Effectiveness Rating (DERa) measures amongst others for each customer the monetary income that remains in the investment country. In 2019, this has been EUR 92.8 billion – comparable to the GDP of Morocco or Ecuador. To understand to what extent this income generation is at risk, we mapped the incomes generated by DEG's customers to KfW's COVID-19 risk categorization[2].

The analysis of the portfolio *excluding funds* (see graph below) shows that local income generation amounts to EUR 64.2 billion. 36% (EUR 23.2 billion) are at high risk, 52% at medium and 12% at low risk.



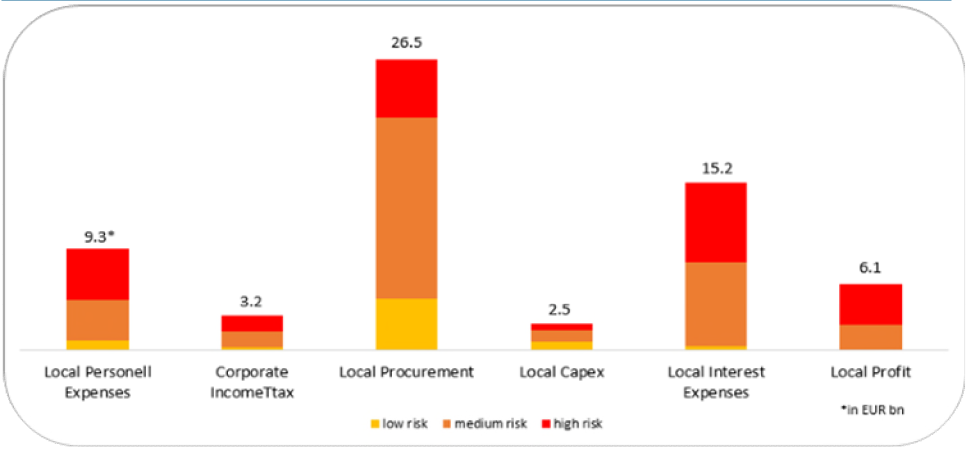


[2] KfW COVID-19 risk classification combines a country & sector risk assessment. The COVID-19 risk of countries is assessed based on multiple indicators (e.g. health system, financial stability, government capability to respond to shocks etc.). The sector assessment is based on a sector development outlook.

Focusing on Africa, we see an even worse risk situation: 75% of local income is at high risk, 24% are at medium risk and only 1% of income is at low risk. We expect an even higher probability of risk manifestation for corporate income tax payments, as they depend on healthy, profitable companies. Consequently, African government can expect that a high proportion of the EUR 1.2 billion tax revenues will not realize in 2020.

The graph below provides an overview of all local income sub-categories. Not only personal expenses and payments to suppliers are risk. Due to the sharply declining profits, the high risks of corporate income tax reductions will even more probably manifest.

Local income categories: all income at risk (in EUR billions)



DFI's long breath and expertise can be a major element of bouncing back after crisis. In the fight against the consequences of the COVID-19 pandemic, DFIs are currently more important than ever before.

> *"DFIs are not central banks. […] Rather, during economic and other shocks, they must find ways to restart or boost financial intermediation for direct and systemic impact on target populations, sectors, and countries."*[1]

DEG is already actively analyzing clients' needs and supporting from restructuring over liquidity injections to COVID-19 BSS support. Keeping business alive, keeping loss of local income and retrenchment at least on short or medium term (3-12month) at bay, can allow these businesses to climb back on the horse. Of course, this will pay back in DEG portfolio, too, as we participate actively in the fate of our clients: Development impact and sustainable business success of our clients are highly correlated when discussing local income.

References and further information

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- 60decibels (2020): as of June 15, the organization 60 decibel spoke by phone to 4,111 people in Cote d'Ivoire, India, Kenya, Myanmar, Nigeria, Paraguay, Philippines, Rwanda, Sierra Leone, Tanzania, Uganda and Zambia about how COVID-19 has affected their lives. (Link: https://app.60decibels.com/covid-19#explore)

Impact in times of COVID-19: Countries at risk

DR. CLEMENS DOMNICK | 13.08.2020

The ongoing COVID-19 pandemic has dealt an unprecedented blow to the global economy. The World Bank forecasts that the group of emerging markets (EMs) is shrinking at a rate last seen back in the 1960s. Although a moderate economic recovery – a "lopsided V" – appears to be on the horizon (see figure 1), this describes an average trend and masks considerable differences among individual EMs with regard to the impact on their economies and their ability to get to grips with the crisis.

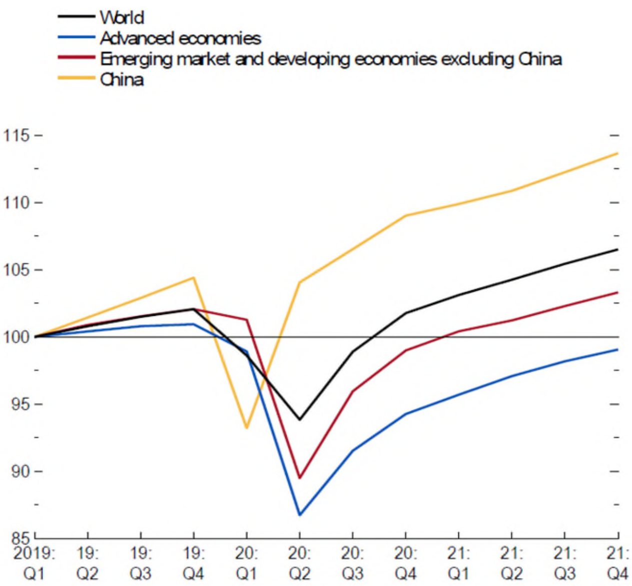


Figure 1: Real GDP (100 = 2019 Q1)

In particular, any recovery is likely to be slower in those countries

(i) that are hit hard by the wave of infections or have trouble containing the outbreak of the epidemic (e.g. in Latin America)

(ii) that are heavily reliant on a) commodity exports, b) tourism, c) international capital and trade flows, leaving them open to the impact of exchange rate fluctuations, an exodus of foreign capital, low levels of remittances, dwindling trade volumes and supply chain disruption.

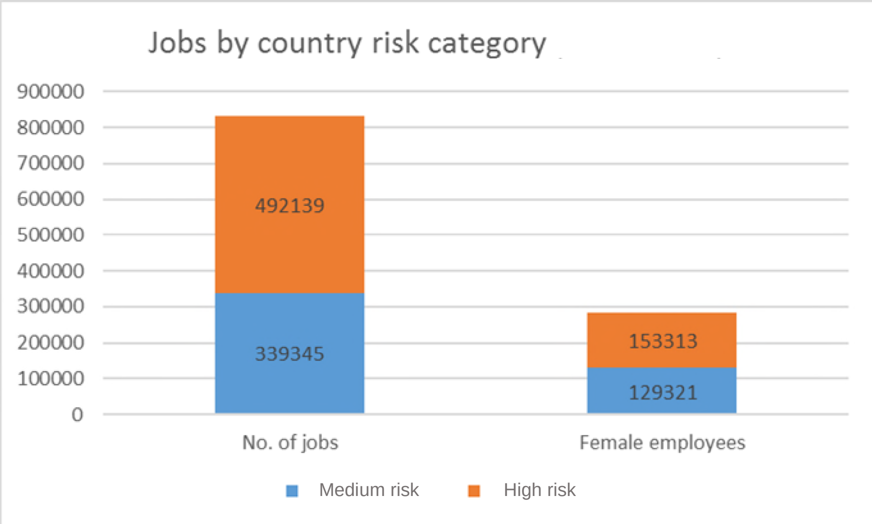
(iii) whose decision-makers have limited options at their disposal when it comes to their response to the crisis: this refers to aspects such as the fiscal and monetary leeway available to cushion the blow of the crisis by stimulating government spending (e.g. due to high debt levels) or in the form of liquidity measures taken by the central bank..

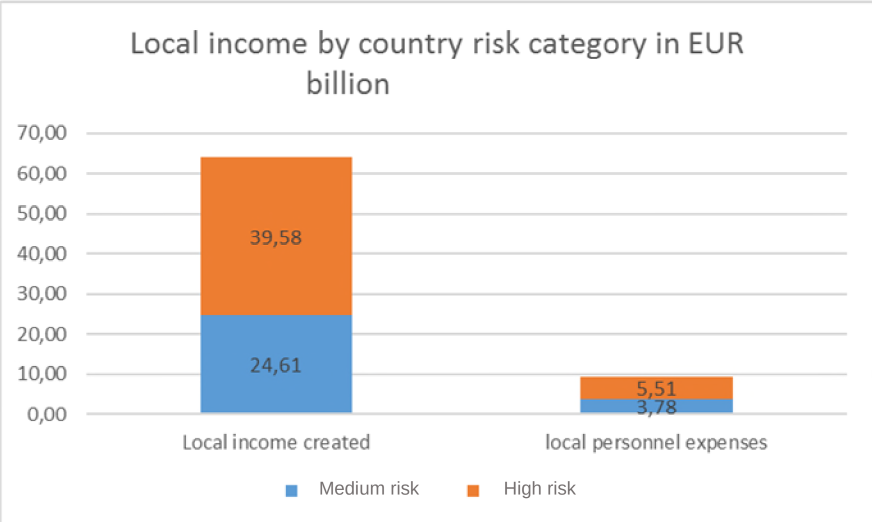
The economic and social implications of the COVID-19 pandemic are set to be particularly disastrous in these countries: recession and lockdowns translate into drastic income losses – particularly in the informal sector – and plunge millions of people into dire poverty; a growing reluctance among local companies to invest leads to low productivity levels and stagnating wages, also putting a damper on growth potential; shaky healthcare infrastructure soon becomes overstretched and only able to mitigate the negative implications of rising infection rates to a very limited extent.

More than 60% of DEG's markets hit particularly hard by the coronavirus. A systematic categorisation of the impact that the coronavirus is having at country level[3] shows that more than 60% of DEG's markets in Africa, Asia, Latin America and Europe fall into the highest (of three) risk categories.

This has consequences for the economic impact of DEG's portfolio. An analysis (excluding funds) shows that over 830.000 jobs are at risk as well as EUR 64 billion in local income generation by DEGs customers (see graphs below)

[3] KfW's COVID-19 risk assessment on a country level is based on various indicators (e.g. fiscal space, tour-ism-dependency).





By supporting and promoting the private sector, DEG is making a key contribution to softening the blow dealt by the crisis. In the 56 countries that have been hit particularly hard by the Covid-19 pandemic, DEG provides support to 222 customers (44% of all DEG customers) employing around half a million people – including more than 150,000 women – and generating local income of almost EUR 40 billion.

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Impact in times of COVID-19: E&S management

ELLEKE MALIEPAARD & DR. JULIAN FREDE | 23.10.2020

Private sector more resilient in the crisis with proper ESG management

The latest literature shows that there is a positive correlation between the management of Environmental, Social and Corporate Governance (ESG) standards and financial return. Statistical analyses highlight the positive economic effects of ESG management: both companies (Ding et al, 2020; Alberquerque et al, 2020) and funds (Pastor and Vorsatz, 2020) with an ESG focus generate an excess re-turn compared to benchmarks (see graphic).[4]

COVID-19 reinforces that trend. Through the outbreak of the global pandemic, the focus of economic players has been shifting towards the resilience of companies and their ability to withstand a crisis. As a result, there are increasing calls – by producers, consumers and investors alike – to embrace aspects of ESG.

Companies with a strong ESG focus show positive performance

The business case for ESG investing is empirically very well-founded

"[…] the study combines the findings of about 2200 individual studies. Hence, this study is by far the most exhaustive overview of academic research on this topic and allows for generalizable statements. The results show that the business case for ESG investing is empirically very well founded. Roughly 90% of studies find a nonnegative ESG–CFP relation. More importantly, the large majority of studies reports positive findings. We highlight that the positive ESG impact on CFP (Corporate Financial Performance) appears stable over time. […]."

Friede et al (2015): ESG and financial performance: aggregated evidence from more than 2000 empirical studies

DEG has been encouraging and calling for ESG management for a long time. DEG has recognised that taking a responsible approach to environmental and social risks is a key factor for successful custom-ers. Corporate and project finance customers are supported to fulfil ESG standards in line with the IFC Performance Standards (IFC PS), while financial institutions and equity funds are encouraged to set up environmental and social management systems in alignment with the IFC PS. An [evaluation study] on environmental and social risk management (ESMS) by financial intermediaries (2017) provides insights into the effectiveness and impact of such ESMS and the role of DEG (see graphic).

Assisting financial intermediaries in setting up ESG management systems

[4] based on data from Thompson Reuters.

How the crisis challenges the E&S Management of DEG customers

Preventing the spread of COVID-19 in the workplace and providing safe working conditions for those still working is of utmost importance for all companies and for society in general. Companies needed to rapidly identify measures for preventing and managing outbreaks of COVID-19 in the workplace (and workers' accommodations).To support its customers in this area, DEG published its COVID-19 guidance for employers. The document summarises recommendations, specifically from the perspective of international guidance on social topics and occupational health and safety (e.g. the IFC Performance Standards). In addition, DEG's sustainability team designed a programme to offer DEG customers free-of-charge advice by health experts out of DEG's Technical Assistance programme Business Support Services: 35 customers have benefitted from this service so far and received expert input on their safety protocols and measures. Another 35 customers have received financial support for protection measures of employees, patients, customers or surrounding communities out of DEG's Business Support Services and the devel-oPPP.de programme.

Businesses may be considering retrenchment as a short-term reaction to the economic pressures. There is, however, a strong business case for job protection (see box below) and "job protection plans" can be used to evaluate what alternative options are available. Where no viable alternatives to collective dismissals are identified and retrenchment will be required, it is key that this is done responsibly (ERGON, 2020). So far, five customers of DEG have received advice by labour experts on job protection out of a DEG's Business Support Services programme, which was designed by labour experts of DEG's sustainability team. Several others have received financial support from the Business Support Services to adapt their business models to the new conditions to stay operational and therefore secure jobs.

The business case for addressing job protection

"COVID-19 as an immediate cause of economic pressures is likely to be time-limited. It is therefore important that adequate continuity planning is in place which allows businesses to recover quickly and effectively when demand recovers. Jobs, and therefore job protection, are a crucial part of this ability to recover. Skills and labour are valuable company resources, and retention of these skills can allow businesses to maintain a competitive edge beyond the crisis, avoiding potentially costly hiring and re-training costs in the future. […]. Clearly demonstrating commitment to the workforce has significant additional benefits including maintaining the goodwill of workers, customers, and the broader community."

ERGON (2020): COVID-19 Guidance for investors and financial institutions on job protection

Environmental management is not businesses' main priority. Businesses, in coping with the pandemic, shift their main attention, resources and capacity towards the crisis response. At the same time, due to travel restrictions, international experts are not able to provide their technical input and support as planned prior to the crisis. Consequently, the implementation of environmental and social action plans is often negatively impacted and likely to progress with lower technical quality, at a slower rate, or to be (temporarily) put on hold.

Customer support and monitoring activities are challenged due to COVID-19. Prior to the pandemic, DEG engaged own and international experts to support and monitor E&S performance at its customers'. As neither DEG nor other international experts are currently able to travel, there is a stronger focus on self-reported data, virtual site-visits and outsourcing to local teams. While the obtained information is still very valuable, the quality of the insights and data is of a lower level and potentially more biased. Overall, transparency of implementation progress and quality deteriorates, which makes the dialogue with customers more difficult. DFIs are keeping in touch and learning from each other how to shape interactions with customers regarding E&S management in the best possible way under current circumstances.

Building back better

To ensure a durable and resilient economic recovery from the COVID-19 crisis, a return to ‘business as usual’, with environmentally destructive investment patterns and activities, must be avoided. “No one wants to return to a society with high unemployment, food insecurity, accelerating destruction of nature, traffic jams and air pollution. This is a once-in-a-generation opportunity to redesign our economies and societies to be more resilient to global shocks, to be more sustainable and to leave no one behind (Bapna & Gorissen, 2020).”

Build back better – a notion originating in the context of recovery and reconstruction from physical disasters – has been increasingly and widely used in the context of the economic recovery from COVID-19 (OECD, 2020; WRI, 2020). It is necessary to build back in a way that addresses the very significant near-term challenges of unemployment, food insecurity and to jump-start the economy, while incorporating a longer-term perspective regarding climate change, biodiversity loss and resilience. OECD’s build back better framework consists of five different dimensions that shall ensure an improved well-being and inclusive-ness. The BMU and the WRI, in their global dialogue on responding to the COVID-19 pandemic and economic crisis, come to a similar set of pillars setting people at the heart of a green and resilient recovery, addressing interlinkages across sectors and borders. In addition, they specify the need to shift towards transitional thinking for the recovery: what are the industries and technologies for the future (e.g. renewable energy, electric vehicles, sustainable agriculture); which industries belong to the past and should be phased out (e.g. coal); and what industries must be shifted toward transformation (e.g. steel, aviation, automotive)?

Key dimensions of building back better (OECD; 2020)

Build back better means fostering resilience to future shocks and impacts of climate change

“To build back better, countries must harness low-carbon investment opportunities to reboot economies while reduc-ing the greenhouse gas emissions and air pollution that jeopardize lives. It means pulling people out of poverty and creating more jobs. And it means fostering resilience to future shocks like disease outbreaks and the impacts of climate change”.

We Mean Business Coalition (2020): Build Back Better

For DEG, this is an inspiration for our future work. Already in the past, elements of the build back better notion have driven DEG’s strategy. The crisis shows however that it is time for a more holistic approach, which is taken into consideration in the current strategy development process. In consultation with our customers, DEG’s Business Support Services already help customers to identify new business ideas and future opportunities for sustainable growth.

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- Bapna & Gorissen (2020, 5 Pillars for a Green and Resilient Recovery from COVID-19
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Impact in times of COVID-19 – Community development at risk

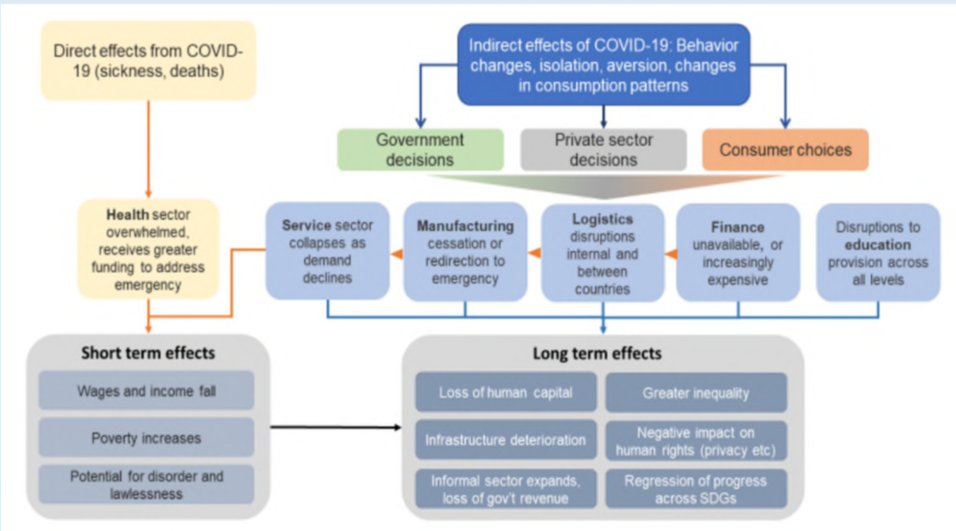
ELLEKE MALIEPAARD & CHRISTIANE RUDOLPH | 17.09.2020

The pandemic continues to have devastating impact on people from local communities, with a disproportionate impact on the poor and the vulnerable, who are faced with job and income loss, uncertain food supply, and disruptions in health and education programmes. More often than not these people lack adequate social protection and depend on informal social safety nets that are under stress caused by the pandemic (Worldometer, 2020).

To inform and tailor the responses of governments and partners to recover from the crisis and ensure that no one is left behind, the United Nations Development Programme (UNDP) supports 162 countries in assessing the socio-economic impacts of the COVID-19 crisis.

UNDP: Socio-economic impact of COVID-19 on the Kenyan economy

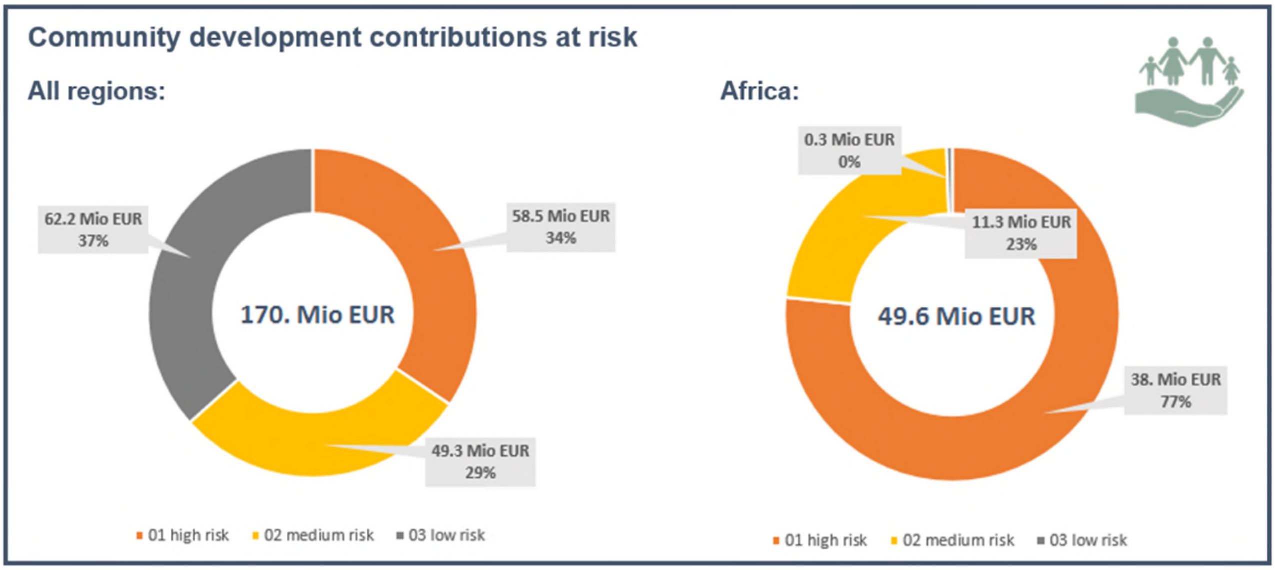
In Kenya, 35.103 cases and 597 deaths are registered[1]. According to the UNDP (UNDP, 2020), the socio-economic impact of the COVID-19 epidemic operates through two distinct channels as displayed in the figure below. First are the direct and indirect effects of the sickness. When an income earner falls ill or dies, the ratio of income earners to dependents falls, resulting in lost earnings and increasing health costs. Second are aversion behaviour effects resulting from thefear of catching the virus, e.g. through government travel bans, closing businesses or individuals reducing their activities. These also result in wages and income fall. Both channels are likely to lead to long-term negative effects.



Poverty remains high in Kenya: according to the 2019 Kenya Population and Housing Census there are about 19.5 million poor people in the country. The pandemic is likely to increase poverty, inequality and unemployment due to its adverse impact on people's jobs and livelihoods in the key sectors of the economy. The lack of health insurance for most of the poor would exacerbate poverty. Several studies suggest in addition that girls and women will be disproportionally impacted by the pandemic.

DEG's customers engage in community development activities. The DERa analysis of DEG's 2019 portfolio shows that around 86% of DEG's portfolio companies are active in this area. During the last reporting year, each company made an average amount equivalent to around EUR 400,000 available for community development. All customers together spent EUR 170 million on community development.

Community development contributions are at risk. Due to COVID-19, our customers face tremendous economic challenges. When having to count every penny to ensure the survival of the company, financially supporting local communities may not be something that our customers can afford. Mapping customer spending on community development to the KfW country & sector COVID-19 risk classification[5] provides us with insights where community support by DEG customers is at risk.



Over one third of the overall community development contributions in 2019, amounting to EUR 58.5m, was spent in geographies or sectors with a high-risk classification. Another EUR 49,3m (29%) is considered at medium risk. This image however changes dramatically when looking at Africa. There almost all community spending is at risk. Of the total EUR 49,6m, 77% is at high risk and 23% at medium risk. As a comparison, in Asia EUR 59m (65% of spending) is at low risk and EUR 10,5m (12%) at high risk. The picture is again different in Latin America, where the medium risk category is the largest with 68% of community development contributions, amounting to EUR 14.9m.

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[5] KfW COVID-19 risk classification combines a country & sector risk assessment. The COVID-19 risk of countries is assessed based on multiple indicators (e.g. health system, financial stability, government capability to respond to shocks etc.). The sector assessment is based on a sector development outlook.