The Growing Role of the Development Finance Institutions in International Development Policy

Dalberg Global Development Advisors

7 July 2010

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Published by Dalberg Global Development Advisors – Copenhagen ©2010
This publication is available from:
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Foreword

The private sector plays a crucial role in developing countries. It is a vital factor for growth and job creation and, by spurring economic development, provides the fiscal base which allows governments to realize general investments and bring about redistribution of wealth.

The private sector is also at the very heart of environmental, social and governance related preoccupations and is the object of much public policy. Many negative externalities can be reduced by fostering best Corporate and Social Responsibility practices in this sector.

But more than just an object of public policy, the private sector can itself become a key player in society. As demonstrated in the impact evaluation analysis of European DFIs' financed projects, it can be directly responsible for the provision of certain basic services in the social sector, and plays an important role in providing access to certain essential services such as water, sanitation, energy, transport and communication, particularly through public-private partnerships.

Throughout the course of their existences, most of the European DFIs have demonstrated their ability to catalyse private investment in developing countries with these three ends in view. Whilst operating under market conditions they have witnessed a continuous growth in commitments and results, bearing testament to a strategy based around complementary strengths between themselves and a complete range of long term financial instruments.

Since 2006, the European DFIs have shared developmental impact evaluation tools applied to their operations. The aim of these tools allow them to highlight the contributions that the projects financed by each of them are making to development, to growth and employment, to the access the populations concerned have to basic services, as well as controlling the effects of its projects on the local and global environment.

As shown by this report, The European DFIs network plays a key role in the international development policies of the European countries, and represent a rising "third pillar" alongside traditional aid instruments and the main bilateral banks dedicated to the public sector.

The European DFIs welcome the contribution of this report to highlight the important contribution of DFIs dedicated to the private sector in international development policy. I strongly hope it will help spark the interest of the public and European policy makers.

Luc Rigouzzo
EDFI Chairman

Executive Summary

Development Finance Institutions (DFIs) are government-controlled institutions that invest in sustainable private sector projects with the twofold objective of spurring development in developing countries while themselves remaining financially viable. DFIs are already quite well-known in some European countries, where their strong track record in promoting development is widely acknowledged. However, more still needs to be done to make private investors and policy-makers aware of the growing role of DFIs and to highlight potential new areas of collaboration.

This report provides an introduction to the European DFIs and their work. It also puts them into the context of current international development policy priorities, including the creation of sustainable employment opportunities and the reduction of poverty levels in low income countries[1].

The European DFIs

The Association of European Development Finance Institutions (EDFI) has fifteen members, all of them operating government-controlled funds mandated to invest in developing countries and emerging markets.

The European DFIs all have different areas of specialization and expertise, often reflecting the comparative advantages of partners in their home countries. Some of them are fully state-owned while others have private participation. The European DFIs also have diverse investment strategies and operate in various countries, using different investment instruments. Each one of them is profiled in this report.

A thriving private sector is the engine of growth

The number of people living in extreme poverty worldwide has levelled off in recent years. But many countries still face numerous obstacles in the fight against poverty. The continuation of the positive trend in economic growth will be essential to sustain that fight. Private sector investment is strongly associated with economic growth through the creation of profits, jobs, government tax revenues and other benefits to the society. According to one major global survey by the World Bank, more than 70% of the world's poor believe that the best way to escape poverty is to get a job.

Getting access to finance presents a challenge to companies in many developing countries. The majority of low income countries do not have sovereign credit ratings that are up to investment grade and this discourages private investors, making it difficult and expensive for entrepreneurs and companies to raise the finance they need in order to grow and develop. Particularly small and medium sized enterprises (SMEs) lack access to finance. This gives rise to a problem referred to as "the missing middle" – those businesses with perhaps the greatest potential to grow and create jobs being the very ones that have the least access to the investment they need to finance that development.

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[1] OECD defines "Low Income Countries" as all countries with per capita GNI < US $935 (in 2007) per OECD DAC List of ODA Recipients effective for reporting on 2009 and 2010 flows.

A track-record of relevant results

The European DFIs have a long track-record of investing in private sector projects in developing countries. The 15 European DFIs have built up a huge depth of experience from decades of investment activity. Many of them have been around since the 1960's and 1970's.

Their combined investment portfolio now amounts to approximately €18.5 billion invested across low and middle income countries, Africa being the largest region with approximately 28% of the portfolio. Every year EDFI funding for new projects in the form of loans and equity investment is around €4 billion. This level of investment corresponds to roughly 6% of Official Development Assistance provided by the governments of the DFIs' 14 home countries[2]. But investments by DFIs often represent a crucial component of private investment in those countries where they operate.

The approach of the European DFIs is to invest in private sector projects that not only have development impact but are also financially viable. In making investments they are guided by three principles: the need to be additional (going where other investors don't), catalytic (paving the way for others to follow) and sustainable (making sure that investments have long-term viability). This investment approach allows the DFIs to provide access to finance for the private sector in countries where this is a prerequisite for economic development and poverty alleviation. The DFIs have a track-record of significant results. Evaluations show that DFIs are able to generate both positive development impact and good financial returns in a majority of their projects. These significant economic effects constitute a major contribution towards achieving the Millennium Development Goals (MDGs) agreed at the UN Millennium Summit in New York in 2000 – eight specific goals to be met by 2015 as a measure of progress in the fight against extreme poverty.

The European DFIs have also provided a very cost-efficient use of public funds for their governments. Their investments have positive development effects that last even after investments have been repaid. Successful projects also make financial returns and eventually return the invested capital, which can then be reinvested in new projects. Through this process, the total combined portfolio of the European DFIs has roughly doubled in the last ten years, with only a modest share of the increase derived from capital injections from governments. Capital injections from private shareholders and borrowed capital also represent a modest share of the portfolio growth. In addition to this process of investment and reinvestment, the DFIs manage to catalyze often significant amounts of investment from private investors who may not otherwise have invested in developing countries.

The "Third Pillar" in Europe's international development policy

DFI's investments in the private sector are complementary to traditional overseas development assistance, which is typically focused on investments through the public and

[2] Belgium has two DFIs: BIO and BMI-SBI.

not-for-profit sectors. Investment in the private sector can be seen as a third pillar in international development policy, standing alongside:

- Aid – donations provided to public and civil society partners through bilateral and multilateral channels
- Development bank public sector lending and guarantees

All three of these pillars are valid and important components of international development policy. They represent very different and highly complementary approaches to fighting poverty. All three recognize the role of private sector growth in ensuring sustainable development. However, DFIs are the channel that most directly delivers this strategy by providing private sector finance where it is most needed in developing countries. It will be very difficult to achieve international development goals without sustaining and scaling up these efforts. This is particularly the case in the context of the global financial crisis, which has had a negative impact on foreign investment in developing countries by creating downward pressure on public spending in donor countries, including the amount spent on overseas development assistance.

A growing role for European DFIs

The European DFIs are determined to take on a growing role in international development policy to continue to grow their successful track record and expand access to finance for the private sector in developing countries.

The DFIs are exploring a number of approaches in an on-going attempt to increase their contribution to improving access to finance. Each DFI plays the key part in exploring the options available to them, but there is also a potential for an increased role of the EDFI association, particularly in promoting awareness of the DFIs' work and role in development policy.

The DFIs are exploring a number of approaches in an on-going attempt to increase their contribution to improving access to finance:

- Increasing visibility for private investors
- Engaging in the public policy debate
- Making public and private sector finance more complementary
- Updating regulatory practices
- Growing the capital base

Finally, DFIs are continually exploring ways and means of updating their working practices and investment strategies to address new issues and opportunities. Measuring development impact and managing the sustainability of investments are two areas where European DFIs have recently developed fresh and innovative approaches. Together with their governments, they have also been looking at how they can update their mandates and regulations so as to become as effective as possible in development policy. Finally, the track record of DFIs makes them potentially an attractive alternative asset class for institutional investors. Several DFIs are considering how best to exploit this potential to expand private sector participation.

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Abbreviations

ACP	Africa, Caribbean and Pacific countries
AWS	Austria Wirtschaftsservice Gesellschaft
BIO	Belgian Investment Company for Developing Countries
CDC	CDC Group plc
CIS	Commonwealth of Independent States
COFIDES	Compañía Española de Financiación del Desarrollo
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
DFI	Development Finance Institutions
EC	European Commission
EDFI	European Development Finance Institutions
EFP	European Financing Partners
EIB	European Investment Bank
FDI	Foreign Direct Investments
FINNFUND	Finnish Fund for Industrial Cooperation
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden
GDP	Gross Domestic Product
IFC	International Finance Corporation
IFU	Danish Industrialisation Fund for Developing Countries
IRR	Internal Rate of Return
LDC	Least Developed Country
LMIC	Lower Middle Income Countries
MDGs	Millennium Development Goals
NORFUND	Norwegian Investment Fund for Developing Countries
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OeEB	Oesterreichische Entwicklungbank
PROPARCO	Société de Promotion et de Participation pour la Coopération Economique
SBI-BMI	Belgian Corporation for International Investment
SIFEM	Swiss Investment Fund for Emerging Markets
SIMEST	Società Italiana per le Imprese all'Estero
SOFID	Sociedade para o Financiamento do Desenvolvimento
SME	Small and Medium Enterprises
Swedfund	Swedfund International
TCX	The Currency Exchange Fund
UN	United Nations

1 Introduction

1.1 European DFIs

Development Finance Institutions (DFIs) are specialised financial institutions that invest in developing countries. In Europe there are 15 national DFIs which serve to implement their governments' international development and co-operation policies. They are usually controlled by their governments. There are also multilateral DFIs, such as the International Finance Corporation and the private sector arms of the regional development banks.

The DFIs invest in private sector companies and projects with the aim of generating development impact while at the same time delivering a financial return[1]. They seek to invest in projects that would not receive funding without their involvement and to attract co-investors from the private sector who would not otherwise have invested in those projects or countries. DFIs also seek to promote responsible corporate governance and to uphold social and environmental standards in the projects in which they are involved.

1.2 Context

EDFI is the Association of 15 European Development Finance Institutions. Since it was founded in Brussels in 1992, the Association's mission has been not only to foster financial and technical co-operation among its members but also to strengthen information flow and co-operation between its members and other bilateral, multilateral and regional development finance institutions. In addition, EDFI serves to inform the general public and government stakeholders about the European DFIs' contribution to development.

1.3 Report objectives

This report has two main objectives:

1) To describe and articulate the role of European DFIs in international development through:
    a) Describing the role of development finance for the private sector as a driver of economic growth in developing countries;
    b) Improving the understanding among decision makers and the informed public of the value-added of the European DFIs in international development; and
    c) Outline how DFIs, aid agencies and development banks complement each other in addressing the breadth of challenges to development in emerging markets.

2) To present options for DFIs to assume a greater role in international development

We hope that the report will spark debate about the growing role of DFIs.

2 Role of the private sector in poverty reduction

2.1 Slow but steady development progress

Although achievement of the MDGs is behind schedule, progress is being made[2]
Poverty reduction, in the context of sustainable development, remains a major challenge. The 2009 MDG Gap Task force report revealed that in 2008 one in four people in the developing world, a total of 1.4 billion, were living in extreme poverty, defined as less than US $1.25 (PPP) per day. And it is estimated that the global financial crisis that then developed will have had the effect of adding an extra 55-90 million more to that total in 2009 than had previously been anticipated.

It is also estimated that as many as one billion people will still live in poverty by 2015, the target date for the Millennium Development Goals. As well as major global economic challenges such as the recent financial crisis, progress in the fight to reduce poverty faces numerous other obstacles such as the growing need for sustainable energy, the increasing threat of climate change impacts and a global food crisis.

And yet developing countries have made substantial, although uneven, progress in poverty reduction over the past thirty years with the result that the total number of people living below the official poverty line has levelled off, despite population increases[3]. And the proportion of people living in extreme poverty has been almost halved since 1990, when almost half of the developing world's population fell into this category. The proportion of people living in poverty has decreased across Asia and Africa, but held constant in Latin America and the Caribbean. In Eastern Asia a sharp fall in poverty has occurred, largely as a result of rapid economic growth in China where the number of people living on less than US $1.25 (PPP) per day was reduced by 475 million.

In Africa, the poverty rate has fallen by almost 6% from 2000 to 2007. Studies indicate that primary school enrolment increased by over 36% between 1999 and 2007 to over 88%[4]. Infant and child mortality decreased by 21% between 1990 and 2008[5]. Healthcare has been improved with the help of key interventions such as the distribution of insecticide-treated bed nets and immunization campaigns. Macroeconomic reforms in many African countries are producing results in terms of delivering growth and stability and several African economies are now becoming success stories[6]. For example, Ghana has implemented political and economic reforms since the early 1990s, leading to significant declines in inflation and poverty and impressive economic growth[7].

2.2 Economic growth has been an important driver for poverty alleviation

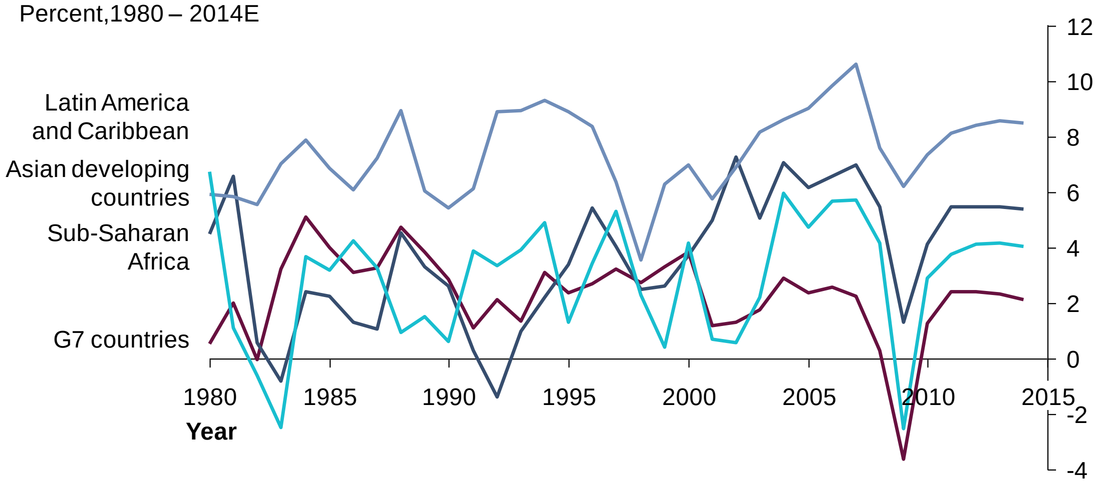
In 2005 nearly all people living in extreme poverty lived in either in Sub-Saharan Africa (28%) or Asia (66%). Of the 66% in Asia, 33% were in India, 15% in China and 18% in other Asian countries[8].

In the past fifteen years Sub-Saharan Africa and developing countries in Asia have experienced steady annual growth rates of 5% and 8% respectively. By comparison, the EU grew 3% and G7[3] countries 2% in the same period. However, where population growth rates are more than 2% in Africa they are close to 0% in EU countries[9].

Solid growth rates expected to continue, but they are not sufficient
The positive trend in economic growth in developing countries is forecast to continue in the near future[10]. Exhibit 1 below shows the evolution of GDP growth since 1980 and projected growth through 2014.

Exhibit 1 – Strong growth expected to continue in the near future in developing countries

GDP growth at constant prices in developing Asia*, Sub-Saharan Africa, and G7 countries**
Percent,1980 – 2014E



* Composed of 23 countries: Bangladesh, Bhutan, Cambodia, China, Fiji, India, Indonesia, Kiribati, Lao People's Democratic Republic, Malaysia, Maldives, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand, Tonga, Vanuatu, Vietnam

** Composed of Canada, France, Germany, Italy, Japan, United Kingdom, and United States

Source: International Monetary Fund. (2009): World Economic Outlook database. October 2009 Update.

Economic growth is an essential pre-requisite for poverty reduction and this link is demonstrated, for instance, by the World Bank study “Growth Is Good for the Poor”. Based on economic data from 80 countries over a period of four decades this shows that as the economy grows, the income of poor people (here defined as the bottom fifth of the population) rises by about as much as the income of everyone else[11]. A World Bank analysis of 19 low income countries[4] suggests that 1% growth in per capita GDP was associated with a 1.3% fall in the rate of extreme poverty and a 0.9% fall in the number of people living on less than US $2 per day[12].

Higher growth rates are needed to speed up economic development. Studies suggest that an additional 2% GDP growth as well as a 40% increase in productivity in Africa could have

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[3] Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

[4] OECD defines “Low Income Countries” as all countries with per capita GNI < US $935 (in 2007) per OECD DAC List of ODA Recipients effective for reporting on 2009 and 2010 flows.

been realized if adequate infrastructure been in place[13]. This is a significant challenge in the context of the financial crisis. Meanwhile, unemployment rose 10% in Africa in 2009 and an estimated seven to ten million young people are added each year to the roughly 200 million young people in Africa not formally employed as of 2009[14].

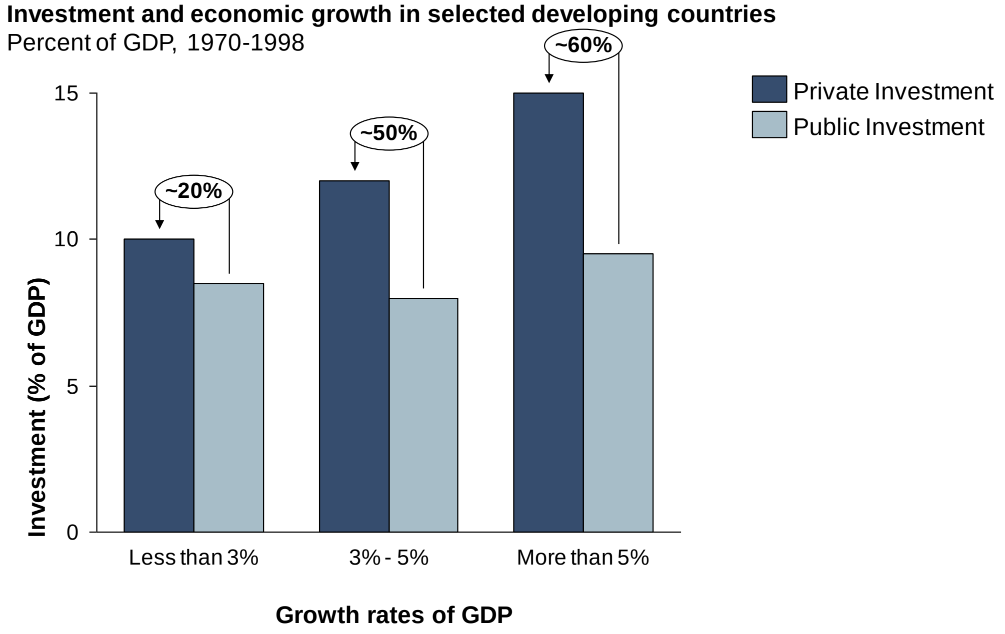
2.3 Private sector growth essential for economic growth

Public sector investments are necessary but not sufficient in poverty reduction
Public sector investments are crucial in supporting the development of a national infrastructure, including education, health and transport systems. A robust public sector can support the growth of private businesses by helping to create an enabling environment with a strong regulatory structure and an educated workforce.

However, poverty reduction cannot be achieved simply through direct aid donations to social sectors; it also requires public and private sector investments[15]. The findings of a January 2010 report by Dutch think-tank 'WRR the Scientific Council for Government Policy,' signalled an increased awareness that fighting poverty can best be achieved not simply through direct giving to social sectors but also through the indirect effects of investments in underserved areas like SMEs[16].

A thriving private sector is the engine of economic growth
Research suggests that private investment is more closely associated with growth than public sector investment[17]. This argument is also supported by an analysis of public versus private sector investments in developing countries. A comparison between investments in the public and private sectors from 1970 – 1998 in both high and low growth developing countries shows that high growth countries invested 15% of GDP in the private sector compared to 10% for low growth countries. Overall, high growth countries invested 60% more in the private sector than in the public sector, as illustrated in Exhibit 2.

Exhibit 2 – Private investment is strongly associated with economic growth



Source: Bouton, L., and Sumlinski, M. (2000): "Trends in Private Investment in Developing Countries: Statistics for 1970–1998." Discussion Paper 21. International Finance Corporation, Washington DC.

Development of the private sector generates private income, but also contributes to general economic and social development in a number of ways:[18]

- Employment – new jobs, wage increases, non-salary benefits and labour mobility through training
- Government – value-added tax revenues
- Customers – improved quality and/or lower price goods and services
- Suppliers – increased demand for and sales of goods
- Broader community – e.g., environmental gains, development of infrastructure

Private firms are a powerful source of job creation in the developing world. Two surveys, from the World Bank and Gallup point to the link between job creation and poverty reduction. The World Bank survey "Voices of the Poor" highlights the fact that more than 70% of the world's poor believe that the best way of escaping poverty is to get a job[19]. A survey conducted by Gallup in 26 Sub-Saharan African countries asked ~26,500 Africans to rank what they consider most important to development[20]. The provision of jobs for young people was identified as one of the most urgent needs. The recent Copenhagen Statement by the African Commission put it like this: "Strong growth and employment opportunities are required to achieve the MDGs, and to sustain progress already made in the areas of health, food security and education[21]."

When the private sector grows, businesses pay more taxes to the government, making more funds available to the public sector for initiatives such as the building of schools and hospitals. Consumers typically benefit in the form of increased choice and lower prices from increased competition when new players enter markets[22]. As the market grows, suppliers overall will experience increased demand from business customers and they will likely grow as well. The broader local communities may also benefit in several different ways – through potential environmental gains, new physical infrastructure and improved social infrastructure, including better environmental, social, and governance (ESG) practices[23].

3 Role of development finance for the private sector

3.1 Access to finance – The key barrier to private sector growth

The DFIs' primary contribution to international development comes in providing finance to segments of the private sectors in developing countries that are underserved, thereby increasing employment opportunities, income, tax revenue, product availability and so on. The DFI portfolio companies help to lift skill levels and facilitate the transfer of technology and knowledge through DFI participation in the management and development of the companies. All these factors contribute to strengthening local conditions and reducing aid dependency.

Barriers that limit private sector growth and lead to market failures
Private sector growth faces several obstacles. This section discusses four types of barriers that typically face private enterprises in developing countries:[24]

- Access to finance
- Enabling environment
- Access to technology and business information
- Training and education

3.1.1 Access to finance

Businesses need money and capital to grow. It is estimated that over three billion people in developing countries lack effective access to loan and deposit services[25]. Access to finance is particularly a challenge in countries that are either rated "non-investment grade"[5] or not rated at all. Low or non-existent credit ratings make it difficult for private financial institutions to invest. Only 9 countries in Asia and five in Africa are rated as investment grade (Botswana, Libya, Morocco, South Africa, and Tunisia). This leaves 49 African countries[26]. This means that 49 out of a total of 54 African countries are either rated as "non-investment grade" or are not rated at all. Excluded countries are those that do not issue debt on global markets and where market information tends to be very limited[6]. Absence of a sovereign credit rating tends to increase the cost of borrowing, further discouraging private investors from working here. For instance, in Sub-Saharan Africa only 5-25% of households have a formal relationship with a financial institution[27]. Interest rates in Africa average 8%, with some countries at 25%, compared to a global average of ~5%[28]. Least Developed Countries and Sub-Saharan Africa along with post-conflict and conflict countries are more often than not rated as "non-investment grade" or are excluded from analysis. Exhibit 3 below provides an overview of the wide range of unrated and non-investment grade developing countries.

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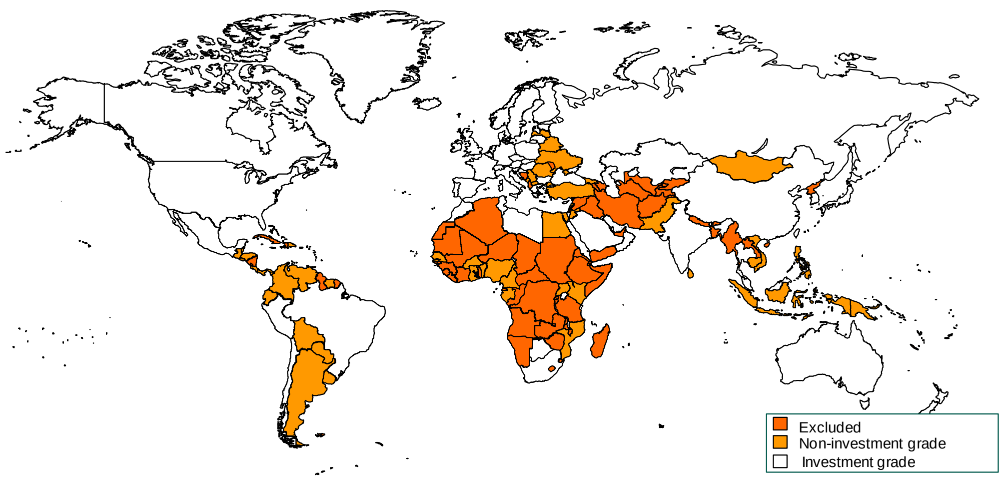
[5] Sovereign risk rating by S&P, which assess the probability that a country will default on its debts. C is lowest and AAA highest and investment grade rating require at least BBB rating.

[6] Based on S&P ratings of 120 countries. In comparison, Moody rates a similar number of countries.

Exhibit 3 – High prevalence of non-investment grade and unrated countries in SSA and other developing regions



Source: S&P. (2010): "Sovereigns ratings." Standard & Poor's.

3.1.2 Enabling environment

The private sector also relies on an enabling environment to grow. Regulatory frameworks, infrastructure, good trade conditions, etc., are crucial to private sector development[29]. The absence of an adequate legal framework can hinder private businesses from operating in the formal sector. Regulation and oversight have impact on a range of factors outlined in World Bank's "Ease of Doing Business" rating system, which looks at what is required to start a new business, get the necessary permits, pay taxes, enforce contracts and partake in international trade[30]. Corruption at local, regional and national levels can also inhibit private sector development.

Public and private infrastructure, such as access to electricity, water supply, paved roads and telecommunications, is also needed to stimulate private sector growth. Enterprise Surveys show that private businesses in developing countries often rate a lack of adequate infrastructure as one of their greatest problems[31]. For example, one estimate has suggested that the upgrading of a trans-national Sub-Saharan Africa road network could increase trade over land threefold to US $30 billion annually[32].

Market barriers restrict trade. For instance, quotas and volatile currency fluctuations reduce purchasing power and make investors hesitant to provide loans in local currencies (see case study on TCX fund for more information on currency risks). This creates substantial hurdles for private businesses trying to sell their goods and services in national, regional, or international markets while also adding to the difficulties involved in accessing finance.

Good market information is also a crucial component of risk assessments for investors as well as private companies seeking to grow in new markets.

3.1.3 Access to technology and business information

Limited access to technology and business information is a barrier to growth of many enterprises in developing countries. This can in part be addressed by increasing access to market information and business knowledge, which can help to facilitate informed decision-making and improve the success rate of their business activities. Also, access to business skills and knowledge of best practices, such as how to best scale-up and gain access to private capital, can help local companies improve their performance.

Being able to access new technologies can help companies to increase productivity substantially, e.g., through innovation and reduction of time-consuming and complex and processes. Further, it facilitates information sharing and connection to international resources. For instance, restricted access to the internet impairs the flow of information to and from private businesses, especially in the more remote areas of many developing countries and in politically and economically fragile post-conflict countries (see BIO DRC case study)[33].

3.1.4 Training and education

Education and training of employees is a key factor in improving labour productivity[34]. Businesses depend on public sector investments in education to be able to recruit employees with a certain level of skills. The businesses themselves can then contribute through on-the-job training. There is no shortage of entrepreneurial spirit and innovation in developing countries, but the lack of an adequate educational infrastructure combined with a brain drain of skilled professionals can often present a significant challenge[35].

3.2 Constraints on public financing for developing countries

In Least Developed Countries in particular public funding is simply not available to cover the full cost of development, which emphasizes the critical role of private sector investments.

Official Development Assistance goes to countries with less than $11,455 per capita GNI[36], and in 2007 these countries between them received a total of US $104 billion[37]. The Least Developed Countries[7] are the poorest countries with a GNI per capita below US $750[38]. In 2007, the Least Developed Countries received about 30% of all Official Development Assistance, equivalent to 0.09% of OECD countries' GNI. Of the 30%, a bit more than half went to eight countries (DRC, Bangladesh, Uganda, Mozambique, Sudan, Ethiopia, Tanzania and Afghanistan), which together account for 16% of the Least Developed

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[7] The list of LDCs has been agreed by the UN General Assembly and includes the following 50 countries, classified by region: Africa: Angola, Benin, Burkina Faso, Burundi, Cape Verde, the Central African Republic, Chad, Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Saõ Tomé and Principe, Senegal, Sierra Leone, Somalia, the Sudan, Togo, Uganda, the United Republic of Tanzania and Zambia; Asia and the Pacific: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, the Lao People's Democratic Republic, Maldives, Myanmar, Nepal, Samoa, Solomon Islands, Timor Leste, Tuvalu, Vanuatu and Yemen; Latin America and the Caribbean: Haiti.

Countries' population. Hence, the remaining 84% of the LDC population received only 14% of total Official Development Assistance (~US $15 billion).

In addition, less than half of the OECD/DAC countries are meeting the 0.15-0.20% target for aid to the Least Developed Countries that was reaffirmed as part of the Programme of Action for the Least Developed Countries adopted in Brussels in 2001[39].

3.3 Development finance for the "missing middle"

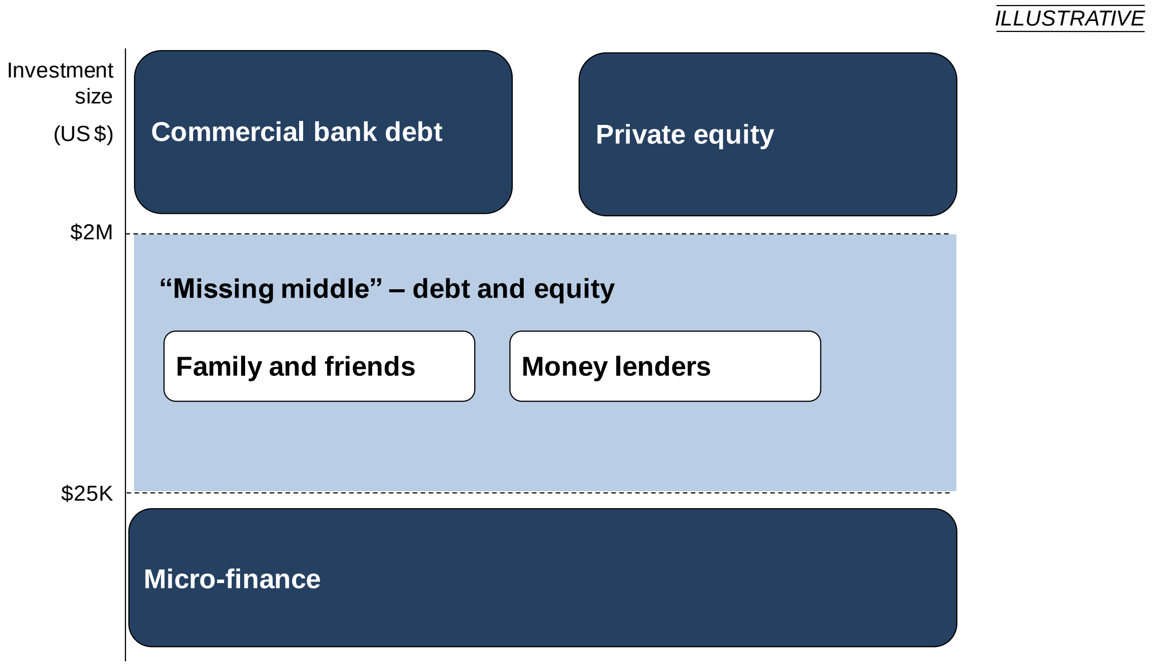
The lack of access to finance is particularly critical for SMEs

The three private sector segments - large businesses, small and medium enterprises (SMEs), and micro-businesses[8], have different degrees of access to finance. Generally, bigger and wealthier clients are served by large banks. Micro-businesses are increasingly served by microfinance institutions that have emerged in the last decade, often following the example of the Grameen bank and other pioneers[40]. Meanwhile, as shown in Exhibit 4 below, SMEs are frequently too large to qualify for microfinance and microfinance loan sizes are too small to meet SME capital needs. At the same time, SMEs are often considered by commercial banks and financial institutions to be risky and costly to serve. This issue is often referred to as the "missing middle" in financing.

The offerings made available by commercial banks to SMEs are often mismatched to their needs, e.g. loans with high interest rates and short repayment periods. The lack of long-term financing options, equity in particular, is a key issue for SMEs in developing countries[41]. As a result, the financial needs of SMEs are often underserved, limiting their growth. They rely instead on access to finance from informal sources such as family members, overdraft and money lenders, who can charge high interest rates for loans that are too small to cover the SMEs' needs.

[8] World Bank defines SMEs as an enterprise that must have at least two of the following three characteristics: (1) between 10-300 employees; (2) assets of US $0.1 –15 million; (3) and/or annual sales between US $0.1 – 15 million. Large and micro businesses fall on opposite ends of this spectrum. Whereby micro-businesses generally have less than 10 employees, assets and annual sales of under US $0.1 million; and large businesses have over 300 employees, assets and annual sales of over US $15 million.

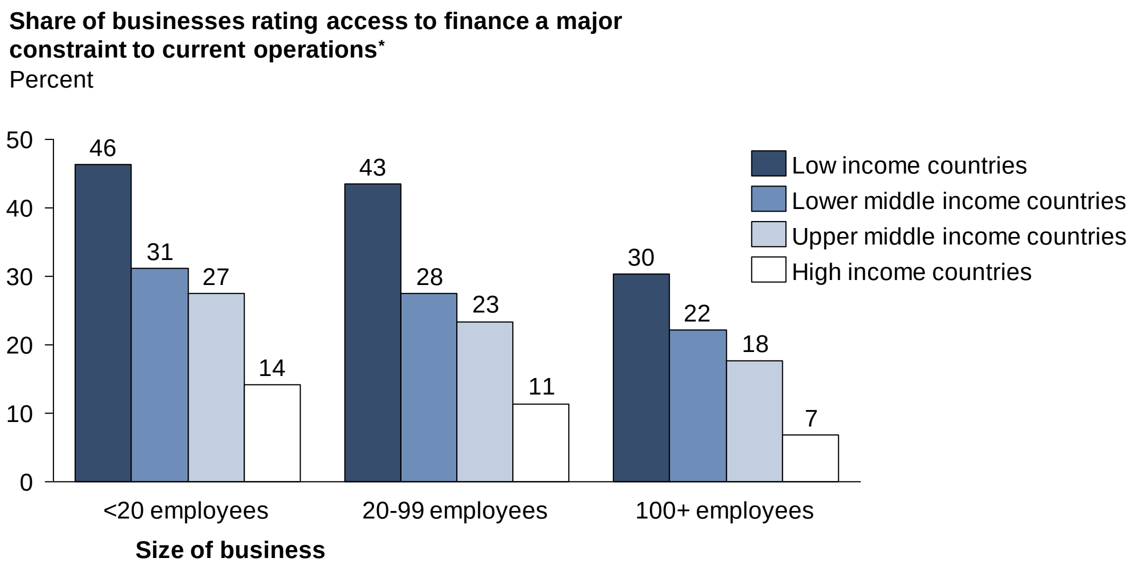
Exhibit 4 – Lack of access to finance for SMEs is a major barrier to growth



Source: Adapted from CFED Desktop Study: SMEs and Poverty Reduction; Thorsten Beck, Ash Demirguc-Kunt and Vojislav Maksimovic, "Financing Patterns Around the World: Are Small Firms Different?"; Thorsten Beck and Asli Demirguc-Kunt, "Small and Medium Size Enterprises: Access to Finance as a Growth Constraint"

Exhibit 5 below shows that almost half of all small businesses with less than twenty staff in Low-Income Countries consider access to finance a major barrier to their current operations, while only 14% do so in high income countries.

Exhibit 5 – Large share of small businesses in developing countries see access to finance as a major constraint



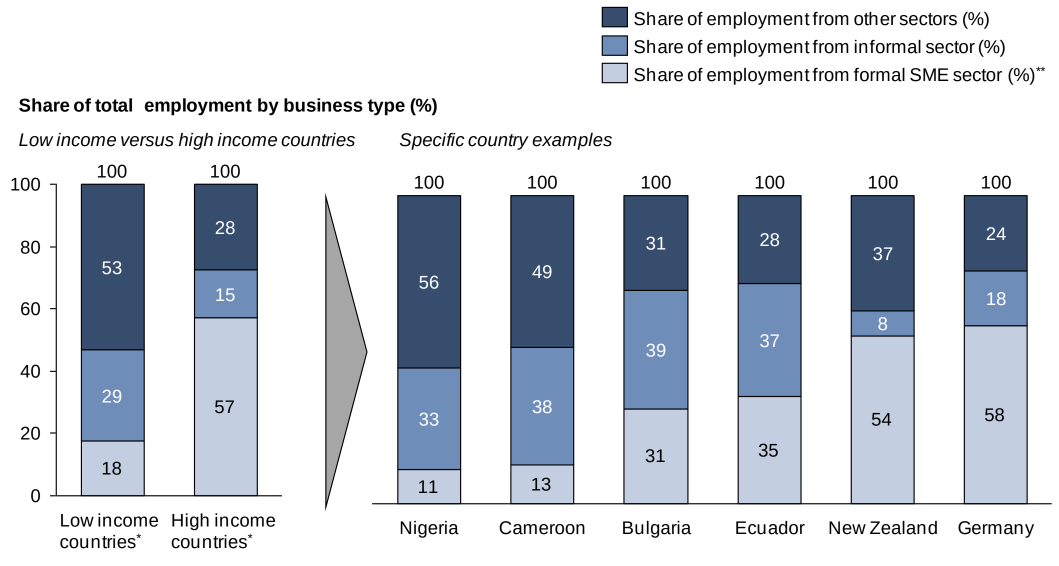
* Countries weighted equally within income groups to calculate overall average; Data collected between 2002 and 2007
Source: World Bank Enterprise Surveys; World Bank List of Economies;

Large potential to strengthen SME activity

SMEs form a critical part of any economy, with both high growth potential and high vulnerability. Economists have found a strong positive link between the size of the SME sector and GDP per capita growth. However, leading studies (World Bank, OECD and others) do not find an immediate causal impact from SMEs to growth and poverty alleviation. Instead, SME growth programmes are typically motivated by a rationale to improve the productivity and growth of important economic sectors over the longer term.

The SME sector has strong potential to grow in poor countries, as they currently contribute only 16% of GDP and 18% of employment in low income as against 51% and 57% in high income countries[42]. Exhibit 6 illustrates the size of the SME sector in low and high income countries.

Exhibit 6 – Formal small business sectors in low income countries are less developed than in high income countries



*Contribution percents are median values for income group. ** Only includes businesses operating in formal sector

Source: Ayyagari, Beck and Demirguc-Kunt, "Small and Medium Enterprises across the Globe: A New Database", World Bank 2003; Dalberg analysis

Direct and indirect approaches to financing the "missing middle"

Investors tend to approach the SME markets from both a direct and indirect perspective. Investing indirectly can be done via intermediaries, through SME banking in PE funds and other types of financial institutions, who then provide access to finance to SMEs in all types of sectors. Indirect investments in financial institutions that support SMEs are viewed as a critical method of supporting SME financing. Best practices for SME banking are being established by stakeholders in the European DFI communities, global investment firms like SEAF and financial associations such as the Emerging Market Private Equity Association (EMPEA) that specialise in targeting developing countries. Investing directly in individual companies requires local knowledge and sector specific skills, and tends to be perceived as higher risk.

More funding is becoming available to SMEs but substantial gaps remain

Financing for SMEs has been emerging as a priority topic in development policy over the last few years. The sort of financing needs of SMEs that are increasingly being catered for include loans and equity in local currency, to avoid exposure to currency risk, along with flexible repayment terms such as quasi-equity offerings – debt instruments with equity-like characteristics that include flexible repayment or revenue based returns[43]. From being a relatively neglected investment discipline, often overshadowed by microfinance and larger-scale project finance, SME financing requirements have been subject to a significant surge of interest recently. An initiative investigating SME best practices is currently underway by the SME Finance subgroup of the G20 process led by Germany and South Africa.

4 European DFIs and their role in development policy

4.1 Combining development impact with financial viability

As of 2009, the total EDFI portfolio was made up of investments worth €18.5 billion, with an additional €4.6 billion committed for new investments. Commitments are typically realized up to five years after they are granted. The investment objectives of European DFIs are to maximize development impact while being financially viable. Although development impact is the key focus for all European DFIs, they have varying approaches to the way in which they deliver on the demand to be financially viable. Some interpret this as a requirement to at least break even, while others set specific return targets, e.g., 6% return on investment.

4.2 Additional, catalytic and sustainable

The European DFIs' approach to delivery on the objectives consists of three key elements, as illustrated in Exhibit 7 below:

Exhibit 7 – European DFIs' approach to promoting private sector development

	Promoting private sector development		
European DFI approach	**Additional – Going where other investors don't**	**Catalytic – Paving the way for others to follow**	**Sustainable – Reducing the dependence on aid**
What it means	• Investing in underserved geographies, sectors and segments, e.g., –LDCs, Africa, post-conflict and conflict states –Financial sector, agribusiness, etc. –SMEs	• Demonstrating to other investors how to conduct investments in high risk environments • Being the first movers in underdeveloped sectors • Mobilizing other investors	• Building sustainable and growing sources of tax income for governments • Promoting responsible governance, human rights environmental standards, etc.
How it works	• The long-run approach enables EDFIs to invest in higher risk segments in developing countries	• EDFIs' expertise, standard-setting and knowledge-sharing enable others to invest in developing countries	• Help build sustainable sources of tax income for local governments • Serve as channels for responsible policy implementation

Source: Dalberg analysis

Additional - Going where other investors don't

European DFIs focus their investments on developing countries and on under-developed sectors and segments considered too high risk for most investors. These markets are underserved and development impact potential is high. European DFIs are unlisted entities and their owners have a long-term approach to investments. This means that they are under less pressure to deliver short term results and are therefore better positioned to invest in countries that have high traditional risk ratings but where a long term approach reduces the risk.

Geographically, European DFIs invest primarily in countries included in the OECD DAC definition of developing countries, with older investments in certain poor regions of Russia remaining as key exceptions. European DFIs also prioritize investments in Least Developed Countries that are often considered high risk, including post conflict and conflict states. Asia is the region with the highest share of the European DFI portfolio with 30% of its total investments, whereas Africa, with 28%, has the second largest share. 17% is invested in Central and South America and 14% in Russia and CIS countries. However, with regard to new commitments made in 2009 the focus on Africa has increased significantly, up to 34%, or €1.6 billion, of all new investments, while 27% went to Asia (incl. 6% to China), 15% to Central and South America, and 7% to Russia and CIS[44].

In terms of sectors, European DFIs focus their investments where they will have strong effects in developing the local commercial infrastructure and capital markets. They develop expertise within these fields and bring it to the local markets. The majority (32%) of the 2009 portfolio is invested in the financial services sector, acknowledging that this sector is key to economic development, generating knock-on benefits for other sectors by helping financial institutions to facilitate access to finance for large companies and SMEs. Half of the financial sector investments went into investments funds and one third into commercial banks.

Industry and manufacturing account for 29% and infrastructure for 26%, where power, telecommunications and roads, ports and airports are the largest sub-sectors. Agribusiness accounts for 7% and other sectors for 7% of the total portfolio. The trend in new commitments in 2009 shows increased focus on the financial sector with 51%, or €2.3 billion, of all new investments placed in this sector, while infrastructure received 25%.

European DFIs address all business segments. Investments in micro businesses and SMEs are conducted within a wide range of sectors where access to finance is lacking due to high risk profiles or other barriers, whereas the focus of large business investment typically involves building up key elements of the local infrastructure such as power and telecommunications networks.

The case study below, featuring the Belgian DFI BIO, provides an example of European DFI additionality by working in a fragile, post-conflict state.

Case study – BIO's loan to Global Broadband Solutions in the Democratic Republic of Congo[45]

Background: Investing in the private sector of underserved areas like post-conflict countries where few other investors are active is a key value add of European DFIs. The Democratic Republic of Congo (DRC) is striving to recover from the war that officially ended in 2003 and was a humanitarian disaster. The aftermath left 5.4 million people dead, mostly from disease and starvation[46]. An important component of its recovery is private sector growth. Limited access to information and communication technologies (ICT) is a large challenge. Despite a 20 fold increase in internet penetration since 2000, under 0.2% of the population (~10,000 users) have internet access as of 2008. This is far below the African average of 5.3% penetration[47].

Description: BIO's decision to provide a direct loan of €700,000 to Congolese ICT company Global Broadband Solutions (GBS) in 2008 illustrates the commitment to development in a post-conflict setting. GBS delivers innovative radio-wave solutions for cost-effective internet access for SMEs and private individuals, along with satellite-based solutions for larger enterprises. The loan is intended to help facilitate an expansion of GBS in the three urban areas of Matadi, Kolwezi and Goma, as well as to improve services in the capital Kinshasa, (these are cities in the east, west, and south of the DRC). In addition, BIO is providing a technical assistance subsidy of ~€23,500 for the training of local technicians and business managers.

Additional role: BIO's financing demonstrates additionality. Local lenders were not able to offer GBS an affordable long-term loan. The BIO loan will cover a period of six years, which is double the maximum period provided by domestic lenders. With the help of this loan, GBS's revenues are expected to grow by 10% per year in the next five years, and the workforce to expand from 100 to 150, creating employment and enhancing technical skills.

Sources: BIO and BBC

Catalytic - Paving the way for others to follow

European DFIs act as catalysts of participation from other investors both directly and indirectly - directly through the mobilization of other investor capital and indirectly through helping local markets to build strong foundations for commercial activity, making them attractive to other investors by proving that profitable investments are possible in these markets. The mobilization of additional funds is also a way for investors to share the risk, which enables them to act as first movers and work in areas perceived as high risk.

European DFIs invest in commercially under-developed areas to help build the markets. Swedfund's partnership with Engro Energy Limited (EEL) is an example of where European DFI financing has been instrumental in helping to achieve the goal of setting up a greenfield power plant in Pakistan. Such projects are usually viewed as especially risky by traditional investors so the catalytic role of DFIs like Swedfund is especially significant in building confidence. Swedfund's financing has provided the starting point from which Engro Energy has set off on its way to becoming a major player in the power sector in Pakistan.

Another example of a European DFI acting as a first mover is Norfund's investment, along with Banco Africano de Investimentos (BAI) in Angola's first private equity fund Fundo de Investimento Privado Angola (FIPA)[48]. DEG's role as a co-founder of the Kyrgyz Investment and Credit Bank at a time when no banks in Kyrgyzstan provided long-term finance to private companies also illustrates the catalytic role of European DFIs[49].

The financing that European DFIs bring to relatively high-risk projects helps to mobilize the involvement of private capital, bringing in commercial banks, investment funds or private businesses and companies. In addition, the DFIs act in co-operation with governments and other organizations in providing funds for technical assistance, feasibility studies and management consultancy.

Some European DFIs such as CDC measure their mobilization efforts. A CDC report states that during 2004-2008 it committed €4.8 (US$ 7.1) billion to its funds managers with an additional sum of more than €13.4 billion (US$ 19.7billion) mobilized from commercial investors. This means that for every dollar invested by CDC, almost 3 additional dollars were mobilized from private investors[50].

The case study below featuring SIFEM provides an example of a European DFI being catalytic by serving as a first mover to build up Ghana's financial sector.

Case study – SIFEM and FMO's support of a Ghanaian private equity firm[51]

Background: Building up the financial sector enables private sector development. Financial services are necessary for entrepreneurship, job creation, economic growth and, ultimately, return on investment. For these reasons, DFIs not only provide financing and capital, but, when necessary, also support financial institution-building in cooperation with public and private sector stakeholders. SIFEM's experience in West Africa provides insight into the steps taken leading to the successful establishment, funding and long-term viability of Ghanaian private equity firm, Fidelity Capital Partners Limited (FCPL).

Description: FCPL commenced business in 1999 with core activities that included corporate finance, advisory services, private equity and venture capital fund management. In 2004, encouraged by FMO and SIFEM, FCPL re-organized by diversifying its shareholding and refocusing on venture capital and private equity as its core business. SIFEM and FMO used their regional relationships and networks to enhance FCPL's viability through South-South partnerships. For example, SIFEM and FMO sought the active involvement of Tuninvest (an experienced Northern African fund manager) as a FCPL shareholder and Board member. SIFEM and FMO also assisted FCPL with operational improvements, such as establishing and upgrading information and control systems, risk management tools, and providing the expertise necessary to generate operational excellence at investee companies. They also helped FCPL to establish its supporting governance, transparency and ESG standards. A decade later, with several million US dollars under management, a regional presence and a staff of qualified investment professionals, FCPL is an independent, viable private equity firm with a strong reputation and diversified shareholding.

In parallel to FCPL's establishment, the Ghanaian government launched an initiative to promote venture capital, boost private sector development and enhance access to long term funding for entrepreneurs. Holding public seminars involving key local public and private sector stakeholders, SIFEM provided input to enhance the efficiency and viability of the government's venture capital vehicle, the Ghana Venture Capital Trust Fund. SIFEM also assisted the Ministry of Finance in the development of the country's regulatory framework to promote private equity and venture capital.

Catalytic role: SIFEM was a first mover in a new market, working in close collaboration with Ghanaian officials and private investors to set standards, share knowledge, promote cooperation and mobilize others. Overall SIFEM and FMO helped FCPL grow from managing one small PE Fund (FEF I) of US $8.5 million, where SIFEM and FMO were the main shareholders, to managing four funds today. FEF I is currently in the exit stage and is set to deliver an IRR of 5-10%. Gaining expertise and establishing a track record has enabled FCPL to mobilize other investors. Today, in addition to FEF I, FCPL also:

(1) manages a second US $25 million fund, FEF II, with co-investors SIFEM, Finnfund, FMO, Oikocredit, SOVEC, Venture Capital Trust Fund and SNNIT (a local pension fund)
(2) is the local investment partner of AfricInvest Fund I, a €34 million pan-African generalist PE fund and follow-on AfricInvest Fund II of €120 million.

With a SME and expansion capital focus, FCPL's investments have created employment and increased revenue in West Africa, i.e. ~2,750 jobs and US $500 million in revenue in 2009 at investee companies through its Fidelity funds.

Sources: SIFEM

Sustainable – Reducing dependence on aid

European DFIs promote sustainable growth of the productive sectors. This helps create the tax base that should ultimately enable local governments to focus on building the required infrastructure, regulatory framework and broader enabling environment; thereby breaking the dependency on aid. By investing in local companies and helping them grow, the potential for sustainable and growing sources of income in local communities are created. For example, DEG was involved in establishing the largest aluminum smelter in Mozambique, which has made the country one of the largest aluminum producers in the world. It contributes 77% of the country's exports and is an important tax payer[52].

European DFIs also help to improve standards in the areas of responsible governance, compliance with environmental regulations and good business practices in relation to staff and the wider community, e.g., by guarding human rights, including gender equality, and also by protecting vulnerable members of society such as children. Local communities are thereby further equipped to grow sustainably and the governments' dependence on foreign aid is decreased.

"Cotton made in Africa" is a case study that features one of DEG's 'develoPPP.de' Public-Private partnerships (PPP), which is supported by the Germany Federal Ministry for Economic Cooperation and Development (BMZ). The project is an example of European DFIs promoting sustainability and providing targeted support for sustainable development projects involving private enterprises in both developed and developing countries. The PPP program also shows how European DFIs promote cooperation between the private and public sectors, as it is financed by BMZ and executed by DEG, GTZ and sequa Partner of German Business along with additional private sector partners[53].

Case study – DEG, German government, and other partners' develoPPP.de programme profiling "Cotton made in Africa"[54]

Background: Cotton is one of the world's most widely traded commodities and is produced in many developing countries that are often heavily dependent on their cotton export earnings. Cotton is therefore a hugely important economic factor, with direct effects on poverty reduction and sustainable growth. With an 8% share in world cotton production, Africa is the second largest exporter of cotton after the US. In the Sahelian countries the revenue from cotton exports accounts for US $1.5 (~€1.2) billion per year. In Benin and Burkina Faso the revenue from cotton exports accounts for 75% of GNP. In Sub-Saharan Africa alone 20 million people depend on cotton production, which is driven by small-scale farmers who are highly vulnerable to volatile world prices, often face poor working conditions and frequently use unsustainable cultivation methods.

Project description: OTTO, one of Germany's largest retailers, founded Aid by Trade Foundation (AbT)[9], which initiated a new multi-stakeholder PPP in several African countries along with DEG, GTZ and BMZ. Additional partners include WWF, GlobalGAP/Foodplus and pilot country stakeholders like Dunavant Zambia Ltd and Faso Coton in Burkina Faso. The key objectives of 'Cotton made in Africa' are to create an alliance of major retailers, including the international textile value chain, to secure demand for these products and to promote socially and ecologically sustainable production. Its main activities are: (1) capacity building for small scale farmers, (2) strengthening links between farmers and cotton companies, (3) enhancing supply and demand chain, and (4) increasing cooperation and best practice sharing along the production chain.

Sustainability role: After two years of implementation, the project is having sustainable effects through the establishment of a system to assess and monitor ecological and social sustainability in production. Pilots are underway in Benin, Burkina Faso and Zambia; and businesses' value chains are being strengthened. Over 100,000 local farmers have been trained in good agricultural practices and it is estimated that some 1.2 million people will benefit from this project (including farmers and their families). In Zambia a sub-programme is being run to increase cotton productivity with the aim of increasing income for small farmers. Thus far, gross margins per hectare of the farmers partaking in the program are ~250% higher than the average of farmers not participating in the program. The project can therefore be seen to contribute to a sustainable and growing source of income for farmers as well as increased tax contributions to local governments.

Sources: DEG and PPP

4.3 European DFIs' diversity

The European DFIs apply different business models to reach their objectives
European DFIs operate in different circumstances and have built different business models to fit their context. The areas in which they differ most are (1) governance structure and

[9] AbT previously was called the Foundation of Sustainable Agriculture and Forestry.

funding and (2) investment strategy, i.e. their choice of financial instruments and geographic and sector focus.

4.3.1 Approach to governance and funding

One-third of the 15 European DFIs are fully owned by governments. Eight European DFIs have a mixed ownership structure with both private and public sector owners, while two are fully privately owned.

Mixed ownership structures provide additional benefits to European DFIs by helping them align with the interests of key stakeholders through having both public and private sector representatives as owners. Mixed ownership also has the potential to provide additional sources of funding.

Overall, European DFIs grew their portfolios by an average of 10% per year from 2001-2009, up to a total of €18.5 billion. The growth in the portfolio comes from capital injections from public or private shareholders, from loans or from accumulated profits. Public sector funding can take different forms, such as Official Development Assistance (ODA), Other Official Flows (OOF) and various additional sources of government funding, e.g., grants from aid organizations. The total capital injections from the government from 2001-2009 amounted to €1.2 billion. Compared to the total EDFI portfolio, the government injections in those nine years make up 7% of the total portfolio value as of 2009. This relatively low share of government injections can partly be explained by the fact that many European DFIs received significant Official Development Assistance contributions in their early years and are expected to grow organically as they mature.

Some European DFIs manage additional funds for the government, outside the DFIs' balance sheets. This option is often used to invest in particularly high risk projects or projects where the expected financial return is too low to make up for the risk. It can be difficult for DFIs to take such projects on their balance sheets and managing a government fund is then an alternative way to still leverage the capabilities of the DFI while avoiding the risk.

Funding from the private sector is either equity- or loans-based. Private sector owners can inject more capital as required to promote the growth of DFIs, which can also borrow funds in the capital markets. Most European DFIs have debt-equity ratios below 0.5, which means that their operations are financed primarily with paid-in capital and retained earnings. Yet, OeEB is an example of a highly-leveraged DFI with a debt-equity ratio of ~10, meaning that it has borrowed 10 times the amount of equity on its balance sheet to finance its investments.

Collectively, the European DFIs made an average €522 million of after-tax profits in 2007-2009, with significant differences in the contributions by each European DFI. Profits can either be re-invested or paid out as dividends. If these profits were all re-invested in new projects, the portfolio growth would equal 2.8% based on the 2009 portfolio. Some DFIs were able to generate enough profits to grow the portfolio by 15%, such as IFU with €78 million per year during 2006-2008 and a 2009 portfolio of €528 million[55].

Exhibit 8: Table of key data points[56]

EUROPEAN DFI	COUNTRY	Total portfolio 2009	Portfolio compounded annual growth rate 2001-2009 (%)	Government injections (2001-2009) as a share of 2009 portfolio (%)	Avg net profit after tax 2007-2009	Avg ROE 2007-2009 (%)	Debt/equity ratio 2009	Share private ownership 2009 (%)
Million €								
bio	Belgium	261	42.0	132	2.2	1.1	0.0	<1
CDC	UK	3,349	7.5	0	314.0	11.1	0.0	0
COFIDES	Spain	482	23.2	0	2.2	4.4	0.1	39
DEG	Germany	4,701	9.5	0	28.5	2.5	1.7	0
FINNFUND	Finland	403	10.1	7	8.6	8.5	0.7	<1
FMO	Netherlands	4,598	11.5	4	71.0	6.1	1.8	49
ifu/iø	Denmark	528	-3.6	-79	35.0	7.5	0.0	0
Norfund	Norway	635	26.7	79	27.8	5.4	0.0	0
OeEB	Austria	149	108.9	24	0.5	10.1	9.7	100
Proparco	France	2,184	12.2	9	22.7	7.6	2.8	41
BMI SBI	Belgium	18	-9.3	0	0.4	1.1	0.0	37
SIFEM	Switzerland	284	14.4	78	-	-	-	100
SIMEST	Italian	701	14.0	0	5.9	4.2	-	24
SOFID	Portugal	3	-25.0	0	-	-	-	40
Swedfund	Sweden	232	14.0	54	3.0	1.6	0.2	0
EDFI	EDFI	**18,527**	**10.0**	**7**	**521.8**	**6.7**		

Notes:
Portfolio: Includes book value plus undisbursed commitments, also includes funds managed for the governments that are not on the DFIs' balance sheets, i.e. for FMO and COFIDES.
Portfolio growth rate:Four European DFIs were established after 2001, and their results are not included for the full period: BIO (2001), SIFEM (2005), OeEB (2008) and SOFID (2007).
Data on average profit and ROE are 2006-2008 for CDC, OeEB, SBI-BMI and SIMEST; these data were not available for SIFEM and SOFID.
Government injections: Equals total government injection between 2001-2009 divided by total 2009 portfolio; BIO total injections for 2001-2009, worth € 346 million, have not yet been fully invested.
Average ROE: Return on equity equals Net profit/(equity-net profit).
IFU/IØ includes IØ, which is being phased out.
Debt / equity ratio: equals total debt/equity

4.3.2 Investment strategies

Most European DFIs have a focused strategy within specific sectors and geographies as well as within financial instruments and products. In order to serve markets perceived by traditional creditors to be higher risk, e.g., SMEs and post conflict countries, European DFIs need to diversify risk. There are clear benefits to be gained by specializing within certain sectors or products and the DFIs differ in the ways that they balance these benefits with risk diversification needs.

Geography and sector

European DFIs focus their investment strategies according to their areas of expertise, with varying degrees of sector and geographic diversification. In 2009, seven of the European DFIs held more than 50% of their portfolio in one sector and eight held more than 30% in one region. The DFIs diversify their portfolio to varying degrees, with a tendency to diversify more on one dimension than others. For example, IFU has a very targeted approach to sector focus, with 63% of its portfolio in the industry/manufacturing sector, but a more diversified approach to geography, with investments in multiple regions including Africa (21%), South Asia (8%), South East Asia (9%), Russia (14%), CIS (12%), China (11%) and so on.

Instruments and products

European DFIs use three different financial products, with equity and quasi-equity making up 55%, loans 43% and guarantees 2% of the combined 2009 portfolio. However, individual European DFIs have very varied product mixes, with an equity share range from 100% at SIMEST and 96% at CDC to 0% at SOFID. DFIs invest in local companies in developing countries both directly and through intermediaries. Managing direct investments requires local knowledge and expertise within the given sector, whereas investing through intermediaries, such as investment funds, leverages the local skills and know-how of the intermediary. Both models are used by the European DFIs. At one extreme, CDC operate fully as a fund of funds, while most DFIs rely on a mixed strategy, such as that favoured by DEG, which involves both investing in funds and also building local knowledge and expertise through its 18 overseas offices (as of 2009).

Partnering with the national private sector

Some DFIs, such as IFU and SIMEST, are tied to promoting national interests. This means that they require a national partner to co-invest with them in order to promote the interests and leverage the expertise of the national private sector. Other DFIs, such as Finnfund and Swedfund, are committed to promote national interests but with no specific requirements on involvement of the national private sector in all projects. Finally, seven European DFIs, including OeEb and CDC, have no ties at all.

There are multiple examples of strong synergies that have developed as a result of leveraging expertise and capital from national companies. For example, FMO has built up strong financial sector expertise, which is leveraged in projects such as the TCX fund (see TCX case study) and also in its 2009 US $10 (€7.4 million) investment in Zanaco, Zambia's oldest and largest bank, aimed at improving access to financial services. Norfund has developed an expertise in the renewable energy sector through its multiple investments in SN Power, which has projects and operations in Asia, Africa and Latin America[57]. However, limiting the flexibility for European DFIs to develop the optimal investment strategy could compromise the overall impact of their investments. For example, it can force the DFIs to become too limited in their sector focus and make it more challenging to mobilize capital beyond what is provided by the national partner.

4.4 Complementarity with other DFIs and development banks

European DFIs, IFC and regional development banks are complementary
National and multilateral DFIs outside of Europe, of which IFC and the US-based OPIC are two of the more significant ones, have similar objectives and priorities to those of European DFIs.

IFC is the largest multilateral DFI and a member of the World Bank Group. Focused on investments in the private sector, it has a consolidated portfolio of €35 billion as of 2009, 11% of it invested in Sub-Saharan Africa. IFC and the European DFIs have complementary approaches and often co-invest. IFC has a world-leading expertise in assessing large investment projects in a range of sectors and has an average project size approximately four times the size of the combined portfolio of the European DFIs.

Many regional development banks also have private sector operations. For instance, AFDB, ADB and IDB all invest in private projects, primarily through loans. DFIs regularly co-invest with regional development banks and private investors on larger projects.

In Europe, the European Investment Bank (EIB) has a mission to further the objectives of the European Union by making long-term finance available for sound investments. Its total assets were €326 billion in 2008[58] and the shareholders are the 27 member states of the European Union. A large majority of EIB’s activities are within the EU, but it also has activities in other regions. It is active in over 150 countries where it works to implement the financial pillar of EU external cooperation and development policies. Loans provided in 2008 to projects in African countries amounted to €464 million[59].

EIB and European DFIs have overlapping missions and often co-invest. EIB is increasingly focused on ensuring effectiveness and efficiency in co-financing[60]. Working with European DFIs helps EIB to fulfil its objectives and also to invest in smaller projects than it would be able to do on its own, given its mandate. The European Financing Partnership has been established as a vehicle to promote this cooperation. The case study below provides an overview of the European Financing Partners (EFP).

Case study – 12 European DFIs and EIB investment in European Financing Partners (EFP)[10]

Background: European DFIs often partner each other and join forces with other financial institutions to leverage mutual expertise and pool funding for a given investment project. Despite the benefits of such collaboration, the decision making process can be lengthy (often more than a year) and the bureaucracy high when multiple organizations need to be aligned on all aspects of an investment project.

Description: EFP was created in 2003 as a joint venture between the multilateral European Investment Bank (EIB) and EDFI members with the purpose of strengthening co-operation between eligible European DFIs and the EIB while simplifying processes[61]. EFP's set-up involves the delegation of authority from the thirteen institutions involved in EFP to a single EDFI member in charge of implementing the project. This structure means that EFP does not have to hire employees specific to this institution but can rely solely on its partners' ownership of individual projects. As a result, EFP's annual operational costs amount to only €40,000[62]. The focus of EFP projects is in line with those of its owners; promoting sustainable development of the private sector in African, Caribbean and Pacific States (ACP). EFP can provide funding through a range of instruments: Senior Loans, Mezzanine Debt, Equity, Quasi-Equity and Guarantees. One outstanding example of how well this can work involves the processing of a large telecommunications project in less than two months from first application to disbursement.

Outcome: The value of the EFP portfolio today amounts to almost €321 million, with 26 projects in 13 African and Caribbean countries including Kenya, Benin, Sierra Leone, Malawi, Mauritius, St. Lucia and Haiti. A broad range of sectors are served, the main ones being industry, financial intermediaries, communications, agribusiness and power, with investments also in the transport, health and hotel sectors. Due to its impressive track record EFP was replenished with €230 million in May 2009, of which €100 million was provided by the EIB and €130 million by the EDFI members[63-64].

Sources: EDFI and EFP

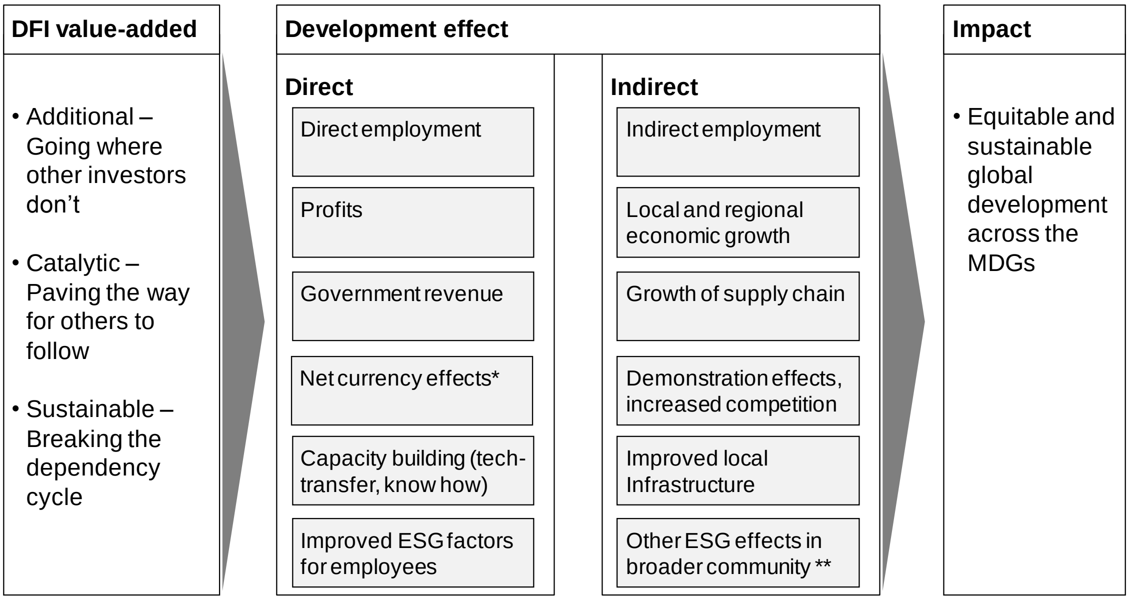
[10] The funding capacity of EFP is provided by the EIB and 12 EDFI members: BIO (Belgium), CDC (UK), COFIDES (Spain), DEG (Germany), FINNFUND (Finland), FMO (the Netherlands), IFU (Denmark), NORFUND (Norway), OeEB (Austria), PROPARCO (France), SIFEM (Switzerland) and SWEDFUND (Sweden).

5 European DFIs' contribution to development impact and the MDGs

5.1 How European DFIs think about development impact

Investment in the private sectors of developing economies generates development by creating new employment opportunities, generating profits that are spent locally, increasing competition, expanding supply chains and providing other direct and indirect benefits. The individual DFIs define development effects in slightly different ways. Exhibit 9 below presents a consolidated view of these effects.

Exhibit 9 – European DFI's direct and indirect contributions to development effects



* Net currency effects estimate the total contributions to the national balance of payments (exports minus imports). This is a useful measure because many developing countries have a balance of payments deficit, so contributing to reserves gives stability to the macroeconomic environment and supports the central bank

** ESG denotes environmental, social and governance factors

Source: Swedfund. (2008): "New thinking, new markets - Sustainability report 2008"; Norfund. (2008): "Creates value, combats poverty – Contribution to development 2008"; DEG. (2008): "Corporate policy rating ("GPR"); CDC. (2008):"Development Report 2008;" and Dalberg analysis

5.2 Increased focus on systems to track development outcomes

European DFIs employ measurement tools to evaluate impact

Public and private funders of development activities are increasingly calling for evidence of the effectiveness of development spending, so the need to document the impact of investments is growing[65]. A lot of work has been put into developing methodologies to capture both direct and indirect impact. The trade-off to capturing all the development impacts of an investment is the need to invest further in the resources required to collect the necessary information. Therefore, DFIs are faced with a challenge of tracking their contribution to development outcomes while at the same time keeping the costs down.

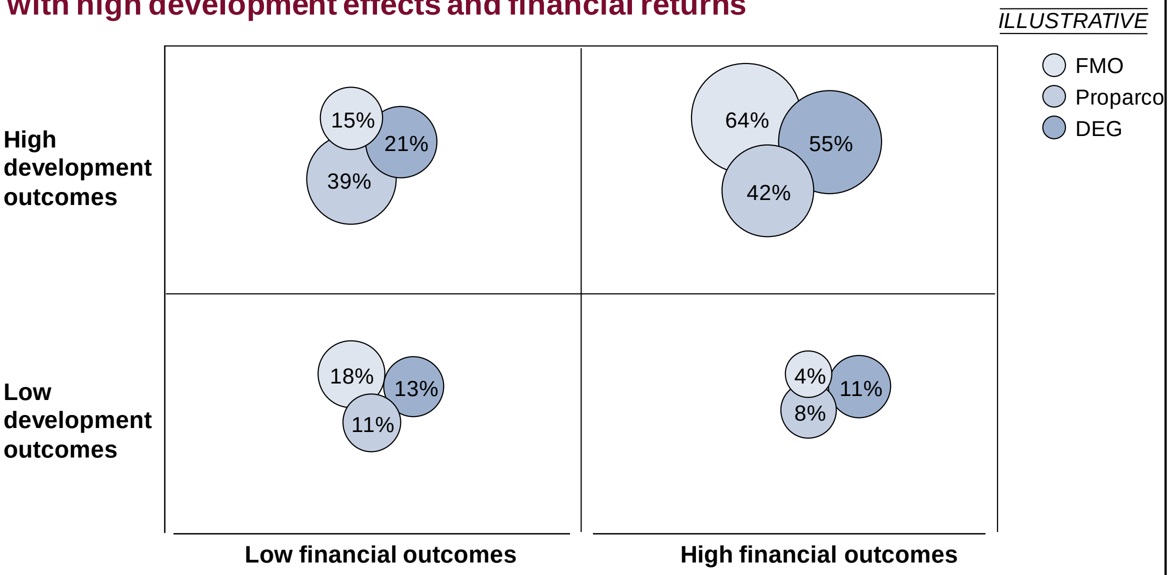
For European DFIs, a key benefit of increased impact measurement is the ability to benchmark performance against each other. Among European DFIs, a commonly used approach is the corporate policy project rating (GPR) tool, which was developed by the DEG in 2000 as a simple and easy-to-use tool to capture profitability, development effects and the strategic role of the DFIs as well as the return on equity. Key quantitative indicators are profits, employment, government revenue, net currency effects and additional value-added benefits to communities. Other tools used by European DFIs include CDC's approach, which captures financial, economic, environmental and social and governance (ESG) performance as well as private sector development. The key quantitative development indicators include employment and taxes paid[66]. FMO has developed a scorecard that also assesses FMO's role as a DFI, monitors environmental and social performance and measures a range of sector outreach indicators[67].

IFC has developed an extensive performance assessment approach named DOTS, which, in addition to financial performance (ROIC, ROE, etc), covers economic performance, environmental and social performance, private sector outcome and additional qualitative indicators of development impact. A key strength of this tracking approach is the level of detail it provides when measuring development effects. For example, quantitative indicators such as number of patients treated, households getting access to electricity and so on are all captured. This allows IFC to assess the development outcomes on a more detailed level and set more detailed objectives of their investments.

5.3 Strong development effects and financial impact to date

Strong contribution to development effects without trading off financial returns
The European DFIs have a strong track record in generating both a strong development outcome and financial return on their investments, thereby countering a common misperception among investors that development financing is unable to generate high development impact and financial returns at the same time. Independent studies by European DFIs have proved that to a large extent it is possible consistently to select projects that deliver both strong development outcomes and high financial returns. The results of these studies are illustrated in Exhibit 10 below.

Exhibit 10 – A large number of European DFI projects achieve dual objectives with high development effects and financial returns



Note: 3 DFIs use different methodologies. Results are illustrative and not meant for direct comparison against each other.
FMO results are based on 96 projects. See footnote in text for full description of definitions. Proparco results are based on study of 156 projects where "high development outcomes" are those with GPR rating of above 65 (out of 150), and "high financial outcomes" are those with a rate of return double Proparco's operational costs during the project lifecycle)." DEG results are based on analysis of 366 projects, where "high development outcomes" are those above GPR rating of 3 (60+ points out of 150) and "high financial outcome" >2% return on equity.
Source: FMO. (2008): "FMO's 6th Annual Evaluation Review, 2007/2008;" Proparco (2007): "Note sur la mesure des impacts des projets finances par proparco entre 2000 et 2006;"Internal DEG report; and Dalberg analysis.

The results of the FMO study on just under 100 projects showed 64% with both good development outcome and good investment outcome[11]. Only 4% ended up with good investment outcome and poor development outcome. The study by DEG of ~366 projects showed a positive correlation between the long-term profitability of the company and development effects, 55% of the projects combining both high development impact and high financial returns. In this instance, only 11% of projects generated high financial return and low development effect[12]. A third study by PROPARCO on 156 projects delivered 66 successful projects (42%)[13]. Overall, that means that more than 75% of all the projects in each study delivered high development outcomes, leaving only 19-23% of the DFIs' projects with low development outcomes.

[11] For FMO, investment outcome is scored depending on whether agreed repayments and interest payments are fully realized (loans) or on whether investment returns have properly compensated FMO for the risks taken (equity). Development outcome is assessed based on the performance against three criteria: (1) the project's business success, (2) its contribution to economic growth and private sector development, and (3) its environmental and social performance / outcome. The criteria are rated on scales and scores below the mid-point are 'poor', and above are 'good'. FMO. (2008): "FMO's internal evaluations: Informing policy and strategy." FMO's 6th Annual Evaluation Review, 2007/2008, along with the response from FMO's Management Board. *FMO.*

[12] DEG's EPOL rating using GPR tool must equal at least 3 (> 60 EPOL points out of 150) and DEG return on equity must at least equal the long-term annual rate of inflation in the Eurozone (> 2 %). Based on correlation analysis provided by DEG in March 2010.

[13] PROPARCO results are based on study of 156 projects where "high development outcomes" are those with GPR rating of above 65 (out of 150), and "high financial outcomes" are those with a rate of return double PROPARCO's operational costs during the project lifecycle)." PROPARCO (2007): "Note Sur La Mesure Des Impacts Des Projets Finances Par Proparco Entre 2000 et 2006."

5.3.1 Financial performance

European DFIs doubled their combined portfolio to €18.5 billion from 2001 to 2009. Only about €1.2 billion of this was injected by governments. This means the portfolio size grew almost eight times the value of public capital injections. This illustrates the European DFIs' efficient handling of government spending on development[14]. The weighted average return on equity was 7% and the average total profit per year generated during 2007-2009 was €522 million, illustrating the fact that the European DFIs provided a solid financial return to their shareholders.

The case study below, on DEG's investment in a Kenyan power plant, is an example of an investment where solid projected financial returns are coupled with high development impact, particularly in terms of taxes paid to the local government and the provision of clean energy.

Case study – DEG, KfW and partners investment in Olkaria geothermal power plant in Kenya

Background: 1.6 billion people, or one-third of developing countries' total population, live without electricity[68]. This challenge is acute in Sub-Saharan Africa where just 26% of the population has access to electricity. Providing electricity is especially challenging for governments and private companies in Africa[15], where low population density in many areas leads to increased operating costs[69]. Almost half of African firms consider the lack of electricity to be a major constraint; almost double the percentage of firms in East Asia and the Pacific. In Kenya, only 17% of the population has access to electricity, (6% in rural areas and 47% in urban areas), and demand often surpasses current supply, leading to power cuts[70].

Description: OLKARIA III geothermal power plant was constructed in 2000 and is the only independent power producer in Africa utilizing geothermal resources, which represent a reliable and affordable form of clean energy. The plant was set for a capacity expansion from 13 MW to 48 MW to meet the growing energy needs of Kenya's population and businesses, but was delayed due to difficulties in obtaining the necessary debt financing. DEG and KfW (national German development bank) joined forces in 2005 to provide €60 and €30 million respectively in financing. Co-investors were mobilized with €25 million from European DFIs' EFP (see EFP case study), and individual contributions of €11-15 million from PROPARCO, FMO and the Emerging Africa Infrastructure Fund (EAIF)[71].

Outcome: Olkaria III was awarded the 'African Renewables Deal of the Year' from Euromoney's Project Finance Magazine in 2009, based on its fulfilment of dual financial and development objectives. Approximately 6.5% return on equity is expected[72], and development effects include government revenues amounting to ~€5 million through tax revenues and royalties. This is particularly notable given Kenya's budget deficit of -3.5%

[14] EDFIs received ~ €1.4B in net replenishments from European governments (2001-2008). This includes IFU/IØ which repaid over €400M in this time period. If IFU/IØ is excluded from analysis, the remaining EDFIs received ~€1.8B.

[15] 21 of 48 Sub-Saharan Africa countries fall below the minimum efficient scale of 200 mega-watts for electricity generation, leading to nearly double the operating costs of the continent's larger power systems.

(or ~€750 million) of Kenyan GDP in 2007[73]. Further, the project provides a transfer of environmentally friendly geothermal technology and know-how to local workers. It complies with ILO labour standards and pays salaries higher than the local minimum wage. The project also contributes directly to the MDGs by supporting the neighbouring Massai community, providing teaching materials and teachers' salaries for a local school and running an HIV/AIDS programme.

Sources: DEG and World Bank

5.3.2 Economic development effects

On an aggregate level, European DFIs attempt to forecast the development effects their investments will generate. They measure three specific quantitative indicators; jobs, taxes and net currency effect[16] generated through the portfolio companies. In addition to these quantitative effects, the investments generate substantial qualitative effects, which are hard to measure and aggregate and rarely captured. During 2006 – 2008, on average €5 billion per year was committed to be invested over the following years[17]. The projected total development effect of this committed sum is:[18]

- 422,000 direct jobs provided by European DFI project companies and 81,000 new jobs created throughout the lifetime of the projects
- 1.3 million indirect jobs procured through their value chains (relations with suppliers) and sub-borrowers in case of financial sector projects throughout the lifetime of the projects
- €1.7 billion in annual government revenues
- €4.1 billion in annual net currency effects

This means that each committed €1,000 is expected to generate 0.08 direct jobs, 0.27 indirect jobs, €338 of yearly tax income and €815 yearly net currency effect. These expected outcomes should be interpreted as total outcomes generated by the European DFIs' portfolio companies, including companies in which European DFIs invest only a minor share. Hence the outcomes cannot be fully attributed to the European DFIs' investments alone. There exists no aggregated measure of actual development effects for all DFIs.

Strong impact in areas considered too risky to invest in by most investors

Despite high credit risk ratings, European DFIs have proved that investing in developing countries is not necessarily higher risk than investing in developed countries if done with due diligence and a long-term perspective. European DFIs demonstrate how investments in underserved segments such as SMEs, Least Developed Countries, post-conflict countries and certain sectors can generate strong development effect and positive financial returns. Since aggregate data is not available, this section builds on individual DFI examples and case studies.

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[16] Net currency effect is a measure of the contribution by the investee companies to the national balance of payment, (exports over imports). It is a useful measure because many developing countries have a balance of payments deficit, so contributing to reserves gives stability to the macroeconomic environment.

[17] The definition of a commitment is when a DFI makes a legal commitment to invest in a project or a fund. An investment is when cash actually flows to a project or a fund.

[18] Based on 2006-2008 average.

DEG has monitored actual development outcomes over several years and the results show that its portfolio companies in 2008 contributed €0.7 billion in government taxes, secured 2,072,000 jobs and produced an additional €13.7 billion in combined net currency effect and contribution to the national income[19]. Of the jobs secured, 49% were in SMEs while 27% of the tax revenues were generated in post conflict and conflict[20] countries[74]. The DEG portfolio in 2008 was worth €4.4 billion and third party capital mobilized amounted to €16 billion. In terms of financial indicators, DEG's average three-year return on equity was 7%[75].

CDC is another example of a DFI able to track the actual development outcomes of its investments. In 2008, €1.7 ($2.2) billion in government taxes and 676,000 people were employed in the portfolio companies in which CDC is invested and which reported employment data' [21]. 27% of taxes and 14% of the jobs were generated in Africa, while the consumer goods and services sector accounted for 31% of the jobs and energy and utility sector for 17% of the tax generated. These outcomes were based on a portfolio that at the end of 2008 was valued at €1.0 (£0.9) billion, with third party capital invested alongside CDC of €14.4 (US$ 21.2) billion. Financially, CDC generated a three year average return on equity of ~11% from 2006-2008[76].

5.3.3 Other development effects

Direct effects

In addition to the quantifiable development effects, the European DFIs have had extensive impact on the remaining direct and indirect indicators. Direct effects from capacity building, transfer of technology and know-how through on-the-job training of local staff is achieved in all projects and is a strong and sustainable value-added benefit to local communities. For example, the Aureos Africa Fund is a joint venture, with CDC contributing staff and overseas offices and Norfund providing cash to help set up new fund management companies on the ground. This project provided capacity building in the form of on-the-job training for its staff while also improving the local management capacity and know-how in running a fund management company. A second example is PROPARCO's US $35M loan to Mumias Sugar Company to build a power plant, which is having a direct impact on the development of renewable energy capabilities in Kenya.

On-the-job training and stable employment help employees to grow in their positions and better provide for their families. For example, a 2004 study by SEAF (with investors including BIO, DEG, Finnfund, IFC, Norfund and SIFEM) found that its portfolio companies investing in SMEs in Latin America, CIS countries and Asia have sustained an average annual employment growth rate of 26% and a wage growth rate of 25% in US dollar terms[77].

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[19] The definition of "contribution to the national income" includes: wages and salaries, interest, rents and pre-tax profit/losses less transferred interest, amortisations, licence fees, transferred profits and transferred wages and salaries.

[20] Post conflict and conflict countries are defined by BMZ. DEG had projects in the following countries rated as 'acute' by BMZ criteria: Afghanistan, Cote d'Ivoire, Georgia, Kenya, Columbia, DRC, Lebanon, Macedonia, Montenegro, Nigeria, Pakistan, Palestine/Gaza, Sri Lanka, Chad, and Turkey; and 'medium' level: Armenia, Azerbaijan, Bolivia, Bosnia, El Salvador, Guatemala, Honduras, Indonesia, Cameroon, Mexico, Philippines, Uganda, and Uzbekistan.

[21] Contributed by CDC's 390 portfolio companies that reported tax data and 514 companies reporting jobs data in 2008. The tax data mostly reflected taxes paid in 2007, while in some instances taxes payable for 2008 was reported.

Direct effects from improved environment, social and governance (ESG) factors and work conditions are achieved through introducing environmental and social standards, transparent governance structures and better adherence to local labour laws along with child labour restrictions, fair wage practices and gender equality. An example of this is Norfund's investment in the Bugoye hydropower station project in Uganda with an ambitious CSR programme, including reconstruction of the local clinic, malaria prevention measures, HIV/AIDS awareness building, tertiary education for women and support for local sports teams[78].

The case study below on CDC Aureos Capital Partners demonstrates an example of European DFIs investing in SMEs, which fulfils the dual objectives of generating both financial returns and development effects. Direct development effects include: local SME growth and profit, tax generation, environmentally sustainable business practices, local jobs, and training for employees.

Case study – CDC and Norfund's investment in Aureos Capital Partners in Africa, Asia and Latin America

Background: SMEs are often considered by commercial banks and financial institutions as risky and costly to support and as a result they are underserved in many developing countries. Providing capital and financing for underserved market segments such as SMEs is therefore a primary focus area for European DFIs.

Project description: Aureos is widely recognized as a leading player in investing in SMEs in developing countries and has raised 16 regional private equity funds in Africa, Asia and Latin America, in addition to the 14 legacy funds it inherited from spin-out from CDC. Since its inception in 2001, promoted by founding partners CDC and Norfund, Aureos has increased its funds under management to US $1.2 billion, covering more than 50 emerging markets in 29 offices employing 97 investment executives.

Outcome: In 2008 Aureos saw its first closings of the Aureos Africa Fund and the Aureos Latin America and realised a series of successful exits, bringing early returns to investors. Its total financial returns to date equal 2.1x with a 31% IRR. Aureos has been able to attract over 70 institutional investors in addition to CDC and Norfund, including recently, Colombian pension funds. In total Aureos has raised US$984 million of capital from investors other than CDC for investment in SMEs since 2004[79].
Aureos contributes significantly to the growth of the SME sector, job creation and increased government taxes. It estimates that for every dollar invested in SMEs in East Africa, three dollars are paid in government taxes. Aureos' investments have shown a marked net increase in employment, bringing more people into the formal sector.
Aureos has also launched an initiative to build capacity in improved management of SME businesses. Aureos' SME practices training programme was established with the support of the Indian government and in partnership with top Indian business schools. So far, over 150 Aureos' portfolio company managers from SMEs across the world have attended. Furthermore, Aureos has instituted a SME Sustainable Opportunities Initiative, which provides financing for environmental and social improvement projects in particular in clean

energy, energy efficiency and carbon emission reductions. The first use of this initiative went to the Athi River Steel smelting and manufacturing plant in Kenya in 2008 to further reduce factory emissions. Athi River Steel provides much needed steel to the East African region and has now grown to be the largest provider of secondary steel in East Africa. This effectively provides a local alternative to importing steel from off the Continent.
Aureos has initiated research to identify best practices among its portfolio companies in SSA with respect to HIV/AIDS by reviewing the supply chain of 14 companies and 150 healthcare providers to see how their distribution networks could be used to deliver healthcare goods and services to remote rural and high-density urban populations. Six individual supply chains were identified through which condoms, malaria nets and over-the-counter drugs could be delivered inexpensively throughout East Africa. This effort is estimated to be able to reach over seven million people on a weekly basis and was funded by Norfund[80]. As a result of this work, Aureos identified the opportunities in and the necessity of investing to improve healthcare in Africa leading to the Aureos managed Africa Health Fund (see Africa Health Fund case study), the first of its kind.

Sources: Aureos and CDC

Indirect effects

Indirect effects include all broader benefits to local communities. European DFIs foster local and regional growth when they provide employees with direct income that supports their families and increases economic activity through consumption and savings at the local level.

By delivering locally-required services in developing countries, the portfolio companies of the DFIs thus help to build value chains and create multiple benefits in the communities in which they operate. For example, a 2007 study of almost 50 SME companies by SEAF found that each SME – through its purchase of inputs – supported an average of 331[22] other local businesses[81]. Furthermore, the increase in available products and services on the market encourages greater competition and provides incentives to others to replicate successful business models. Finally, it enhances infrastructure, health and agribusiness, which are frequent outcomes of European DFIs' investments, and benefits the broader community, as noted in the DEG case study on 'Cotton made in Africa' PPP.

FMO's investment in Indian slum rehabilitation provides an example of a European DFI project in an underserved sector bringing solid financial returns along with development benefits in the local community, including direct and indirect employment and safe housing for the poor.

Case study – FMO investment in Slum Rehabilitation in India

Background: Today, approximately one billion people live in slums and this number is likely to double by 2030[82]. Although the proportion of slum dwellers fell from 47% to 36% between 1990-2005, the aggregate number is rising due to population increases[83]. The

[22] Total is broken down as follows: 18 manufacturers, 10 distributors, 20 service providers, 3 equipment suppliers, and 280 micro-suppliers and farmers, with a high of 6,000 farmers and micro-suppliers for one investee.

majority of Mumbai's 17 million inhabitants live in the slums that cover a third of the city, with little or no access to running water, sanitation and electricity. Over 40% of the densely-built shacks cover less than 10 square meters and yet they house 5-8 people on average. Less than 1% of Mumbai's slum areas have been developed to date, representing a tremendous development need and investment opportunity that the local government has been unable to address on its own[84].

Description: FMO invested US $30 million (~€22.3 million) in local currency in Indian slum rehabilitation in partnership with local real estate developer Ackruti City Limited (ACL). FMO worked in close collaboration with the local government, which in 1992 introduced the Slum Rehabilitation Scheme to construct new housing options for the urban poor. Private co-investors include Deutsche Bank with US $5 million (~€3.7 million), Guarantco with US $19.8 million (~€14.7 million) and Cordiant with US $10 million (~€7.4 million).

Outcome: FMO expects its investment to contribute extensively to indirect development effects by making possible the construction of free housing for over 30,000 households and thereby improving the lives of approximately 135,000 slum dwellers[85]. To date, 12,000 homes have been built and 10,000 more are underway. 50 new direct jobs and over 1,000 indirect jobs[86] have been created. Financially, the project has posted an 11% internal rate of return thus far in US dollars[87].

Sources: FMO and EDFI

5.3.4 Some high risk investments require innovative approaches

Some projects are too risky for European DFIs to be able to carry them on their balance sheets. DFIs have therefore found ways to complete projects without taking the risk on themselves, e.g., through managing government funds with a high risk profile. Two examples are FMO and PROPARCO, which manage government funds outside their own balance sheets, (see FMO MASSIF and PROPARCO FISEA case studies below). In the case of FMO, by the end of 2009 it managed a committed investment portfolio of €4.6 billion, including a portfolio of €720 million financed out of managed government funds. In addition, FMO had access to capacity development grant funding. These funds have slightly different risk profiles and specific sector focus from that of FMO, and the fund management role helps FMO leverage its investment expertise without taking the risk on its balance sheet, e.g. the MASSIF Fund for SMEs profiled in the case study below.

Case study – FMO and Dutch government joint effort "MASSIF Fund" for SMEs[88]

Background: SMEs' financing needs are generally underserved. Such investments tend to carry a high risk profile, but are of critical importance in building up the private sector in developing countries.

Description: MASSIF is a joint effort between FMO and the Dutch government that came into existence in 2006, originating from three different SME funds. The focus of MASSIF shifted over time from enabling small and later micro-entrepreneurs to invest in productive capacity to a broadening of access to reliable financial services at the bottom end of the market. MASSIF contributes to the development of financial services for SMEs by increasing financial resources available to them and by strengthening the financial intermediaries. MASSIF clients are financial institutions that have limited or no access to local finance, let alone local currency financing – for instance, commercial banks looking to expand their client-base by downscaling, microfinance institutions seeking to expand or NGOs keen to professionalize and gain financial status. MASSIF is an intermediary to a wide group of micro and small businesses and households, offering a wide array of financial services, including those related to savings, cash flow, credit, guarantees, mortgages, leasing and insurance. FMO makes it possible for these financial intermediaries to provide the SMEs with local currency products by offering long-term debt and equity in local currency while also assuming the currency risk.

Outcome: This successful partnership between the Dutch government and FMO represents a scalable model for governments to increase their investments in the development of the private sector in developing countries through collaboration with European DFIs. It provides a proven mechanism to effectively and sustainably provide development assistance, targeting high impact but high risk market segments like SMEs.

Sources: FMO and WRR

PROPARCO manages FISEA, a government fund created in 2009 and held by the Agence Française de Développement (AFD) targeting African growth[89]. FISEA is one of the main mechanisms and tools of the French initiative to promote growth and employment in Sub-Saharan Africa launched by the President of the French Republic in 2008. The fund has an annual investment target of €50M and is expected to finance roughly sixty projects over the next five years and create over 100,000 jobs in Africa. The case below provides an overview of a specific new FISEA investment promoting growth of the agricultural sector in SSA and supporting a fair trade certified family run business.

Case study – PROPARCO managed government fund's investment in Kenyan horticulture[90]

Background: Very small enterprises and SMEs, in particular in the agricultural sector, account for the bulk of employment in developing countries. In order to promote private sector investment, AFD and PROPARCO have developed a wide range of financial products that can be tailored to the needs of businesses, whatever their size: equity, long-term loans, lines of credit, guarantee tools, and private equity investments. AFD and PROPARCO are also in charge to implement FISEA, an African investment fund.

Description: One FISEA partner is the Bigot Group, a family-run business in Kenya with longstanding experience in the cut flower sector. It received €2.5M FISEA equity investment in 2010 as it plans to acquire the land on which the production facilities are located and replace 27 hectares of greenhouses with obsolete facilities under a 3-year program.

Outcome: This investment program's enhancement of facilities is expected to raise productivity by 20% leading to increased financial returns. Further, Bigot Group's activity has a sizeable impact on employment in the region: some 1,000 employees work in the farm, half of which are women. Securing the future of this fair trade flower farm not only guarantees the production of products that comply with international standards but also that 10% of total sales are transferred to the employee community for the implementation of social operations. Although flowers are generally not destined for local consumption, they constitute a considerable source of food security thanks to the income they provide to thousands of people, mainly women, in a relatively remote and poor region of Kenya. Finally, studies have proven that greenhouse gas emissions from the production and import of Kenyan roses (including air transport) are six times lower than emissions from European production.

Sources: AFD and PROPARCO

5.3.5 Comprehensive estimates of full development outcomes are demanding

Two studies of investment impact were conducted by SEAF in 2004 and 2007 at significant cost and level of effort. The insights provided by these studies into the scale of development outcome, which were focused specifically on SME related investments, suggested that every US $1 invested in SMEs in developing countries generated[23], on average, US $12 in the local economy[91]. By comparison, using a very simple tool, European DFIs combined are able to measure an outcome of €1.16 per €1 invested, a calculation based on €5.8 billion in local taxes (€1.7 billion) and net currency effect (€4.1 billion) expected to be generated from the €5 billion in new commitments. The monetary value of the jobs generated and supported are not included. Though this is significantly lower compared to the 12 fold increase documented by the SEAF study, the effort required by the European DFIs to capture these development outcomes is limited and their simple method serves a good indicator of the development outcomes of their investments.

It is clear that there is a great trade-off between the accuracy of development outcome measurements and the resource demands to obtain them, and DFIs, as well as other organisations, have to balance their need to demonstrate development effects against the need to allocate their resources where they deliver most value.

5.4 Significant contribution to MDGs

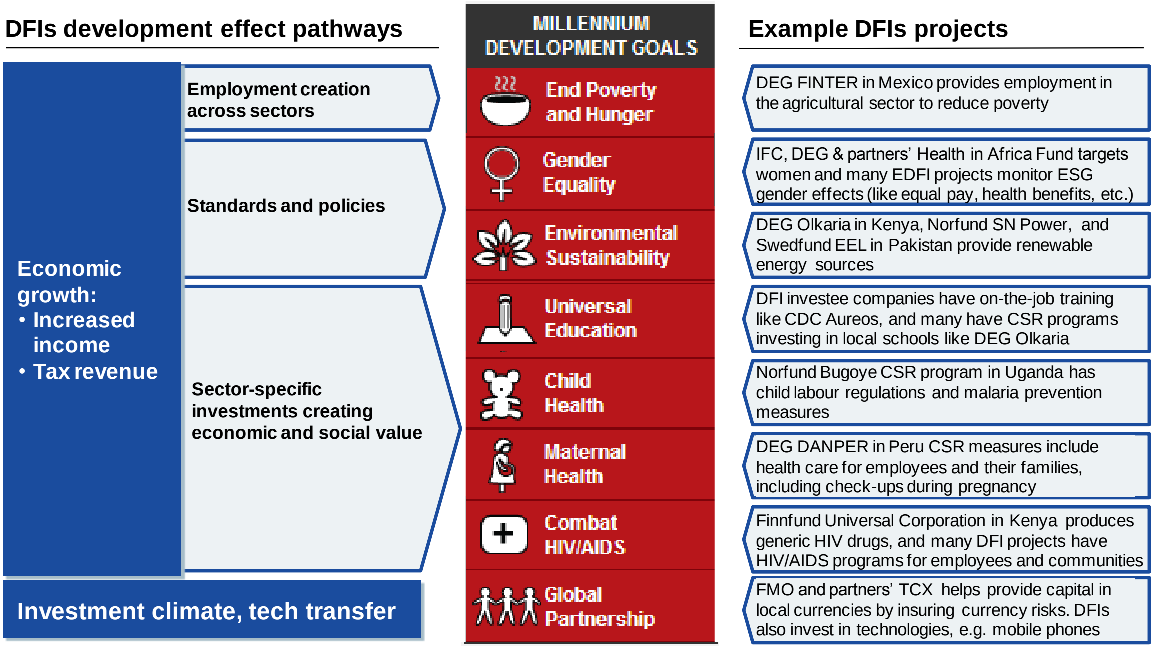
The development effects contribute to the MDGs

The direct and indirect effects of European DFIs' portfolio companies contribute to reducing poverty and achieving the Millennium Development Goals (MDGs). One of the key drivers is employment creation, to which European DFIs contribute significantly. The standards and policies introduced in portfolio companies help to improve gender equality and environmental sustainability. Sector specific investments generate value across the fields of education and health among other things. And, finally, paving the way for other investors helps to improve the investment climate and the transfer of technologies and know-how to

[23] Based on 18 case studies, SEAF's methodology for calculating the multiplier effect is based on an IFC model devised by Frank Lysy. The model uses a stakeholder framework to analyze the socioeconomic externalities of each investment, by individually assessing the impact on each broad category of stakeholders—or groups—that are affected by SEAF's investments: financiers, employees, customers, suppliers, competitors and new entrants, producers of complementary goods and services, the local community, and national governments. Note: it assumes a 0% discount rate.

local players while also facilitating the building of global partnerships. The Exhibit 11 below suggests how the examples and case studies described contribute to achieving the MDGs.

Exhibit 11 – Primary development impacts of European DFIs



Note: Goals have been reordered for the purposes of illustration
Source: United Nations. "End poverty 2015, Millennium Development Goals: Make it happen" http://www.un.org/millenniumgoals/; Dalberg analysis

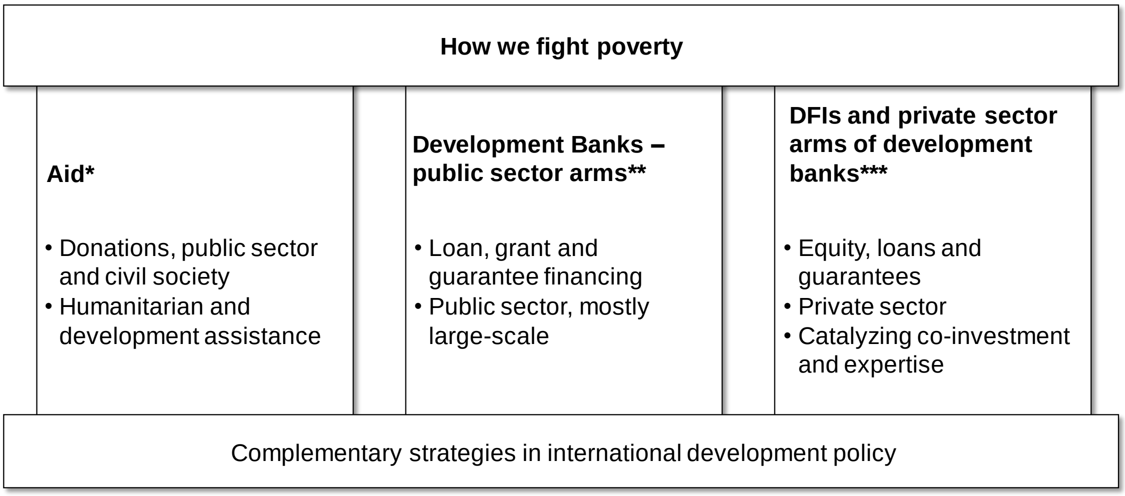
6 DFIs are the “Third Pillar” in development policy

6.1 The three pillars in development policy

Investment in the private sector in developing countries is an important third pillar in development policy, alongside aid and public sector finance from development banks. The third pillar is comprised of national DFIs and the private sector arms of the multilateral development banks. This chapter describes the importance of the three pillars and highlights the very complementary nature of their approaches to fighting poverty. Exhibit 12 illustrates the complementary roles of the three pillars.

Exhibit 12 – Complementary roles of the three pillars in international development policy

ILLUSTRATIVE



* Bilateral and multilateral (UN, EC)
** World Bank Group institutions (IDA, IBRD, MIGA, excl. IFC); regional development banks’ public sector arms
*** National and regional DFIs, IFC, EIB, regional development banks’ private sector arms
Source: Dalberg analysis

Pillar 1 – Aid agencies
This pillar is comprised of bilateral and multilateral aid agencies that provide grant financing and technical cooperation for public and civil society partners in developing countries. Aid programmes tend to focus on the poorest populations and emphasize investment in social sectors such as health, nutrition, education, the environment, governance and human rights.

Pillar 2 – Public sector finance from development banks
Pillar 2 features the public finance activities of national and multilateral development banks such as the World Bank and the regional development banks. These focus on enabling development through investments in public infrastructure such as transport, energy, health

and education systems and communications technology as well as public finance and governance capacity building.

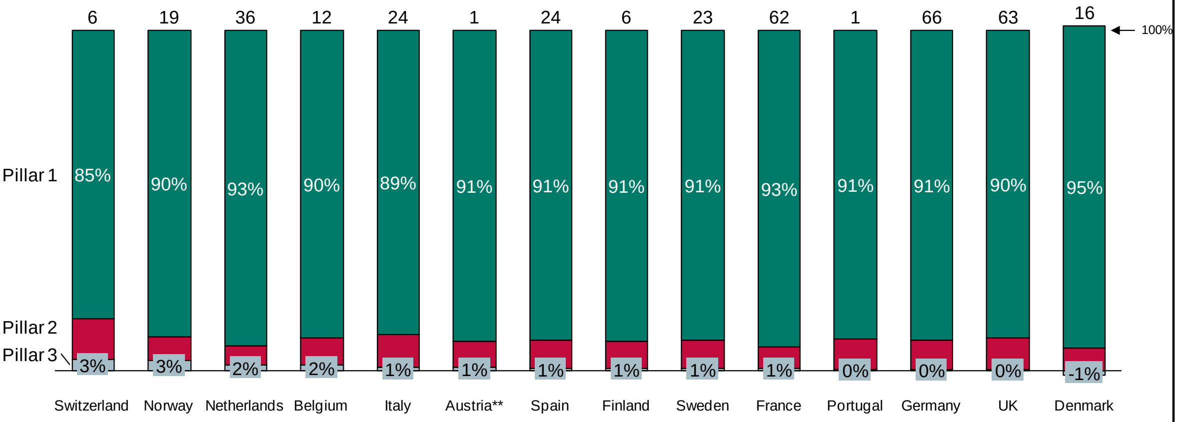
Pillar 3 – Development finance for the private sector
DFIs and private sector arms of multilateral development banks make up the third pillar with their investments in private sector projects that have a positive development impact. Investments are typically made in sectors and projects that would not otherwise have ready access to finance from private investors. The largest sectors of investment are financial services and infrastructure such as energy services and telecommunications.

6.2 European DFIs make up a small share of financial commitments

Exhibit 13 below illustrates how, in the period 2000-2008, governments prioritized financial allocation across the three pillars in the 14 European countries where DFIs operate.

Exhibit 13 – Net capital replenishments to European DFIs are only a small fraction of ODA

Official development assistance (ODA) to pillars 1 and 2, and net government replenishments to European DFIs and ODA to pillar 3* 2000-2008, € billion, %



Note:1st pillar: Includes ODA to bilateral institutions, UN, EC,GEF, Montreal Protocol and other agencies, and concessional lending. 2nd pillar: Includes ODA to multilaterals supporting public sector, i.e. IDA, IBRD, and public arms of regional development banks. 3rd pillar: Includes ODA to multilaterals supporting private sector, i.e. IFC, MIGA, private arms of regional development banks and EDFI replenishments.
Assumptions: 1) Equal amounts of ODA allocated to IBRD, IFC and MIGA, 2) 10% of ODA to development banks goes to the private sector arms.
* Other government funds managed by EDFIs are excluded from replenishment figures above. Analysis for Austria only includes 2008 aggregates, Belgium 2001-2008, Switzerland 2005-2008 and Portugal 2007-2008; as OeEB, BIO, SIFEM and SOFID were established in 2008, 2001, 2005 and 2007 respectively.
** Only includes OeEB. AWS excluded as do not have AWS replenishment data.
Source: EDFIs, OECD

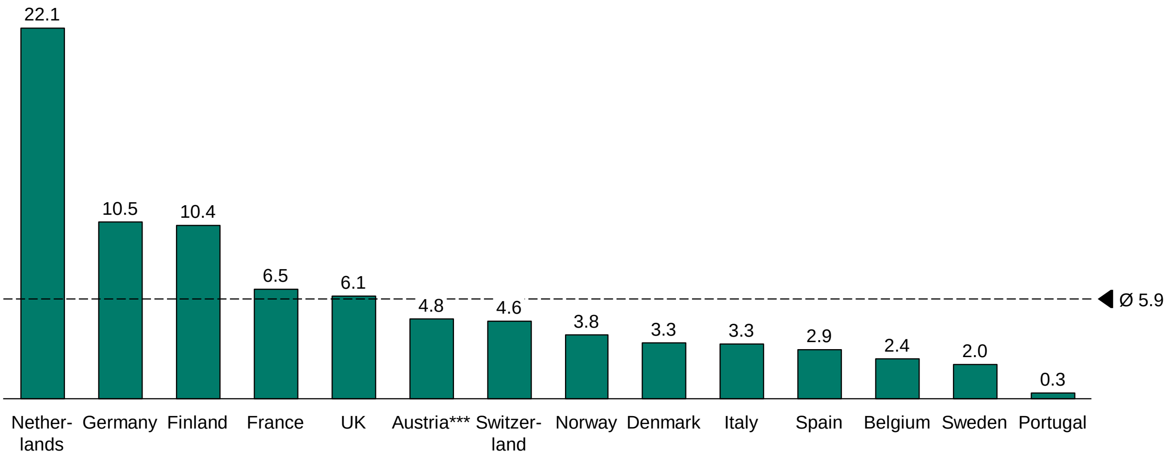
As illustrated in the exhibit, governments have dedicated only a small fraction of Official Development Assistance (ODA) to injecting new capital into European DFIs over the last ten years. ODA to pillar 3 plus other net capital injections to DFIs range from -1% to 3% of Official Development Assistance[24]. The vast majority of Official Development Assistance is dedicated to aid programmes in Pillar 1, with a range of 85-95%.

[24] Total Official Development Assistance for bilaterals and multilaterals plus net government replenishments to EDFIs.

DFIs make new investments on an on-going basis, based on returns and repayment of investment plus new capital infusions from the public and private sectors. A comparison of the amount of new investments DFIs are able to commit to with the total ODA of the country provides an illustration of the financial contribution of the DFIs. As data for new investments are not available for all DFIs, the new commitments are illustrated in exhibit 14 as share of total Official Development Assistance to all pillars during the period 2006-2008[25].

Exhibit 14 - Despite the limited government replenishments received, most European DFIs commit significant funds to new projects every year

Comparison of new commitments by EDFIs as percent of total official development assistance (ODA) to all pillars*
2006-2008, %



* Comparison of total new commitments (2006-2008) and ODA to Pillars 1 and 2 along with ODA to Pillar 3 plus government replenishments to Pillar 3. Analysis for Austria only includes 2008 aggregates and Portugal 2007-2008 aggregates, as OeEB and SOFID were established in 2008 and 2007 respectively.
** CDC Ratio based on new investments (not commitments) over total ODA
***Only includes OeEB. AWS excluded as do not have AWS replenishment data.
Source: EDFIs, OECD

On average, new commitments by European DFIs correspond to roughly 6.4% of Official Development Assistance in these 14 European countries. In some, such as the Netherlands with 22.1% and Germany with 10.5%, the proportion is significantly higher than the average, while in nine of the countries new commitments from DFIs correspond to less than 5% of Official Development Assistance. This illustrates that if DFIs receive government replenishments, they are able to efficiently mobilize significantly larger investment sums due to their profit generation and ability to acquire additional capital from private sector capital and loans[26].

As indicated by the two exhibits above, government capital injections to DFIs translate into investments in developing countries worth many times the amount supplied by the government. There is a large potential to increase investments in private sector

[25] The value for CDC is however based on new investments, not commitments

[26] The new commitments might not count fully as ODA once realized as investments, since some of the European DFIs' investments will not fall within the guidelines of ODA investments, e.g., for DEG, only 20-30% of new commitments are counted as ODA once invested. This data is not readily available for most DFIs.

development through increased government funding. It is the role of the European DFIs and the EDFI association to increase awareness of this potential to help governments take this into consideration when making decisions on development policy – a role that has not been filled to the extent possible.

6.3 Promoting cooperation between the three pillars

At the macro-level, an effective interplay between the public and private sectors is a pre-requisite for economic development. The private sector relies on the public sector to develop effective systems of governance, building the capacity of regulatory agencies and delivering public services, basic infrastructure and a stable economic environment. The public sector relies on the private sector to create jobs and generate tax revenue. Participants in each of the three pillars of development policy need to be mindful of their respective roles in promoting their complementary input.

But the interplay between the participants in the three pillars is also critical at the level of specific projects and sectors. DFIs can benefit from the activities of aid agencies in preparing communities and entrepreneurs for the setting up of sustainable and growing businesses. DFIs, on their part, can often help to kick-start private sector activity in under-developed sectors of the economy.

Coordination between DFIs and other development organizations can often be challenging. This is particularly true in countries where local institutions work with a large number of multilateral and bilateral partners. But there is great potential for DFIs and aid agencies to establish effective mechanisms for collaboration.

There are three areas of cooperation between the three pillars that are particularly relevant:

- Technical assistance and capacity-building
- DFIs as first-movers in under-developed sectors
- Innovative financial mechanisms

Each of areas is described in more detail below, together with some examples of cases where such collaboration has been successfully achieved.

6.3.1 Technical assistance and capacity-building

DFIs and other investors in the private sector will typically only become seriously involved in an investment opportunity once it has been established. They rarely act as seed investors, developing early-stage opportunities themselves, so business projects need to have reached a certain size and level of development before investors can get involved.

This means that investment opportunities can be slow to emerge, particularly in under-developed sectors. Aid agencies or philanthropic donors can play a role in providing technical assistance to help communities and entrepreneurs develop small and growing businesses. Technical assistance can also help make investors, such as DFIs, aware of emerging investment opportunities. The Health in Africa Fund provides an example of a partnership between philanthropic and commercial investors where technical assistance played a key role in launching a new investment fund.

Case study – IFC, ADB, and DEG invest in Health in Africa Fund

Background: Building up health system capacity remains a major challenge in many African countries, especially constructing smaller rural facilities.

Project description: In June 2009, IFC, DEG, African Development Bank, and the Bill and Melinda Gates Foundation launched the Africa Health Fund, a new private equity fund that invests in Africa's health sector. The fund, managed by Aureos Capital (See Aureos case study), invests in SMEs in SSA, such as health clinics and diagnostic centres, with the goal of helping low-income Africans gain access to affordable, high-quality health services. The fund will be measured not only by fiscal performance but also by its ability to cultivate businesses serving the poor. The Africa Health Fund will target commitments of between US $100-120 million (~€75-90 million) over two closings. The fund's first closing included US $57 million, with investments from IFC and ADB equalling US $20 million each (~€15 million), DEG with US $10 million ~€7.5 million), and the Gates Foundation with US $7 million (~€5 million)[92]. The Fund will have a final close in June 2010.

Outcome: The fund will make about 30 long-term equity and quasi-equity investments, ranging from US $250,000 to US $5 million (~€0.2-3.7million), in socially responsible and financially sustainable private health companies. The innovative fund is investing in 8 subsectors of Healthcare goods and services, to increase access, improve quality and increase affordability of healthcare to Africans, including: health services (clinics, hospitals, diagnostic centres, labs); risk pooling and financing vehicles (health management organizations, insurance companies); distribution and retail organizations (eye clinics, pharmaceutical chains, logistics companies); pharmaceutical and medical-related manufacturing companies; and Medical education. The fund aims to reach significant populations of those at the Bottom of the Economic Pyramid served by the portfolio companies. The funds first investment, involved acquiring a stake in the Nairobi Women's Hospital for US$2.7 million (€~2.1 million), which provides in-patient, out-patient and specialized services for women and children, (e.g. antenatal, gynaecology, obstetrics, breast cancer detection and surgery). Its Gender Violence Recovery Centre is believed to be the first in East Africa[93].

IFC Executive Vice President and CEO Lars Thunell considers this project as "A great opportunity to provide health services where it's needed most," and said that its "a key component of IFC's US $1 billion Africa health strategy, which includes improving the operating environment for companies in addition to providing financing." Such projects directly targeting underserved sectors like health systems represent an integral part of development.

Sources: IFC and ADB

6.3.2 DFIs as first-movers in under-developed sectors

Private investors do not always respond quickly to improvements in macro and micro economic market conditions in developing countries. In particular, foreign investors can be slow to enter sectors of the economy where they do not have previous experience. As a result, governments and development banks can often invest in significant improvements in public sector services and capacity without seeing benefits materialize for several years.

DFIs can play a first-mover role by taking an early initiative when opportunities arise in new regions and sectors that have benefited from public investment. The skills and experience that DFIs are able to offer can often help to structure investment projects in a way that also encourages private investors to participate where they may not otherwise have done so. Sometimes aid can also boost this catalytic effect by contributing technical assistance to develop investment opportunities.

The Norfund's Norwegian Microfinance Initiative (NMI) is one example of an initiative where DFIs work with governments to open up new investment opportunities for private investors.

Case study – Norfund, Norad and private partners invest in the Norwegian Microfinance Initiative

Background: Sustainable development of the private sector necessitates successful partnership models involving both public and private sector stakeholders.

Description: The Norwegian Microfinance Initiative (NMI) is a new and innovative strategic partnership between the Norwegian public and private sectors that invests in microfinance institutions (MFIs) in developing countries and provides professional assistance and technical support for these institutions. NMI demonstrates a unique collaboration between DFIs, private investors and Norad, (the Norwegian aid agency). Launched in 2008, Norfund has contributed half the capital of €72 million, while the rest was invested by its private partners, Ferd, KLP, Storebrand and DnB NOR /Vital. NMI's partners in Norway have extensive experience and expertise in banking, insurance, pension fund management, and investments. This unique collaboration of partners allows NMI to provide broad and deep financial services resources to portfolio MFIs while Norad contributes technical assistance support through the NMI Professional Assistance Facility, with the Norwegian government aiming to contribute NOK 8 million (~€988K) annually[94].This program provides professional support for microfinance enterprise institution-building, mainly through the development of local talent, through such things as training and skills development in markets and products, information management systems, risk management, financial management, human resources and strategic issues.

Outcome: NMI operates on a commercial basis, providing both development effects and financial returns that lead in turn to a strengthened economic position for poor people through new job opportunities and social progress[95]. It also provides a mechanism for private sector investors to engage in development by leveraging their specific financial expertise. Simultaneously, it provides an opportunity for the Norwegian government and Norad to fulfil their expanded edict of contributing to the effective management of development funds while also ensuring high quality in Norwegian private sector development cooperation[96].

Sources: Norfund and NMI

6.3.3 Innovative financial mechanisms

Development banks, DFIs and private investors often face similar challenges in handling their international financial transactions. Systemic risks can prevent private investors from entering emerging and developing markets, especially where insurance or risk protection is difficult to obtain from regular market providers. Development banks and DFIs can advance development policy objectives by cooperating to find solutions to such risks.

An innovative financial mechanism to help investors cope with currency fluctuations is one example of this type of cooperation. The Currency Exchange Fund N.V (TCX) was set up to promote lending in local currencies in some 30 countries by offering protection for currency fluctuations. As described in the case study below, TCX is a collaboration between over twenty DFIs and development banks.

Case study – DFIs, multilaterals and private banks launch first of its kind Currency Exchange Fund

Background: Due to high currency volatility in many emerging markets, investing and lending in local currencies carries significant risks. World Bank and UN studies on the adverse impact of currency fluctuation consider it a key risk for public and private investment in developing countries[97].

Description: FMO and some twenty partners (including six other EDFI members, multilaterals ADB, IADB, and EBRD and commercial banks in Africa and Europe), have pooled funds and created a fund which allows investors to cover their local currency risks. Called The Currency Exchange Fund N.V (TCX), this also represents an example of working together with Pillar 1, since the Dutch government made the establishment of the fund possible by acting as a special investor, providing a first loss buffer.
TCX is a special purpose fund providing long-term local currency and interest rate derivatives to investors active in emerging markets. The fund focuses on currencies and maturities that are not efficiently covered by regular market providers[98]. Its service offerings are extremely valuable to investment partners in emerging markets and serve to catalyze long-term lending in local currencies despite the inherent risks in these non-liquid emerging market currencies. TCX manages its risk through portfolio diversification across over 30 currencies, such as the Bangladeshi Taka, Zambian Kwacha, and Dominican Peso. This large and innovative fund started up with a transaction capacity of US $1.2 billion. This has now risen to between US $2-3 billion, and TCX has obtained an “A-“ rating from S&P.

Outcome: TCX provides an example of complementary co-operation between the pillars, catalyzed and spearheaded by DFI innovation, which is successfully helping to address an important market failure. The results so far suggest drastically reduced default probability, improved business sustainability and a major contribution to the development of local capital markets[99]. The importance of such a service for public and private investors is underscored by increased currency volatility related to the financial crisis[27]. Although the on-going crisis created a challenging business environment, TCX's performance indicates that it has been well positioned to absorb currency shocks in a global crisis. TCX's monthly report for December 2009 indicated a profit of US $73 million for the year. This exceeded the losses amounting to US $65 incurred in 2008 as a result of the financial crisis and the sharp appreciation of the US dollar. TCX is especially important for the microfinance sector, which is the largest beneficiary of its products, having absorbed nearly 40% of the nominal value of TCX's transactions. It is highly active in developing countries, as around 70% of the nominal portfolio value is in currencies of low income or lower middle income countries to date.

Sources: TCX, World Bank and Norfund

[27] In the fourth quarter of 2008 all currencies except the Japanese Yen witnessed a sharp depreciation against the US dollar.

7 Conclusion – The growing role of European DFIs

7.1 A growing role for DFIs in international development policy

In light of their successful track-record, the European DFIs are determined to take on a growing role in international development policy. There is a compelling need to continue to expand access to finance for the private sector in developing countries.

The DFIs are exploring a number of approaches to increase their contribution to improving access to finance. Some of these relate to how DFIs create awareness of their approach and track-record among private investors and among policy-makers. Others relate to how they capital and set effective investment strategies.

Each DFI develops its own strategies and approaches to how it works with partners in the public and private sectors. As bilateral institutions, the DFIs rely to a great extent on collaboration with national and regional stakeholders. From time to time, DFIs can also work to build a common agenda in Europe through the EDFI association. The remainder of this chapter discusses how the European EDFI can take more active steps to expand their role in international development policy.

7.2 The EDFI association's role in promoting awareness

Generally speaking, the European DFIs take a relatively low-key approach to public information compared to other partners in international development policy. The DFIs dedicate only very limited resources to outreach and advocacy activities that explain their work and role. It is usually fair to say that it has not been a priority for European DFIs to build and maintain a strong public profile. As a result, the public awareness of the DFIs is quite low. Organizations with relatively modest reputations have a harder time pursuing ambitious strategies to expand and have a greater impact. This is particularly the case in the international development area where many public and not-for-profit institutions have invest heavily in public affairs activities and where there is strong competition for attention and resources.

The EDFI association's public information platform is an important vehicle in promoting awareness of the work of the European DFIs. The present report itself is intended to contribute to this platform and help highlight the role of DFIs in European development policy.

However, there is a strong case for doing more to expand the public awareness and interest in the growing role of the DFIs. EDFI members should explore how they could best launch outreach activities that, within means, allow them to achieve this. Institutions and stakeholders at the European level could be a particular point of focus.

7.3 Approaches to growing the role of the DFIs

There are five priority topics for the European DFIs to seek to further develop their role in international development policy:

- Increasing visibility for private investors
- Engaging in the public policy debate
- Making public and private sector finance more complementary
- Updating regulatory practices
- Growing the capital base

7.3.1 Increasing visibility for private investors

Arguably the most important impact DFIs can have is to demonstrate convincingly to private investors that their patient approach to investing in developing countries is financially viable, sustainable and involves an acceptable level of risk.

Many of the European DFIs have, for a long time, worked closely with national institutional investors as part of their investment strategy. However, there is a feeling that more can be done to create awareness among private investors of the track-record and success stories of the DFIs. Among other things, there is a growing interest in “impact investing” also among large institutional investors in Europe and the experience of the DFIs could enable more of these to convert their interest into actual financial commitments.

7.3.2 Engaging in the public policy debate

As governments prepare to convene in 2010 to review progress on the Millennium Development Goals, there is widespread concern about the ability to sustain the steady, though lagging, progress that has been made in economic and social development in the poorest countries. Global challenges such as the financial crisis, threats to food security and high energy prices have been severe in the last years and have impacted negatively on the poorest countries. These concerns are all the greater given the current pressures in donor countries on public spending, which includes development aid.

Experiences in Africa in the last decade have highlighted the importance of the private sector in driving growth and poverty alleviation[100]. However, private sector approaches often play a remarkably small role in international development strategies. As an example, the European Commission recognizes that “private sector companies contribute to economic growth by creating jobs and providing income,” yet the European Consensus on Development offers very little in terms of concrete strategies to promote private sector approaches[101]. The picture is often similar at national level. The balance between public and private sector approaches needs to be continuously examined, as also highlighted in the recent scientific review of development policy in the Netherlands[102].

The experience of the DFIs gives rise to an optimistic view of the prospects for developing countries. The experience they have gained from investing in growing enterprises and the lessons they have learnt provide a platform for improving the understanding of private sector development among policy-makers and development professionals. Often this can be promoted through a more conscious approach to engaging with development partners and the public. In general, the European DFIs have not focused sufficiently on broadening awareness and understanding of the work they do and the impact they have.

7.3.3 Making public and private sector finance more complementary

At the practical level of policy development and execution there is also a significant potential to promote engagement between DFIs and the partners that invest in the public sector to promote development, as discussed in chapter 6.

The three pillars in development policy can be highly complementary. Grants or technical assistance can significantly speed up the exploration of new opportunities and prepare projects for private investment by DFIs or others. Similarly, training, education and capacity-building efforts can complement private investment in emerging sectors in the economy where entrepreneurs and companies face significant barriers.

7.3.4 Updating regulatory practices

As government-controlled financial institutions, the European DFIs operate within tightly defined boundaries. Regulations and national practices play a key role in shaping the strategies that the different DFIs can pursue. Over the years, European governments have shared experiences and national regulations governing DFIs have been updated along the way. The European DFIs also work together to address policy issues within their own control, such as the development of guidelines for the management of environmental, social and governance factors in investments and the use of offshore financial centres[103].

There are several areas in which regulatory practices vary widely among the European countries and where reforms could improve the European DFIs' ability to deliver on their mandate. Some of these areas are discussed below.

International regulations – Official Development Assistance counting

OECD/DAC defines guidelines for how injections of public capital in European DFIs should be counted as Official Development Assistance. The current guidelines treat multilateral and bilateral DFIs differently and this acts as a disincentive for governments to allocate Official Development Assistance to the bilateral DFIs. The guidelines also mean that returns and repayment of investments count as negative Official Development Assistance unless they are reinvested within the same year. But given the due care and attention involved in placing new commitments it is not always possible for DFIs to place them that quickly.

These timing and reporting factors can impact negatively on the ability of governments to meet their stated Official Development Assistance targets in a given year. An update of the Official Development Assistance guidelines to put multilateral and bilateral DFIs on an equal footing and to accommodate a reasonable delay in making new commitments could promote allocation of Official Development Assistance in a way that would allow more active use of the European DFIs[104].

National regulations
National regulations define the boundaries within which European DFIs access capital and set investment strategies. Some of the key areas where regulations vary across countries and where it may be relevant to consider reforms include:

- **Access to private capital:** Some DFIs are permitted to access private capital while others are barred from doing so. And yet several European DFIs have learned from experience that the participation of private owners brings an extra benefit in that it promotes alignments with the surrounding environment.
- **Ties to co-investment with national businesses**: Some European DFIs have targets for the share of investment that they make together with national businesses while a few are required to ensure such ties in all of their investments. Partnering with national companies clearly promotes the catalytic role of the DFI. However, such ties can also become a limiting factor as DFIs seek to balance investment portfolios and diversify risk. It would be easier if there were the flexibility that allowed DFIs to include national partners when feasible and invest alone or with other partners when that is more appropriate.
- **Obtaining a banking licence**: Some DFIs currently operate under a banking licence. This means that they can borrow in capital markets to leverage their equity and that they are supervised by national financial authorities. Other DFIs are constrained by special regulations stipulating that they can take on either a limited amount of debt or no debt at all.
- **Investing through other funds**: Some DFIs are not permitted to invest through other funds (fund of funds activities). But this form of investment has been growing and is seen as a useful instrument in risk diversification and co-investment with other partners.

7.3.5 Growing the capital base
Finally, the impact of European DFIs may also be expanded through increasing their capital base. The significant expansion in the capital base over the last ten years has been driven to a large extent by accumulated returns on investment. However, opportunities should be explored for both strategic public and private investment in DFIs.

Accumulated profits
With the positive returns on investment achieved by the majority of European DFIs in most years, there has been a steady increase in portfolio sizes. However, this source of additional capital is not strategic in the sense that European DFIs do not set investment strategies primarily with a view to growing their capital base. Project selection and the investment horizons are guided by the prerogative to generate positive development effects while also being financially viable.

Public sector capital injections
Some governments have injected new capital or added guarantees to back European DFIs in the past ten years. Governments have also in some cases contributed to new funds aligned with their international development policies, often with a higher risk profile, to be managed by DFIs outside their own balance sheets. In the aftermath of the global financial

crisis DFIs can have a positive counter-cyclical effect through their investments in developing countries and should be seen as a relevant economic policy tool.

Private sector participation

The large variability in private sector ownership and debt/equity ratios indicate that some European DFIs have explored private sector funding to a larger extent than others. There is potential for several DFIs to work with their government owners to explore this source of capital further. Indeed, the track-record of European DFIs makes them a potentially attractive alternative asset class for institutional investors.

The main challenge in combining participation from public and private owners is to ensure alignment on the targets for financial returns and social impact. Several DFIs have been able to achieve this through setting clear financial return objectives for all investments and attracting private sector investors that are aligned with these objectives.

7.4 The Future Role in International Development Policy

The European DFIs have shown a proven track record in structuring and financing projects that are generally smaller and located in poorer countries compared to those financed by multilateral institutions. In addition to country and sector expertise, EDFIs demonstrate pace, flexibility and innovation in seeking joint solutions to the developmental bottlenecks on developing and emerging markets. Also taking into account the present efforts in harmonizing procedures and key performance indicators for developmental effects, EDFI could become a truly European player in international development policy.

Annex A: Methodology

Report process

Dalberg Global Development Advisors was commissioned by EDFI to produce a report to describe the role of DFIs in international development policy. The research process was undertaken between February and May 2010. The Dalberg team collected data and perspectives from a range of participants within and external to the EDFI network. Economic data was collected from a range of authoritative sources to put development challenges into context. Extensive data was also collected directly from the European DFIs to build up the fact base for profile and case studies.

The fact base from European DFIs has been based on central data collection and individual European DFI interviews. Some data, such as that relating to the DFI portfolios, was available for 2009. However, at the time of writing other data points, including profits, expected investment outcomes, development effects etc. were not available for 2009. The report assumes that the data collected centrally has been validated by the individual European DFIs.

Dalberg is an international advisory group focused on global challenges and development. Dalberg serves a broad cross-section of clients across aid agencies, multilateral banks and investors. The group works on the ground in developing countries and provides research and advice at the global level.

Annex B: Individual European DFI profiles

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General information

BIO was established in 2001 in Belgium to foster private sector growth in developing and emerging countries in order to achieve sustainable economic and social prosperity and alleviate poverty. It is the second Belgian DFI; the first, BMI/SBI, was founded in 1971 (see profile below). BIO is 50% owned by the Belgian State and 50% owned by BMI/SBI. BIO's investments are not tied to Belgian private investors. Note: BIO is one of two Belgian DFIs (the other is BMI-SBI see below).

Strategy

BIO is tasked with enabling and managing finance allocations from Belgium's development cooperation budget to the private sector in the least developed, low and middle income countries. According to its governing principles, it can operate in Least Developed Countries, Low-Income Countries and Lower Middle Income Countries, as defined by the DAC of the OECD, with a focus on the Least Developed Countries and partner countries of the Belgian Development Cooperation. BIO facilitates access to development finance for the emerging private sector both directly and also indirectly through financial institutions and investment funds. BIO's strategy is built around three cornerstones: (1) Indirect support for the financial sector, including microfinance institutions, commercial banks, non-bank financial institutions and investment funds/companies; (2) Investment in local SMEs and larger corporations; and (3) Investment in private infrastructure projects with a focus on energy, access to water, telecoms and transport.

Portfolio

By the end of 2009, BIO had 93 projects and a consolidated portfolio of €261.4 million, up 51% on the previous year. Its new commitments in 2009 amounted to €111.8 million. BIO also manages a Capacity Building Fund, which provides grants to co-finance feasibility studies[28]. In addition, the Fund can provide subsidies for technical assistance programmes (training, technology transfer, etc).

BIO portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	45%	45%	Africa	25%	22%	Equity	38%	18%
Infrastructure	20%	47%	Asia	17%	15%	Loans	62%	82%
Industry	30%	4%	Latin America	17%	12%	Guarantees	0%	0%
Agribusiness	5%	4%	Eur/CIS/Russia	-	-			
Other	0%		Mediterranean	4%	1%			
			Cross-regional	37%	51%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."
Note: "New '09" indicates data for new commitments made in 2009.

[28] Grants are available up to a maximum of 50% of their total cost. The maximum grant available is €100,000.

CDC CAPITAL for DEVELOPMENT [106]

General information

CDC was established in 1948 in the United Kingdom. CDC is the oldest development finance institution in the world. Its mission is to foster growth in sustainable businesses, helping to raise living standards in developing countries. CDC is 100% state owned, and its investments are untied to UK private investors.

Strategy

CDC's target is to make 75% of its investments in low income countries, i.e. those with annual GDP per capita below US$905 (per World Bank 2006 definition). 50% of its investment must be in SSA. In 2001 and 2004, two new private equity fund managers, Aureos and Actis, were created to manage CDC's existing investments and CDC became a fund of funds in 2004. This means CDC does not make direct investments in companies, but places capital with managers who know and understand the emerging markets. Its capital is currently committed to more than 134 separate funds in Africa, Asia and Latin America. CDC's investments are spread across all sectors and include companies of all sizes.

Portfolio

By the end of 2009, CDC had 794 projects and a consolidated portfolio of €3.3 billion. Its new projects in 2009 equalled €583 million with a 10% growth rate from the previous year.

CDC portfolio

Sector split (Percent)*			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	23%	n/a	ACP*	40%	57%	Equity	96%	90%
Infrastructure	34%	n/a	Asia	47%	33%	Loans	4%	10%
Industry	18%	n/a	Latin America	7%	4%	Guarantees	0%	0%
Agribusiness	6%	n/a	Eur/CIS/Russia	2%	1%			
Other	19%	n/a	Mediterranean	4%	5%			
			Cross-regional	-	-			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

* ACP denotes African, Caribbean and Pacific Island regions

COFIDES[107]

General information

COFIDES started operations in 1990. It provides cost-effective financial support for projects in developing, transitional and emerging countries. COFIDES is majority-owned (61%) by the Spanish government through different public institutions, namely the Spanish Institute for Foreign Trade (ICEX), the Institute for Official Credit (ICO) and the National Innovation Enterprise (ENISA). The remaining 39% is held by the three largest Spanish commercial banking groups (BBVA, Banco Santander and Banco de Sabadell). COFIDES finances private projects that are tied to Spanish interests, which is defined in terms of project contribution to the internationalization of Spanish enterprise or the Spanish economy.

Strategy

COFIDES can support any viable private direct investment projects undertaken in emerging or developing economies that involve Spanish interest. The ultimate aim is to conduct a profitable business that contributes both to host country development and the internationalization of Spanish enterprise and the Spanish economy. As a general rule, COFIDES does not participate in projects such as housing construction, defence, education or health care. It is in a position to provide backing for infrastructure or other public utilities, provided that they are privately managed.

Portfolio

By the end of 2009, COFIDES had 117 projects and a consolidated portfolio of €482.0 million in emerging and developing countries, up 12% on the previous year. Its new commitments in 2009 amounted to €152.1 million. COFIDES manages two Spanish Government trust funds established to support Spanish investments abroad (FIEX and FONPYME) as well as cofinancing facilities established with Multilateral Financial Institutions such as the EIB and IADB. COFIDES also counsels potential investors on how to optimise the project financial scheme and gives advice on project-related environmental matters. Through its Representative Office in Mexico (D.F (Mexico) it also provides counsel in the pre-investment stages on various other issues.

COFIDES portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	*Total*	*New '09*	*Region*	*Total*	*New '09*	*Type*	*Total*	*New '09*
Financial	1%	9%	Africa	5%	4%	Equity	94%	96%
Infrastructure	45%	38%	Asia	12%	32%	Loans	6%	4%
Industry	47%	52%	Latin America	61%	35%	Guarantees	0%	0%
Agribusiness	5%	1%	Eur/CIS/Russia	19%	18%			
Other	3%	-	Mediterranean/ Middle East	2%	2%			
			Cross-regional	1%	9%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

DEG KFW BANKENGRUPPE [108]

General information

DEG, which is part of KfW Bankengruppe (KfW banking group), has been specialising in long-term project and corporate financing since 1962. As one of Europe's largest development finance institutions, DEG structures and finances investments by private companies in Africa, Asia and Latin America as well as in Central and Eastern Europe. DEG is 100% owned by KfW, (KfW is owned 80% by the federal government and 20% by Länder. Its investments are not limited to German private investors.

Strategy

DEG's aim is to establish and expand private enterprise structures in developing and transitional countries, thereby creating the basis for sustainable economic growth and a lasting improvement in the living conditions of the local population. DEG invests in profitable projects that contribute to sustainable development in all sectors of the economy. It pays particular attention to agribusiness, infrastructure and processing industries and focuses on the financial sector to facilitate reliable access to investment capital for enterprises.

Portfolio

By the end of 2009, DEG had 670 projects and a consolidated portfolio of €4.7 billion, up 6% on the previous year. Its new commitments in 2009 amounted to €1.0 billion. DEG also provides consultancy services to assist clients and partners in planning and preparing investments. With regard to sectors, priority was attached to environmental protection and resource conservation, financial sector development, food security and assistance to rural areas. DEG also received €12 million in 2009 to administer BMZ's Public-Private Partnership (PPP) Programme, (See 'Cotton made in Africa' case study), and an additional €1.8 million for complementary technical assistance. In addition to PPP, DEG manages three government trustee funds[29] that support pre-investment or investment-tied measures in developing countries.

DEG portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	*Total*	*New '09*	*Region*	*Total*	*New '09*	*Type*	*Total*	*New '09*
Financial	35%	30%	Africa / Caribbean	18%	25%	Equity	42%	37%
Infrastructure	19%	25%	Asia	30%	38%	Loans	57%	60%
Industry	27%	27%	Latin America	20%	19%	Guarantees	2%	2%
Agribusiness	13%	14%	Eur/CIS/Russia	25%	13%			
Other	6%	4%	Mediterranean / Middle East	5%	3%			
			Cross-regional	1%	1%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

[29] Three government funds: Treuhandmittel Bund, Stabifond and Existenzgründungsprogram.

FINNFUND [109]

General information

Finnfund was established in 1980 within the context of broader government goals to increase Finnish development aid. Finnfund provides long-term risk capital for profitable projects in developing countries and in Russia. Finnfund is 87.1% owned by the State of Finland. Finnvera Plc (the Finnish Export Credit Agency) owns 12.8 % of the share capital and the Confederation of Finnish Industries 0.1%. Finnfund finances private projects in which there is a Finnish interest. This is defined in terms of the involvement of a Finnish enterprise and a contribution to the country's development goals.

Strategy

Finnfund's vision is to double its investments in 2009-2013 and to build bridges between Finnish know-how (e.g. in forestry, clean technology and telecommunication) and the needs of developing countries, with particular focus on medium-sized companies. Key elements of Finnfund's strategy include: focusing on Low-Income and Lower Middle Income Countries (in particular the Commonwealth of Independent States) and investing in projects combating climate change. Finnfund invests in microfinance by indirectly financing SMEs and also participates in the financing of infrastructure projects.

Portfolio

By the end of 2009, Finnfund had 129 projects and a consolidated portfolio of €403.0 million, up 30% on the previous year. Its new commitments in 2009 amounted to €152.4 million. Finnfund also manages a business partnership programme, Finnpartnership, on behalf of the Ministry for Foreign Affairs, providing advisory services and financial support for Finnish company projects in developing countries. The government also provides special risk finance for pilot projects that entail significant development impacts.

Finnfund portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	419%	34%	Africa	35%	36%	Equity	45%	46%
Infrastructure	28%	19%	Asia	26%	29%	Loans	53%	54%
Industry	44%	40%	Latin America	15%	5%	Guarantees	2%	0%
Agribusiness	1%	3%	Eur/CIS/Russia	15%	25%			
Other	7%	4%	Mediterranean	<1%	-			
			Cross-regional	9%	6%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

FMO

Finance for Development [110]

General information

FMO was established in 1970 and serves as the entrepreneurial development bank of the Netherlands. It is committed to growing a healthy private sector in developing countries. FMO is a private company of which the Dutch government owns 51% directly, with private sector parties holding 49% of the shares. FMO's finance operations are not tied to Dutch national interests.

Strategy

FMO's vision is that a thriving private sector will help support and grow lasting economic and social development. It pursues this vision by providing capital, sharing knowledge and creating partnerships. FMO only invests in countries classified as Low Income, Lower Middle Income or Upper Middle Income by the World Bank. FMO's 2009-2012 strategy focuses on three key sectors: access to finance (especially for SMEs in Low Income Countries), energy, and housing. FMO holds a banking license from the Dutch Central Bank, (obtained in March 2008).

Portfolio

By the end of 2009, FMO had 904 projects and a consolidated portfolio of €4.6 billion, up10% on the previous year. Its new commitments in 2009 amounted to €911.2 million. FMO manages a number of special purpose funds and facilities for the Dutch government:

- MASSIF contributes to the development of financial services for SMEs
- Infrastructure Development Fund provides long-term financing for infrastructure projects, (energy, telecom, transport, water, environmental and social infrastructure)
- Access to Energy Fund (AEF) contributes to improving access to affordable and sustainable energy for the world's rural poor, with Sub-Saharan Africa as a particular target area
- Capacity Development (CD) program facilitates the transfer of know-how and skills that help clients improve their businesses (see case study X)
- Fund Emerging Markets (FOM) supports the development of emerging markets by encouraging investments by Dutch enterprises, especially SMEs

FMO portfolio

Sector split (Percent)			**Geographic split (Percent)**			**Investment type (Percent)**		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	42%	60%	Africa	29%	34%	Equity	45%	39%
Infrastructure	24%	30%	Asia	25%	28%	Loans	51%	61%
Industry	30%	8%	Latin America	22%	23%	Guarantees	3%	0%
Agribusiness	3%	2%	Eur/CIS/Russia	16%	9%			
Other	2%	0%	Mediterranean	2%	3%			
			Cross-regional	6%	4%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

[111]

General information

IFU was established in 1967 in Denmark. Its mission is to enhance global economic growth, development and more equitable income distribution through increased global flow of socially and environmentally responsible, productive investments. IØ (the Investment Fund for Central and Eastern Europe) is IFU's sister fund and was founded in 1989. IFU/IØ are 100% owned by the Danish government and are tied to national interests as it is a condition that they co-invest with private Danish partners.

Strategy

IFU's vision is to help enhance Danish enterprises' active participation in the global flow of productive investments towards developing countries through contributing information and advice in connection with co-investments. Its strategy is to become known, recognised and used by all relevant Danish enterprises as a competent provider of know-how, experience and external financing as well as establishing itself as their most preferred investment partner in developing countries. IFU only invests in countries with a GNI per capita below US $3,084 (2010), with the exception of South Africa, Botswana and Namibia. IFU places special focus on investments in Africa and on projects supporting the agricultural value chain, infrastructure, financial services and environmental sustainability. IØ only invests in Russia, Belarus and Ukraine.

Portfolio

By the end of 2009, IFU/IØ had 307 projects and a consolidated portfolio of €528.1 million, up 5% on the previous year. Its new commitments in 2009 amounted to €104.3 million.

IFU/IØ 2009 portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	5%	22%	Africa	21%	32%	Equity	53%	53%
Infrastructure	10%	5%	Asia	28%	41%	Loans	44%	46%
Industry	63%	54%	Latin America	4%	1%	Guarantees	3%	1%
Agribusiness	15%	15%	Eur/CIS/Russia	40%	22%			
Other	8%	5%	Mediterranean	6%	4%			
			Cross-regional	1%	<1%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

Note: Includes totals for IFU/IØ and projects with the Department of Food Science (IFV)

[112]

General information

Norfund was established in 1997. It is an integral part of Norwegian development cooperation, with the mandate to operate as a commercial investor in the private sector in developing countries. Norfund is 100% owned by the Norwegian government and is not tied to Norwegian private investors.

Strategy

The Norfund Act of 1997 specifies that “Norfund shall establish viable, profitable business activities which would not otherwise be initiated because of high risk.” In geographic terms, Norfund focuses on four areas: Southern Africa, Eastern Africa, Central America and parts of South East Asia (the Mekong area). Norfund tries to identify commercial viable projects where the lack of capital is greatest. As of 2009, it can make investments in countries with a GDP per capita under US $6,725. Projects are often located in the poorest countries and Norfund therefore has a special focus on LDCs. When focusing on LDCs, Norfund often accepts a more substantial role in project development than most commercial investors would find appropriate. Norfund seeks to invest in selected sectors where it already has experience or where it can build on in-depth expertise in the Norwegian business community. Infrastructure, with an emphasis on renewable energy, hydropower and the financial sector are Norfund’s key focus areas. Norfund works actively to promote social and environmental sustainability.

Portfolio

By the end of 2009, Norfund had 83 projects and a consolidated portfolio of €634.7 million, up 29% on the previous year. Its new commitments in 2009 amounted to €113.6 million. In addition to its annual capital increases, Norfund has established a global subsidiary; SN Power Invest, that is its strategic joint venture in the renewable energy sector. Norfund also received some funds for technical assistance within its area of responsibility.

Norfund portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New ‘09***	***Region***	***Total***	***New ‘09***	***Type***	***Total***	***New ‘09***
Financial	23%	75%	Africa	35%	78%	Equity	85%	50%
Infrastructure	55%	19%	Asia	27%	4%	Loans	15%	49%
Industry	11%	-	Latin America	36%	18%	Guarantees	0%	1%
Agribusiness	5%	7%	Eur/CIS/Russia	-	-			
Other	5%	-	Mediterranean	<1%	-			
			Cross-regional	1%	-			

Source: EDFI. (2010): “2009 Comparative analysis of EDFI members.”

OeEB [113]

General information

OeEB was established in 2008, when it became EDFI's newest member. It serves as the official Development Bank of Austria, acting on behalf of the federal government. OeEB’s mandate is to support commercially self-sustaining projects in the private sector of developing countries that meet certain development policy criteria (i.e. positive employment effects, generation of tax revenues and foreign exchange reserves). OeEB is 100% privately-owned by Oesterreichische Kontrollbank AG, Vienna. Although a privately-owned bank, the political and commercial risks involved in the projects of OeEB are covered by sovereign guarantees issued by the Government of Austria. OeEB is not tied to Austrian interests. Note: a second Austrian DFI AWS exited the EDFI association in 2009, (AWS is tied to national interests, and primarily focused on supporting Austrian companies working in emerging markets).

Strategy

OeEB supports viable projects in developing countries that are primarily located in the private sector, including the financial sector. OeEB can also work in the manufacturing trade, services, industry and agricultural sectors. In addition, it finances infrastructure projects and, on a case-by-case basis, it may also support infrastructure projects in the public sector. OeEB uses loans as its primary financial instrument. It can be active in all developing countries (defined by the OECD DAC list of Official Development Assistance Recipients), excluding countries that have joined the European Union. In well-reasoned cases, projects may also be implemented in countries that are not included in the DAC list (e.g. Russia). It is OeEB’s long-term goal to have 20% of its portfolio invested in LDCs.

Portfolio

By the end of 2009, OeEB had 14 projects and a consolidated portfolio of €149.4 million, up 109% on the previous year. Its new commitments in 2009 amounted to €76.7 million. In addition to its commercial financing activities, OeEB also offers investment-related technical assistance through its Advisory Programmes. These can be utilised to enhance the development effect of the financed projects through activities in advance of these projects being implemented or through accompanying measures (e.g. project related training and upgrading qualifications or the introduction of international standards).

OeEB portfolio

Sector split (Percent)*			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New ‘09***	***Region***	***Total***	***New ‘09***	***Type***	***Total***	***New ‘09***
Financial	100%	100%	Africa	14%	25%	Equity	47%	39%
Infrastructure	-	-	Asia	-	-	Loans	42%	61%
Industry	-	-	Latin America	19%	18%	Guarantees	11%	0%
Agribusiness	-	-	Eur/CIS/Russia	54%	31%			
Other	-	-	Mediterranean	-	-			
			Cross-regional	13%	26%			

Source: EDFI. (2010): “2009 Comparative analysis of EDFI members.”

* Note: Most of the portfolio in the financial sector (88%) was earmarked for a particular purpose: 18% SME lending, 49% microfinance and 21% infrastructure finance.

Proparco[114]

General information

PROPARCO was established in 1977. Its mission is to act as a catalyst in helping to boost private investment in developing countries so as to reach the MDGs and serve as a catalyst for private investment in developing countries. It is a public entity fully owned by the French State through the Agence Française de Développement (AFD), which has a 59% stake in PROPARCO's capital. The remainder is owned private shareholders from the North and South. PROPARCO's investments are not tied to French interests.

Strategy

PROPARCO is part of France's overall foreign aid programme and contributes to economic and social progress in more than 150 developing and emerging market countries In 2009, its geographical coverage was extended to all emerging and developing countries, divided into Africa, the Middle East, Asia, Latin America, East Europe, and the Caribbean as well as in the French Overseas Departments and Territories (with a priority for Africa). Its sector strategy is tailored to the level of a country's development and focuses on the productive sector, financial systems, infrastructure and equity investment. PROPARCO uses loans as its primary financial instrument, but has a wide range of financial tools (equity, guarantees and financial engineering) to meet the specific needs of private investors in developing countries.

Portfolio

By the end of 2009, PROPARCO had 353 projects and a consolidated portfolio of just under €2.2 billion, up 45% on the previous year. Its new commitments in 2009 amounted to €1.1 billion. PROPARCO also manages FISEA, a government fund held by the Agence Française de Développement (AFD) targeting African growth[115].

PROPARCO portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	45%	51%	Africa / Pacific / Caribbean	40%	45%	Equity	14%	15%
Infrastructure	36%	39%	Asia	20%	17%	Loans	84%	85%
Industry	12%	6%	Latin America	4%	9%-	Guarantees	2%	0%
Agribusiness	4%	3%	Eur/CIS/Russia	-	-			
Other	2%	1%	Mediterranean	25%	24%			
			Cross-regional	12%	4%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

[116]

General information

BMI-SBI was established in 1971. Its mission is to provide capital and know-how for international investments made by Belgian private sector companies. It is a private company, of which the Belgian state owns 63% (via the Belgian state holding “SFPI” of 57% and Belgian National Bank’s 6%). The remaining 37% is held by private sector parties such as BNP Paribas Fortis, ING Belgique and Electrabel. SBI’s investments are tied and require a Belgian interest. Note: BMI-SBI is one of two Belgian DFIs (the other is BIO see above).

Strategy

Its activities are oriented towards the creation of new “joint ventures” or subsidiaries worldwide, as well as the acquisition, restructuring or development of existing companies, always in co-operation with Belgian companies. Under its company charter, BMI-SBI can invest worldwide; its reach extends to emerging or developing countries as well as to countries in the industrialized world.

Portfolio

By the end of 2009, BMI-SBI had 24 projects and a consolidated portfolio of €17.8 million, up 0% on the previous year. Its new commitments in 2009 amounted to €3.5 million.

BMI-SBI portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New ‘09***	***Region***	***Total***	***New ‘09***	***Type***	***Total***	***New ‘09***
Financial	21%	37%	Africa	7%	-	Equity	57%	0
Infrastructure	13%	5%	Asia	27%	29%	Loans	43%	100%
Industry	47%	44%	Latin America	6%	-	Guarantees	0%	0%
Agribusiness	18%	14%	New EU states	12%	-			
Other	0%	-	Mediterranean	-	-			
			Cross-regional	49%	71%			

Source: EDFI. (2010): “2009 Comparative analysis of EDFI members.”

SIFEM [117]

General information

SIFEM was spun-off from the Swiss Confederation's State Secretariat for Economic Affairs (SECO) in 2005 and established as a privately-held management company mandated to oversee SECO's investment portfolio and advise on new investment opportunities. SIFEM also manages the investment portfolio of other private and public entities. It is foreseen that SIFEM will become a DFI by the end of the year. The government will transfer the assets into the balance sheet of the DFI and will become the owner. SIFEM's investments are untied to Swiss interests.

Strategy

SIFEM invests in developing and transitional countries, defined by the World Bank, as those with a GNP per capita of under US $6,000. A large part of the investments will be made in SECO's priority countries. SIFEM operates as a fund of funds. Its investment philosophy is guided by the belief that investing in commercially viable emerging market SMEs can provide investors with risk adjusted returns, as well as generating sustainable, long-term development effects in local communities. SIFEM's primary focus is on institutions investing in the small and medium enterprise (SME) sector. On a selective basis, SIFEM also invests in microfinance, makes direct investments and extends credit lines to financial institutions.

Portfolio

By the end of 2009, SIFEM had 63 projects and a consolidated portfolio of €284.0 million, up 14% on the previous year. Its new commitments in 2009 amounted to €33.8 million.

SIFEM portfolio

Sector split (Percent)*			Geographic split (Percent)			Investment type (Percent)		
Sector	*Total*	*New '09*	*Region*	*Total*	*New '09*	*Type*	*Total*	*New '09*
Financial	18%	100%	Africa	24%	53%	Equity	88%	85%
Infrastructure	3%	-	Asia	34%	16%	Loans	12%	15%
Industry	79%	-	Latin America	13%	16%	Guarantees	0%	0%
Agribusiness	0%	-	Eur/CIS/Russia	21%	14%			
Other	0%	-	Mediterranean	4%	-			
			Cross-regional	3%	-			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

* Note: As SIFEM operates as a fund of funds, it breaks down its indirect investments (classified by EDFI system under financial sector) further by sector. Its portfolio is broken down as follows: SME investments (77%); infrastructure (3%), and mezzanine (2%) private equity funds, and microfinance funds (4%). Direct equity and debt investments in financial institutions comprise 15% of the portfolio.

SIMEST [118]

General information

SIMEST was established in 1991. It is 76% publicly owned. SIMEST's investments are tied and require an Italian partner.

Strategy

SIMEST's purpose is to promote Italian investment abroad and to provide technical and financial support for projects. It promotes direct investment by Italian companies outside the European Union (also participating as minority partner to the equity of vehicle companies) and administers various forms of public support for the internationalization of the Italian economy. As regards other activities abroad, SIMEST also: supports export credits for investment goods produced in Italy; finances pre-feasibility and feasibility studies and technical assistance programmes; and finances market penetration programmes. In addition, SIMEST provides Italian companies seeking to internationalize their businesses with technical assistance and advisory services. Its activities in this field include: scouting, matchmaking and advice on financial, legal and corporate questions concerning investment projects abroad to which SIMEST may contribute equity capital.

Portfolio

By the end of 2009, SIMEST had 341 investment projects and a consolidated portfolio of €700.5 million, up 34% on the previous year. Its new commitments in 2009 amounted to €204.4 million. SIMEST also runs the venture capital fund of the Ministry for Productive Activities, which is used for the promotion of investments abroad by Italian companies in China, Russia; Ukraine; Moldova; Armenia; Azerbaijan; Georgia; the Mediterranean Countries (Morocco, Tunisia, Algeria, Libya, Egypt, Israel, Lebanon, Jordan, Syria, the Palestinian Authority, Turkey, Iraq, and countries bordering with Iraq provided their activities are prevalently directed at Iraq); all African Countries; India; Indonesia; Malaysia; Maldives; Sri Lanka; Thailand; the Balkans and the former Yugoslav Republics; and Central and South American Countries.

SIMEST portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	2%	0%	Africa	3%	2%	Equity	100%	100%
Infrastructure	8%	14%	Asia	30%	25%	Loans	0%	0%
Industry	78%	71%	Latin America	12%	18%	Guarantees	0%	0%
Agribusiness	8%	10%	Eur/CIS/Russia	25%	25%			
Other	4%	5%	Mediterranean / Middle East	18%	17%			
			Cross-regional	12%	14%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

Note: The above portfolio includes only investments.

SOFID[119]

General information

SOFID was established in 2007. Its mission is to foster investment and business and to support Portuguese companies that have investments or wish to invest in these countries, either alone or in partnerships which local investors. SOFID is as a limited liability company, but is majority-owned by the Portuguese State (59.99%). The remaining shareholders are the four major Portuguese banks: Banco Espirito Santo, Banco BPI, Caixa Geral de Depósitos and MillenniumBCP, which have 10% each and ELO - Associação Portuguesa para o Desenvolvimento Económico e a Cooperação ("ELO - Portuguese Association for Economic Development and Cooperation") which has 0.01%. Its status allows SOFID to exercise diverse financial operations except the collection of deposits and reimbursable funds. SOFID's investments are tied and require a Portuguese interest.

Strategy

SOFID's role is to offer the full spectrum of financial tools to foster investment and business in developing countries and to contribute towards the sustainable development of these countries. SOFID is mandated to focus especially on the beneficiary countries of the Portuguese Official Development Assistance (ODA).

Portfolio

By the end of 2009, SOFID had 3 projects and a consolidated portfolio of €3.0 million, with a 25% decrease in the value of its portfolio from the previous year. Its new commitments in 2009 amounted to €3.0 million.

SOFID portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	-	-	Africa	100%	100%	Equity	0%	0%
Infrastructure	-	-	Asia	-	-	Loans	83%	83%
Industry	100%	100%	Latin America	-	-	Guarantees	17%	17%
Agribusiness	-	-	Eur/CIS/Russia	-	-			
Other	-	-	Mediterranean	-	-			
			Cross-regional	-		-		

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

Swedfund[120]

General information

Swedfund was established in 1979, working to promote development and bolster the positions of Swedish companies in the emerging markets. Swedfund is 100% owned by the Swedish state. It strives to promote Swedish investments, but is not tied to Swedish private investors.

Strategy

Swedfund's vision is to contribute to the development of profitable companies and thereby stimulate sustainable economic development in the countries in which it invests. Swedfund can provide finance for investments in countries that are eligible for Official Development Assistance finance. Within this group, Swedfund gives priority to the Least Developed Countries and to investments where the development impact is considered to be high. In Eastern Europe, Swedfund can also invest in non-EU member countries not eligible for Official Development Assistance. It cannot make new investments in new EU member states. New investment priorities for Swedfund include: environmental technology and energy, immigrant entrepreneurs, and post-conflict investment environments.

Portfolio

By the end of 2009, Swedfund had 72 projects and a consolidated portfolio of €232.0 million, with a 26% decrease in the value of its portfolio from the previous year, (Note: Swedish Crown depreciated against the Euro by 6% in 2008-2009). Its new commitments in 2009 amounted to €42.7 million.

Swedfund portfolio

Sector split (Percent)			Geographic split (Percent)			Investment type (Percent)		
Sector	***Total***	***New '09***	***Region***	***Total***	***New '09***	***Type***	***Total***	***New '09***
Financial	8%	26%	Africa	45%	22%	Equity	64%	38%
Infrastructure	22%	19%	Asia	30%	37%	Loans	36%	60%
Industry	64%	35%	Latin America	6%	16%	Guarantees	0%	2%
Agribusiness	1%	-	Eur/CIS/Russia	12%	-			
Other	5%	21%	Mediterranean/ Middle East	2%	1%			
			Cross-regional	4%	23%			

Source: EDFI. (2010): "2009 Comparative analysis of EDFI members."

End Notes

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