

# Business Case

## Summary Sheet

<b>Title:</b> Capital increase to CDC, the UK's development finance institution		
<b>Programme Summary:</b> Capital increase to CDC, the UK's development finance institution, to deliver increased development impact in Africa and South Asia through commercial investment and innovative higher risk strategies.		
<b>Programme Value: Average £620million -£703 million per year (over 5 years from 2017 through to 2021)</b>		<b>Country/ Region:</b> Africa and South Asia
<b>Programme Code:</b> 203444	<b>Start Date:</b> 2017	<b>End Date:</b> 2022
<b>Overall programme risk rating:</b>	Major	
<b>Vault Number:</b>		

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## Intervention Summary

**Narrative summary of why UK support is needed, what the funds will be spent on, where, over what period of time, via whom and what they will deliver**

- 1. Sustainable and inclusive economic growth is essential for overcoming poverty and achieving the UN's Global Goals. DFID's Economic Development Strategy** sets out the Department's approach to spurring economic growth and poverty reduction through transforming economies and ensuring that growth delivers for all. Within this strategic framework, **DFID has a role to use public resources where markets have failed, providing patient capital** to support pioneering investments that create jobs in the most challenging markets. This in turn will raise the incomes of poor women and men, and reduce poverty.
- 2. CDC is the UK's development finance institution (DFI). It makes investments in private companies in Africa and South Asia in the form of equity and debt, either directly or via funds with a dual objective to 1) achieve development impact and 2) generate a financial return.** Long-term patient capital from CDC (backed by high environmental, social and business integrity standards) delivers development benefits, while allowing businesses that would otherwise not attract funding to grow, and management skills to develop. This can demonstrate the financial viability of investing responsibly in the world's poorest countries and thereby mobilise private sector investment.
- 3. DFID has agreed a new strategy with CDC in 2017 which builds on CDC's transformation since 2012 and provides a strong foundation for scaling up CDC's operations.** The new strategy will pilot new higher risk investment strategies and develop a robust reporting framework to steer and track CDC's development impact. CDC has also made strategic commitments to women's economic empowerment and tackling climate change and will increase its accountability and transparency, leading the way within its DFI peer group.
- 4. DFID will provide a capital increase to CDC with a base case of an average of £620million per year with an option to increase this to a maximum of an average of £703 million per year** in response to market demand and real world events. This will be committed over the five years from 2017 to 2021, supporting investments until 2022. The capital increase will be accommodated within DFID's existing Economic Development budget and will present less than 8% annually of forecast ODA. This structure of a base case with appropriate flexibility to respond to higher or lower demand is the best way to provide a measure of stability in the face of dynamic markets. **This business case will include the remainder of the £638 million previously approved for the Impact Funds through the Impact Programme.** CDC will take on legal ownership of the existing assets under these two Impact Funds, which are currently DFID assets under CDC management, and future capital for these funds will be made as part of the capital increase. All future capital will be provided to CDC as core capital and can be used to fund all investment activities.
- 5. The capital increase will allow CDC to maintain its current average 2015-2016 commitment pace for commercial investments of \$1.6bn annually.** Commercial DFI investments generate development impact through job creation, sectoral transformation and building investment markets. Increasing CDC's ability to deploy more commercial capital is vital to crowd in the private investment needed to achieve the Global Goals. **In addition, this business case will also allow CDC to scale up new higher risk investment strategies with an average investment of \$300 million annually.** CDC will pioneer a higher risk investment approach where it accepts higher risks and lower risk-adjusted returns in order to

open up new and unproven markets and catalyse impact that would not otherwise occur. This fills a gap for capital that sits between donor grant funding and normal DFI returns and builds on CDC's capabilities developed through management of the Impact Programme.

6. To enable CDC to achieve this additional impact it needs the capacity to take on a greater level of risk and lower or uncertain risk adjusted returns. This business case delivers this by lowering CDC's required portfolio return, such that **CDC will now be required to remain profitable at an institutional level<sup>1</sup> on a 10 year rolling average (after covering its operating expenses)**. CDC is still required to deliver a minimum of a 3.5%<sup>2</sup> return on its commercial portfolio, but can take additional risk on the new higher risk investment strategies. This increased flexibility means CDC can respond to opportunities to achieve additional impact, but also means CDC does not require ongoing capital injections from the UK taxpayer unless an explicit decision is made by the Government to scale up its activity.
7. The proposed capital increase to CDC is projected to provide strong developmental benefits. Modelling results suggest that providing **£3.1bn to CDC will enable it over 25 years to support 2.4m additional jobs and £5.8bn of socio-economic benefits with an overall benefit/cost ratio of 2.21**. The model does not take into account the development impacts of additional private investment mobilised as a result of CDC investment activities.

### **Intervention Summary (mandatory approval questions)**

**Does the programme fit with DFID's strategic architecture: the UK Aid Strategy, Single Departmental Plan, International Development Act and the department's Business Plan?**

8. Promoting global prosperity is one of the strategic priorities of the **UK aid strategy**. [The **Single Departmental Plan** sets out that development capital is vital to support the creation of productive jobs.] Through CDC's new 2017 strategy, DFID has continued to strengthen incentives for CDC to invest in sectors and geographies which maximise development impact. The power to provide financial assistance to CDC is found in the **Commonwealth Development Corporation Act 1999 (the "CDC Act")**. **This was amended in 2017 to raise the cap on the amount of financing that government can provide to CDC**. The International Development Act 2014 does not apply to financial assistance provided under the CDC Act.

**What percentage of DFID's Single Departmental Plan results target does this programme represent? Could the programme be adjusted in scope or scale to deliver SDP results?**

9. DFID reports on two SDP indicators under strategic objective 3 - Promoting Global Prosperity. CDC is solely responsible for achievement of the first of these indicators, which measures the average Development Impact Grid score achieved by CDC over a rolling three-year period. The second indicator tracks the level of catalytic investment made by DFID to create more and better jobs. DFID will not achieve the objective, as measured by this second indicator, without the capital increase to CDC set out in this business case.

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<sup>1</sup> Based on a cumulative ten year rolling average to reflect CDC's long-term investment horizon.

<sup>2</sup> Ibid 1.

**Is the programme coherent with the wider international community and partner government response? Has the programme set out a sustainable exit strategy?**

10. DFID's Economic Development Strategy sets out the approaches DFID will use to support inclusive economic growth in the poorest countries. This business case outlines how DFID proposes to create jobs and stimulate private investment to achieve this objective through CDC.

**Has the programme considered working with HMG Departments and accessing cross-HMG funds?**

11. DFID will work side by side with the Foreign and Commonwealth Office (FCO) and Department for International Trade (DIT) and as we develop partnerships with the emerging markets of the future. CDC will also take advantage of networks with the City of London to strengthen relationships with investors who may be interested in increasing their investment in Africa and South Asia. CDC is 100% owned by DFID as the sole shareholder, we therefore have not considered accessing cross-HMG funds.

**How does the programme relate to other UK aid within the specific sector, including multilateral, bilateral and centrally managed programmes?**

12. CDC's investment in businesses through development capital **complements use of grants for wider DFID priorities**. This includes supporting basic humanitarian and development aims as well as providing technical assistance to address the barriers that deter investors, including weak enabling business environments. Development capital through CDC **complements investment work undertaken by multilateral and regional development banks** as well as other organisations such as the Private Sector Infrastructure Development Group (PIDG).

**Is there sufficient flexibility to learn and adjust to changes in the context? What level of flexibility is there to shift this and future commitments?**

13. **CDC needs certainty on a minimum capital increase in order to credibly source a pipeline in the market and scale up the organisation accordingly.** CDC has recently launched an ambitious 5-year strategic framework that envisions increasing CDC's development impact resources, pursuing more innovative investing strategies, establishing more international offices and mobilising additional private sector capital – all of which requires funding certainty and market credibility. DFID will therefore commit to £3,100 million. The maximum capital increase of £3,515 million will be subject to actual market demand whilst CDC will provide an update 2 years before new capital is provided to confirm that they are still comfortable absorbing the additional capital.
14. **This business case includes a comprehensive evaluation plan** with approaches to monitoring, results reporting and scaled up efforts to generate evidence and knowledge. This includes a DFID commissioned external assessment of CDC's strategy in 2020 to inform any adjustments and changes for the following strategy period. In addition, the business case proposes a prudent scale up under qualifying strategies for higher risk investments, allowing a full framework to be developed over time, taking into account lessons learnt.

**Does the proposed level of risk to be taken fit with DFID's risk appetite for this portfolio?**

15. The overall risk rating is major. Risk is an inherent component of CDC's activities as an investment company operating in some of the world's poorest and

most fragile countries. **CDC's internal processes and governance framework with DFID will ensure that all risks are properly mitigated and managed.**

**Is there a clear communications strategy to reinforce our objectives? Will the programme be branded with the UK aid logo and recognise UK Government funding – and, if not, why not?**

16. As a fully owned UK entity, CDC is recognised as part of the UK's offer to mobilise private investment into countries in South Asia and Africa. A clear communications strategy is being developed between CDC and DFID communications teams, which is not intended to be branded as UK aid to ensure commercial independence and credibility in the markets.

**Has the programme been quality assured? How confident are we that the skills, capability, resources and political will exist to deliver the programme?**

17. **In 2016, the NAO undertook a full value for money study on CDC as a follow-up to their 2008/2009 report.** The report highlighted key aspects of CDC's transformation and DFID's strengthened oversight since 2012, including stronger alignment between CDC's investment portfolio and DFID's priorities, CDC having met its performance targets; and CDC's efficient and economic operating model. It noted that thorough governance arrangements with DFID existed and that DFID had made a convincing business case for the capital increase in 2015. **DFID also commissioned an independent review of CDC's performance against 2012-2016 strategy** and investment policy which made recommendations which have been taken into account in developing the 2017 strategy.

**Does the SRO and team have the capability and resources to deliver this programme?**

18. CDC, as a plc, is governed by a Board of Directors that is answerable to the shareholder (DFID) through the normal company governance process, such as via quarterly and annual shareholder meetings, reports and accounts. Based on this, DFID and CDC have established a thorough governance framework. A dedicated A1 Lead Adviser in the Private Sector Department's Investment Team will be the Senior Responsible Officer, accountable for managing delivery and oversight of all DFID's shareholding of CDC. She/he will be supported by a range of advisers and programme managers in the Investment Team, drawing on expertise across DFID as required. There will be supervisory and quality assurance inputs from the Head of the Private Sector Department and Director for International Finance and Director General for Economic Development.

## **A. Strategic Case**

The strategic case will set out the following:

**Section 1 Context:** Mobilising investment through development capital is an important part of DFID's Economic Development Strategy. Investment and job creation are fundamental to poverty reduction and leaving no one behind.

**Section 2 Need:** There is a **huge financing gap to achieve the Global Goals** with current investment levels less than half of the \$2.5 trillion needed every year. Private equity in particular has an important role to support business growth but remains low and concentrated (section 2.1). **Investment flows remain low due to real and perceived risks** (section 2.2).

**Section 3 How DFID responds: DFID (through CDC) has to deploy public finance as a catalyst of private investments by:**

- **scaling up commercial investment:** to demonstrate that market rate returns can be generated in the hardest to reach places (section 3.1) AND
- **piloting innovative approaches to higher risk investment:** to support development of unproven markets and sectors (section 3.2)

**Section 4: CDC as partner for scaling up commercial investment and innovation,** based on its transformation since 2012 (section 4.1) and new 2017 strategy (section 4.2)

**Section 5 Theory of Change:** How DFID achieves impact and outcomes by investing through CDC

**Section 6 Gender Equality Act/Terrorism and Financing:** How investing through CDC addresses key DFID requirements

**1. Context: Mobilising investment through development capital as an important part of DFID’s Economic Development Strategy.**

19. **Sustainable and inclusive economic growth is essential for overcoming poverty and achieving the UN’s Global Goals.** No country can prosper or move beyond reliance on aid without it. As the Growth Commission puts it, growth ‘can spare people *en masse* from poverty and drudgery. Nothing else ever has.’<sup>3</sup> For this growth to have lasting, resilient impact, it must **transform economies, create jobs and private sector investment, and spread benefits inclusively.** However, current rates of growth in many countries are not high enough to meet the zero poverty target at the heart of the Global Goals; nor enable them to transition from aid.
20. **Promoting global prosperity is one of the strategic priorities of the UK aid strategy.**<sup>4</sup> **DFID’s Economic Development Strategy**<sup>5</sup> sets out the approach to spur economic growth and poverty alleviation through:
- a. **Transforming economies:** Creating large numbers of jobs for women and men that generate rising incomes and improving working conditions. This entails moving jobs into higher productivity sectors and boosting productivity within existing sectors to steadily change the structure of economies.
  - b. **Ensuring that growth delivers for everyone:** Removing barriers so that the opportunities created by economic development are more fairly distributed – helping ensure growth translates into real improvements for poor people and no one is left behind.
21. In recognition that **a thriving and well governed private sector is the driving force behind structural transformation,** the **Addis Ababa Action**

<sup>3</sup> Commission on Growth and Development, *The Growth Report: Strategies for Sustained Growth and Inclusive Development*, World Bank, 2008, p.1.

<sup>4</sup> <https://www.gov.uk/government/publications/uk-aid-tackling-global-challenges-in-the-national-interest>

<sup>5</sup> <https://www.gov.uk/government/publications/dfids-economic-development-strategy-2017>



**Agenda** changed the landscape of development finance, emphasising the **importance of mobilising private sector finance and developing countries' domestic resources**. As the UK Independent Commission for Aid Impact noted in January 2016:

*'If the Millennium Development Goals were predominantly about public services, the new aid agenda is also shifting the **focus back to the private sector as the engine of growth and prosperity**. The consensus is that the eradication of extreme poverty cannot be achieved without robust economic growth, including a shift in developing economies towards more productive sectors.'*

22. DFID's Economic Development Strategy sets out the **approaches DFID will use to support inclusive economic growth to lift people out of poverty**. This includes building the potential for developing countries to trade more with the UK and the rest of the world and integrate into global value chains; technical partnerships with partner governments to improve macroeconomic and regulatory environments; developing local financial sectors and deepening links with the City of London and partnerships with international companies and SMEs to develop new business models. **Stimulating private investment and creating jobs is also an important part of DFID's approach and the focus of this business case.**
23. **Investment and job creation are fundamental to poverty reduction and leaving no one behind.** Analysis of countries which have had sustained, high growth suggests that overall investment rates of 25% of GDP or above are needed, counting both public and private. Average Investment rates in Sub-Saharan Africa have been persistently between 15-20% over the last 30 years.<sup>6</sup> It is estimated by the World Bank that the doubling of investment rates is associated with a 2% increase in the rate of GDP growth.<sup>7</sup> Research shows that a 10 percentage-point increase in the ratio of private credit to GDP could lead to a 2.5–3.0 percentage-point reduction in poverty incidence. Specifically, evidence shows that **investment in labour-intensive productive sectors generates higher levels of poverty reduction**.<sup>8</sup> The majority of the poorest and most marginalised people work in the informal sector with limited prospects for moving from subsistence to higher productivity activities. Investment to create more and better jobs is needed to give people the income, opportunity and dignity to live better lives and leave poverty behind. The 2013 World Development Report on jobs was clear that **“job-related events are the main escape route from poverty in developing and developed countries alike”** through raising living standards, productivity and social cohesion. In ten of 18 countries considered, income from jobs explains more than half of the change in poverty. In another five, it accounts for more than a third of the reduction in poverty.<sup>9</sup> However current investment levels are not sufficient to create the number and quality of jobs needed to transform economies and peoples' lives. **Investment levels are less than half of the approximately \$2.5 trillion needed globally every year to achieve the Sustainable Development Goals (Figure 1).**<sup>10</sup> There is a strong argument to use public finance to catalyse multiples of private investment, given market failures that restrain investment in developing country markets.

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<sup>6</sup> The Growth Report: Strategies for Sustained Growth and Inclusive Development, World Bank, 2008.

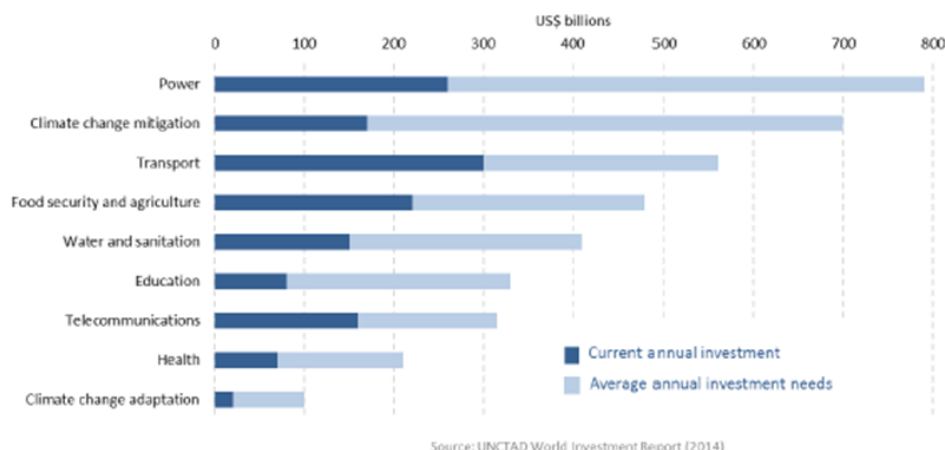
<sup>7</sup> Ibid

<sup>8</sup> Hull, Katy (2009). Understanding the Relationship between Economic Growth, Employment and Poverty Reduction. In Economic Growth, Employment and Poverty Reduction. Organisation for Economic Co-operation and Development

<sup>9</sup> World Bank. 2012. *World Development Report 2013 Overview: Jobs*. Washington, DC: World Bank.

<sup>10</sup> UNCTAD World Investment Report (2014)

**Figure 1: Funding gaps in priority sectors**



24. Private investors continue to hold back from the long-term investment needed for reasons outlined below in section 2.2. DFID is a shareholder in the World Bank Group and Regional Development Banks all of which have tools for direct investing in the private sector in developing countries and DFID is continuing to require these organisations to use their balance sheets more effectively and to step up their actions to mobilise more investment, including particularly in fragile states. Alongside these multilateral channels **DFID has a role to use public resources where markets are fragile or have failed, to use development capital to create jobs, catalyse private investment and build markets in challenging settings. As the UK's development finance institution, CDC is currently DFID's principal partner in doing so,** complementing work through multilateral and regional development banks as well as other organisations such as the Private Sector Infrastructure Development Group (PIDG).

## **2. Need: Investment flows continue to be deterred by high risk perceptions**

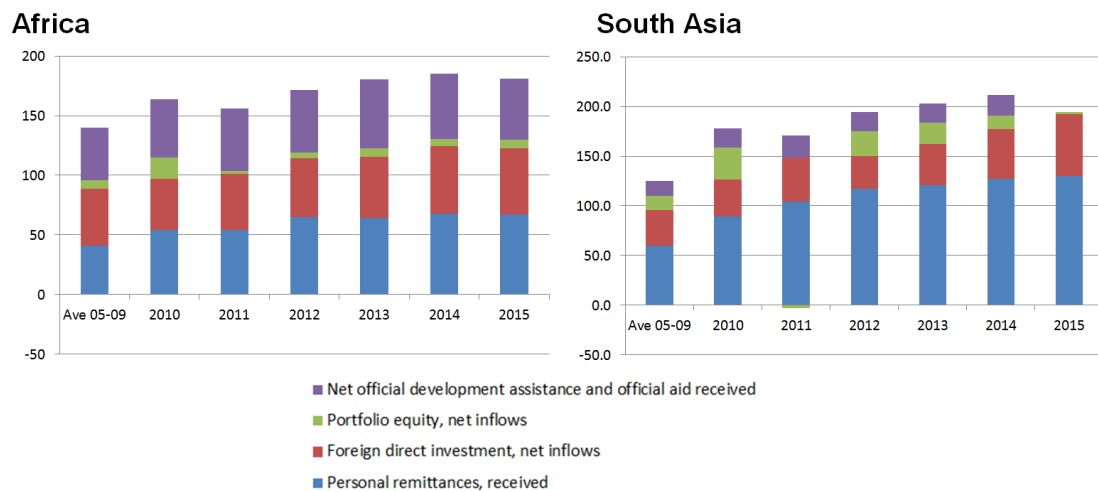
### **2.1 Financial flows in Africa and South Asia remain insufficient to achieve the Global Goals**

25. **Continued investment via CDC and other DFIs is only warranted if there is reasonable expectation that private financial flows will not reach the levels needed for sustainable economic development and the Global Goals anytime in the near future.** Latest numbers of international and domestic financial flows in paras 27-28 confirms that despite some positive economic developments in Africa and South Asia in recent years, current levels of finance fall far short due to (i) weak political and economic institutions in individual regions/countries, (ii) low levels of domestic savings and (iii) high perceptions of risks (as detailed in section 2.2). and (iv) perceptions that better financial returns are available in other markets. As these factors are projected to persist, **investing directly to catalyse more private finance in Africa and South Asia offers opportunities for the UK to respond to these challenges, especially to provide long-term capital, including to tackle counter-cyclical trends, and to provide targeted and**

innovative support in addition to that provided through the multilateral system.

26. **International private investment (foreign direct investment and portfolio equity) in Africa and South Asia has remained persistently low**, especially compared with ODA and remittances (figure 2). This reflects high actual and perceived risks and high costs in those markets. In addition, **constraints preventing the growth of domestic capital markets (figure 5) mean that there is a shortage of long term capital**. Loan durations to firms in low-income countries average 23.3 months (for example 8 months in Sierra Leone, 4.4 months in Liberia), less than half of the average for firms in high-income countries which average 58.7 months.<sup>11</sup> Given this, **almost 38% of African businesses identify a lack of finance as a major constraint to doing business, and the same is true for nearly 27% of South Asian businesses.**<sup>12</sup> **Lack of finance also constrains business growth and the creation of formal jobs.** According to available data, Ethiopia (99m people) has less than 20 businesses that reported revenues above \$50 million over the last twelve months, many smaller African countries such as Uganda, Malawi, Sierra Leone fewer than 10 compared with the UK's (64 million people) over 10,000 businesses in that range<sup>13</sup>. Inter-state variation in India is high, with Bihar's (100 million people) less than five companies above the \$50m mark compared with Uttar Pradesh's over a hundred companies for 200 million people.

**Figure 2: International financial flows to Africa and South Asia<sup>14</sup>**



27. **In sub-Saharan Africa, financial flows are characterised by significant volatility (due to strong dependencies on commodities) and concentration (in individual countries) (figure 3):**<sup>15</sup> From a period of significant increase between 2004 and 2008, **FDI<sup>16</sup> flows** to Africa have flat lined and have fallen since 2013. Reflecting deteriorated overall growth in 2016 (mainly from lower commodity

<sup>11</sup> World Bank's Global Financial Development Report 2015/2016

<sup>12</sup> World Bank Enterprise Surveys

<sup>13</sup> S&P Capital IQ database, accessed July 2017.

<sup>14</sup> World Development Indicators

<sup>15</sup> Data from UNCTAD (2017), World Investment Report - Investment and the Digital Economy, UN, New York

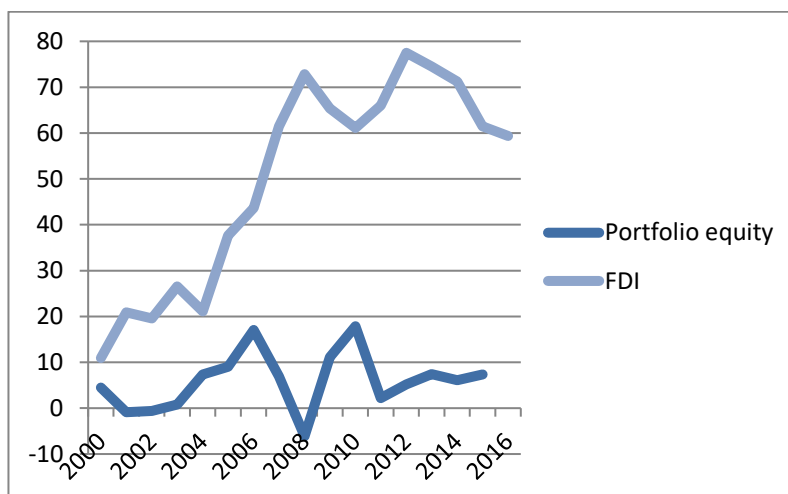
[http://unctad.org/en/PublicationsLibrary/wir2017\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf) and World Development Indicators

<http://data.worldbank.org/products/wdi> – unless otherwise indicated

<sup>16</sup> The sum of equity capital, reinvestment of earnings, and other capital. The criterion for direct investment is ownership of 10 percent or more of ordinary shares.

prices)<sup>17</sup>, FDI inflows to Africa accounted for 3.4% (\$59bn) of global FDI flows. Within Africa, there is a significant annual variation in FDI inflows driven by large one off infrastructure or mining investments in specific countries. Much of the most recent growth in FDI flows to Africa in 2016 can be attributed to investments related to natural gas discoveries in Egypt; much FDI in past decades has also been associated with oil and gas. Other countries such as the DRC have suffered significant falls in FDI in 2016 as a result of low commodity prices.<sup>18</sup> Similarly, **portfolio equity investments**<sup>19</sup> to Africa have more than halved since 2010 and are lower than in 1998, standing at \$7.2bn in 2015. This trend is not set to reverse, with the African Economic Outlook 2017 predicting further falls over coming years.<sup>20</sup> **Domestic credit**<sup>21</sup> is an important source of capital with 46% of GDP being lent to the private sector in Africa, but well below the global average of 129%. However, there are substantial inter-regional variations with most of Africa's figure driven by South Africa's 150% ratio, compared with 5% in South Sudan or 7% in the Democratic Republic of the Congo. Since 2009, average domestic credit to the private sector in Africa has been falling as a share of GDP.<sup>22</sup>

**Figure 3: FDI and portfolio equity inflows to Africa (USD billions)**



28. **In South Asia<sup>23</sup>, financial flows are characterised by trend reversals (due to more integration with world markets) and inter-regional variations (given the diversity of the region)** (figure 4):<sup>24</sup> Similar to Africa, South Asia experienced a period of significant increase of **FDI** from 2000 until 2008. Since then FDI flows have mostly fallen and only since 2012 have grown again. Nevertheless, South Asia still accounted for only 3.8% (\$66bn) of global FDI flows in 2016.<sup>25</sup> South Asia's FDI inflows remain among the lowest relative to GDP among developing

<sup>17</sup> African Economic Outlook 2017 [http://www.africaneconomicoutlook.org/sites/default/files/2017-05/African\\_Economic\\_Outlook\\_2017.pdf](http://www.africaneconomicoutlook.org/sites/default/files/2017-05/African_Economic_Outlook_2017.pdf)

<sup>18</sup> Ibid.

<sup>19</sup> Portfolio equity includes net inflows from equity securities other than those recorded as direct investment and including shares, stocks, depository receipts (American or global), and direct purchases of shares in local stock markets by foreign investors. Data are in current U.S. dollars.

<sup>20</sup> African Economic Outlook 2017 [http://www.africaneconomicoutlook.org/sites/default/files/2017-05/African\\_Economic\\_Outlook\\_2017.pdf](http://www.africaneconomicoutlook.org/sites/default/files/2017-05/African_Economic_Outlook_2017.pdf)

<sup>21</sup> Financial resources provided to the private sector by financial corporations, such as through loans, purchases of non-equity securities and trade credits that establish a claim for repayment.

<sup>22</sup> World Bank database

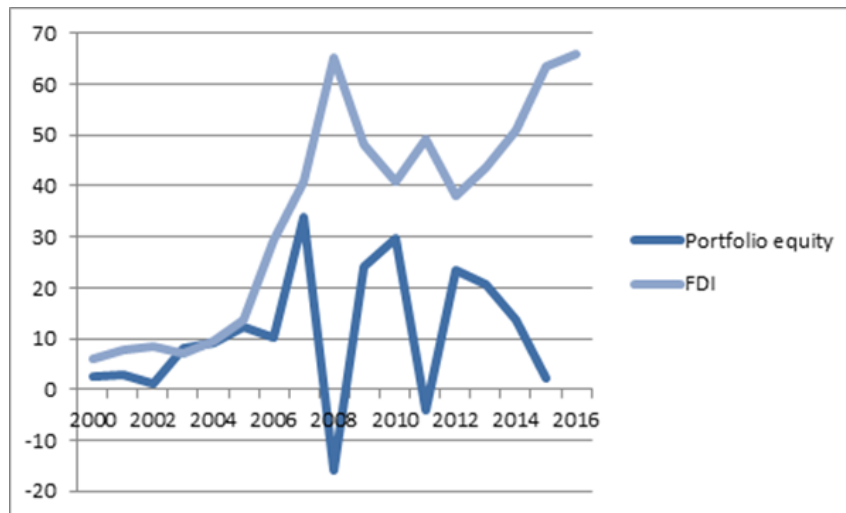
<sup>23</sup> Definition of South Asia as per CDC's Investment Policy

<sup>24</sup> Data from UNCTAD (2017), World Investment Report - Investment and the Digital Economy, UN, New York [http://unctad.org/en/PublicationsLibrary/wir2017\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf) and World Development Indicators <http://data.worldbank.org/products/wdi> – unless otherwise indicated

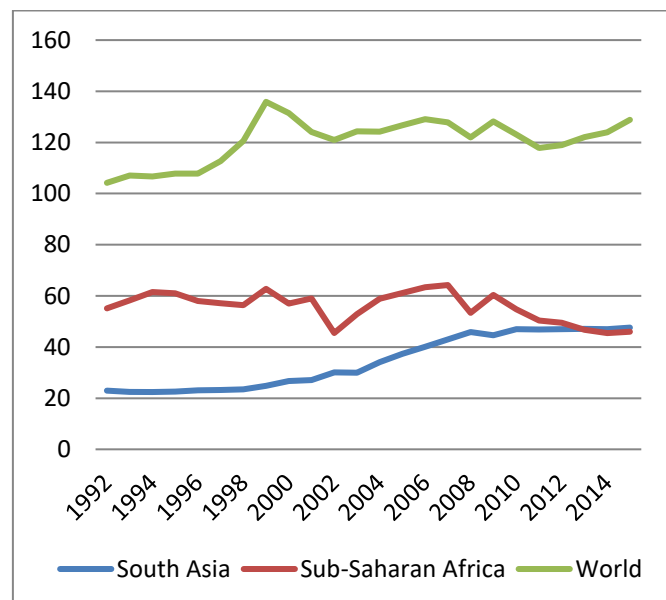
<sup>25</sup> UNCTAD World Investment Report 2017 [http://unctad.org/en/PublicationsLibrary/wir2017\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf)

country regions: for example in 2015, the UK's FDI per capita was US\$897, whereas Pakistan's was just \$5.<sup>26</sup> **Portfolio equity inflows** to South Asia have also fallen dramatically since 2012, down from \$23.4 billion to \$2.3 billion in 2015. **Domestic credit** to the private sector is 48% of GDP, only slightly higher than in Africa. There are also substantial inter-regional variations with Nepal's emerging capital markets (65%) standing against Pakistan's (15%) or Afghanistan's (4%) constraints. Even though average domestic credit has been consistently increasing in South Asia since the 2000s, it has done so from a low basis of 20%.

**Figure 4:** FDI and portfolio equity inflows to South Asia (USD Billions)



**Figure 5:** Domestic credit to the private sector as a % of GDP

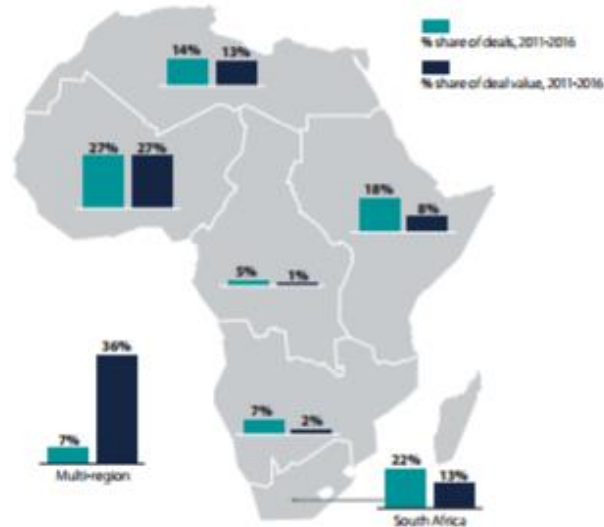


<sup>26</sup> 2015 FDI new inflows data based on World Bank data <https://data.worldbank.org/> divided by population numbers for the UK and Pakistan

**Figure 6:** Share of number and value of PE deals in Africa, by region 2011-2016

29. FDI can also come in the form of private equity where companies are not listed on stock markets.<sup>27,28</sup> Private equity investments have a particularly important role to play by actively supporting businesses to (i) expand their operations in poorer regions, (ii) expand their products and services to new/different customer bases, (iii) support innovative and disruptive business models, as well as (iv) improve environmental, social and business integrity standards – thereby contributing to economic growth through job creation, service provision and tax revenues. CDC has played a pioneering role in establishing the private equity industry in emerging markets according to an independent evaluation of CDC’s funds business from 2004-2012 conducted by Harvard Business School. CDC’s presence in many of these first-time funds catalysed their closing and raised the environmental, social and governance standards of these funds and their portfolio companies.<sup>29</sup> Other DFIs have not targeted equity to the same extent as CDC.

Share of number and value of PE deals in Africa, by region, 2011 – 2016



30. In Sub-Saharan Africa, following the end of the commodities “super-cycle” which saw annual private equity investment in Sub-Saharan Africa more than doubling from \$0.8bn in 2010 to \$2.1bn in 2014, there was a contraction of private equity in 2015 that continued through 2016 to \$1.6bn. Fundraising has been hit accordingly with investors holding back from making new investments, down from \$4.5bn in 2014 to \$2.0bn in 2016 (figure 7).<sup>30</sup> An EMPEA survey cited political instability and currency risks as investor’s main constraints.<sup>31</sup> Within Africa, most deals by value over the last five years have been multi-regional, reflecting the need for risk diversification. West Africa received with 27% a large share compared to just 1% in Central Africa (see figure 6).<sup>32</sup>

<sup>27</sup> Wacker, K.M. ‘On the measurement of foreign direct investment and its relationship to activities of Multinational Corporations’, European Central Bank, Working Paper Series, No 1614, November 2013.

<sup>28</sup> To note that private equity numbers below include foreign and domestic sources

<sup>29</sup> Lerner, Josh, Ann Leamon, Steve Dew, and Dong Ik Lee. “The Impact of Funds: An Evaluation of CDC 2004-12.” Working Paper, October 2015

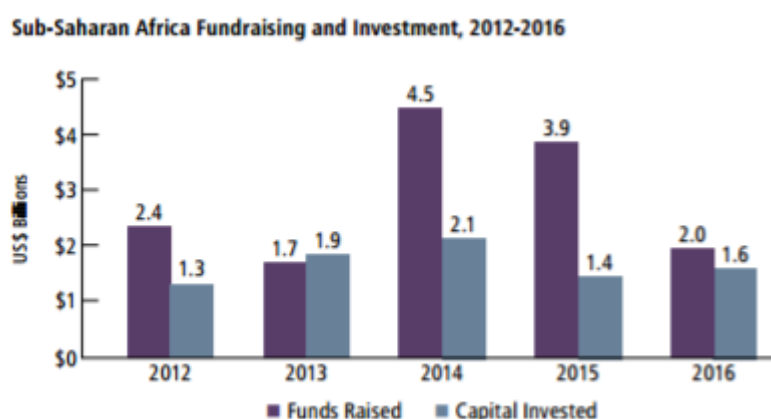
<sup>30</sup> EMPEA Sub-Saharan Africa Data Insight 2016

[http://empea.org/files/listing\\_pages/SSA\\_data\\_insight\\_Q4\\_2016\\_member1.pdf](http://empea.org/files/listing_pages/SSA_data_insight_Q4_2016_member1.pdf)

<sup>31</sup> EMPEA Global Limited Partner Survey 2017 <http://go.empea.org/50512/2017-05-01/8j22vs>

<sup>32</sup> African Private Equity and Venture Capital Association – 2016 Annual African Private Equity Data Tracker [http://www.avca-africa.org/media/1685/avca-2pp-a4-public-24-02-2017\\_2.pdf](http://www.avca-africa.org/media/1685/avca-2pp-a4-public-24-02-2017_2.pdf)

**Figure 7: Sub-Saharan Africa fundraising and Investment, 2012-2016**



31. **The picture in South Asia is mainly driven by investor interest in India** which was the most attractive investment location for emerging markets investors according to EMPEA, up from second in 2016.<sup>33</sup> India-focused funds increased by 8% in 2016 in aggregate to reach \$4 billion and total PE deal value in 2016 was the second highest since 2008 at about \$16.8 billion. Banking, financial services and insurance (BFSI), IT and manufacturing were high-growth sectors and contributed to half of the total deal value. New asset classes like alternative investment funds (AIFs) have grown in the Indian market, aided by government regulations and tax breaks, comprising 41% of the total India-focused funds raised in 2016, compared with only 11% in 2014.<sup>34</sup> And investment within India is heavily concentrated in certain states, bypassing the poorest (such as Bihar and Orissa). Indeed, despite poorer Indian states accounting for over 60% of the population and 35% of India's GDP, they only receive 3% of the total FDI to India. For instance, in 2016 only \$300m of private equity was invested in the Northern and Eastern states of India (excluding the Delhi / National Capital Region), out of an estimated total of \$20bn invested in India. Some of the main issues facing investors in other parts of South and Southeast Asia are the limited number of experienced fund managers and the fact that the opportunities available are too small to be investable by large investors seeking to invest significant capital.<sup>35</sup>
32. **Social impact investing is an emerging source of financing which can be made across asset classes**, including but not limited to private equity (both FDI and portfolio equity investments), venture capital and fixed income. **In 2016 impact investors invested at least USD 22.1 billion worldwide; of this only USD 670 million was invested in Sub-Saharan Africa and South Asia.** Impact investors include institutional and family foundations, banks, financial advisors and wealth managers. Government investors and DFIs also allocate a share of their portfolio to impact investments.
33. **The hallmark of social impact investing is the intention of the investor to achieve a positive social or environmental impact, which they commit to measure and report**<sup>36</sup>. Impact investors target financial returns that range from lower risk-adjusted returns to risk-adjusted market rates, with approximately one third targeting lower risk-adjusted returns<sup>37</sup>. Impact investing therefore means different things to different people and there are many different types of impact

<sup>33</sup> EMPEA Global Limited Partner Survey 2017 <http://go.empea.org/50512/2017-05-01/8j22vs>

<sup>34</sup> Bain & Company: 'India Private Equity report 2017'

<sup>35</sup> EMPEA Global Limited Partner Survey 2017 <http://go.empea.org/50512/2017-05-01/8j22vs>

<sup>36</sup> <https://thegiin.org/impact-investing/need-to-know/#s2>

<sup>37</sup> [https://thegiin.org/assets/GIIN\\_AnnualImpactInvestorSurvey\\_2017\\_Web\\_Final.pdf](https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf)

investors pursuing a variety of impact objectives and financial return targets (both commercial and higher risk). The large majority of impact investors are headquartered in developed markets, particularly US, Canada and Europe<sup>38</sup>. Impact investing should have an important role in funding the Global Goals; however it is unlikely to reach the scale required in the medium term future.

## 2.2 Investment flows remain low due to real and perceived risks

34. **Real and perceived risks explain why investment flows remain low in African and South Asian markets, as described above.** For investors to act at the scale required for the Global Goals, they require evidence of the track record of the firm, sector and country they are investing in. According to Global Impact Investing Network 2017, the lack of high quality investment opportunities with a track record of risk-adjusted returns is one of the top challenges reported by impact investors, together with (among others) the challenge of the availability of appropriate capital across the risk/reward spectrum.<sup>39</sup> Despite instances and periods of successful investments in Africa and South Asia, **scale and continuity of track record is still lacking** mainly due to the following reasons:

- a. **Macroeconomic fundamentals and political risks:** The economic environment remains challenging with low domestic saving rates, dependencies on commodity prices and increasing private debt burdens. Political risks arising from pockets of conflicts and instability and lack of trust and accountability in public institutions due to corruption and weak rule of law add to actual and perceived risks.
- b. **Regulatory environment:** In most developing countries, regulatory frameworks have improved but the pace of reform is slow and further progress is needed to create a predictable, safe enabling framework for firms while protecting consumers.
- c. **Lack of infrastructure:** Poor enabling infrastructure in many developing countries means high transaction and transport costs. Overall the poor state of power infrastructure is estimated to reduce growth rates on the African continent by an average of 2.1% per year<sup>40</sup>.
- d. **Scarce management skills and viable business models:** Successful companies depend on high quality management skills and strong corporate governance. The next generation of business leaders is emerging, but experienced entrepreneurs and management skills are still scarce, particularly in Africa. Investors are often expected not only to provide capital but also to support the development of business models, and the improvement of management processes as well as environmental, social and governance standards.
- e. **Lack of suitable exit options:** Investors need not only confidence that they find the right type of companies to invest in, but also that they can exit at an appropriate time and generate a return. However in many developing countries, exits can be challenging due to a mix of regulatory/legal constraints, shallow capital markets (lack of public exchanges and secondary markets) and issues with major currency and other macroeconomic fluctuations.

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<sup>38</sup> <https://capria.vc/updates/global-trends-in-impact-investing-east-africa-focus/>

<sup>39</sup> Annual impact Investor Survey 2017, the Global Impact Investing Network, 17 May 2017

<sup>40</sup> World Bank Investment Climate report 2011 on World Bank Doing Business Index.



- f. **Regulatory constraints for investors:** Institutional investors face regulatory constraints in their own jurisdictions which inhibit scaling up investment in developing countries (e.g. higher capital requirements).
35. **Lack of track record together with scarcity and unreliability of information means investors increase their view of the risk** associated with an investment, and as a consequence the required return and thereby the cost of capital for businesses. Paul Collier<sup>41</sup> notes how investors remember and over-compensate for negative information such as news of unrest or conflicts, and are slow to adjust their investment decisions as a situation improves. This means that even if political and regulatory environments improve, this will not enable sufficient private investment to flow. Instead investment markets will find an equilibrium based on a lower level of investment because of the perception of risk. **Long-term patient capital from Development Finance Institutions (backed by high environmental, social and business integrity standards) helps businesses to grow, builds management skills, and adds to a track record of successful investments, demonstrating the financial viability of investing responsibly in the world's poorest countries, reducing costs and risk for private investors.** In this way, DFID-supported investments could draw in multiples of the aid funds invested and unblock trillions of investment needed to support the Global Goals, create more and better jobs and economic opportunities for people to lift themselves out of poverty, and generate increased tax receipts to finance vital public services.

### **3. How DFID responds: Investing through CDC, the UK's Development Finance Institution**

#### **3.1 DFI commercial investment to demonstrate that market rate returns can be generated in the hardest to reach places**

36. **The UK, through CDC, has an important role in the DFI landscape. DFIs use public money to make investments in private companies with dual objectives to 1) achieve development impact and 2) generate a financial return.** Investment can take the form of equity or debt (either direct or through funds) (more detail in **Annex A**) as financing needs vary significantly from one investment to another and should be tailored to the business supported. **DFIs bring together the best of private and public sectors: the rigour and discipline of a commercial investor combined with a clear development mandate.**
37. **DFIs mainly generate development impact in four ways** (i) through the **jobs created** by their portfolio companies and by forward and backward linkages in the economy (e.g. from supply chains, wages spent and productivity growth) (ii) by fostering technical change in those companies, with possible spill over effects for **structural transformation** in the sector and the whole economy <sup>42</sup> (iii) boosting **affordable access to goods and services** and (iv) through **building investment markets** by:
- a. supporting businesses, through the provision of more patient capital which other private investors with a lower risk threshold and shorter return timeframes will not advance (**financial additionality**)

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<sup>41</sup> The Bottom Billion Paul Collier, Oxford University Press 2008

<sup>42</sup> Jouanjean, M-A.; Massa, I and Te Velde, D.W. (2013) 'The role of development finance institutions in promoting jobs and structural transformation', London: ODI.

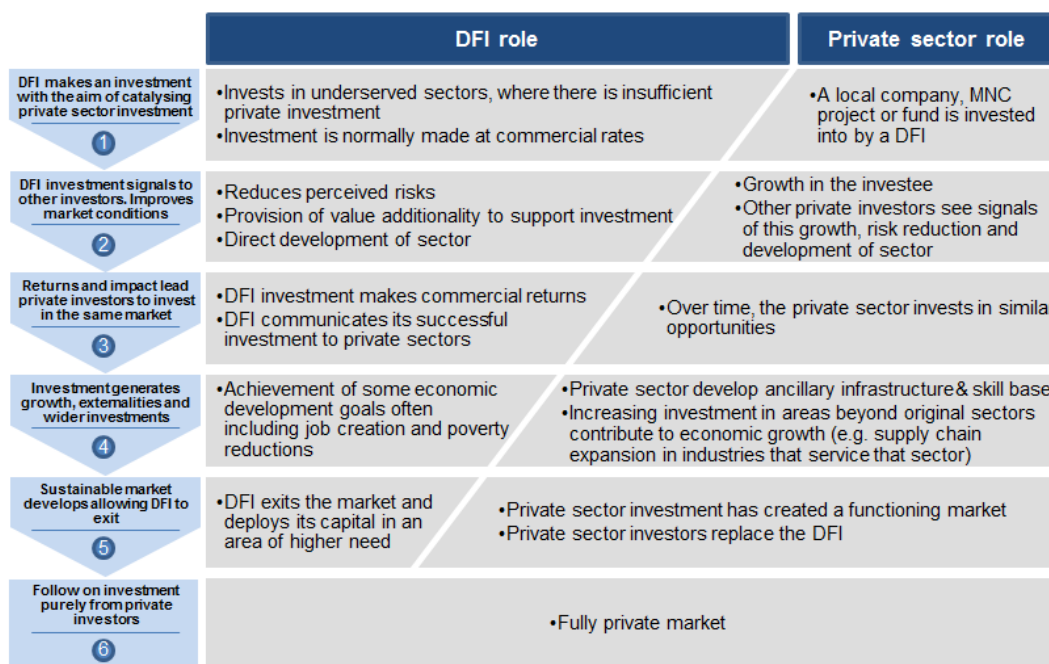
b. supporting businesses to achieve development impact through providing expertise in addition to capital, e.g. through board involvement, management support and environmental, social and governance improvements (**value additionality**)

c. demonstrating to other investors and business that one can invest and grow businesses successfully and responsibly in the most challenging markets (**demonstration effect**)

d. de-risking investments in ways that crowd in the private finance that is needed in the poorest countries in Africa and South Asia (**mobilisation**)

Figure 8 illustrates the progression from DFI investment to private investors over time, and the ancillary benefits of improved capacity they can bring.

**Figure 8:** Role of DFIs to catalyse investment and sustainable markets



38. **There is considerable evidence on the impact of DFIs on economic growth through contributing to increasing investment flows and labour productivity.** Overall findings suggest that a 10% increase in multilateral DFI investment commitments may increase growth by 1.3% in lower-income countries, and by 0.9% in higher-income countries.<sup>43</sup> With regard to investment, ODI research found that DFIs increased total investment in recipient countries. A 1 percentage point increase in DFI investment as a percent of GDP would lead to a 0.8 percentage point change in the investment to GDP ratio. Hence, for 26 countries researched, DFIs have kept investment to GDP ratios more than 1.5 percentage points higher (both foreign and domestic) than would otherwise have been the case.<sup>44</sup> In terms of labour productivity, ODI findings show that a three-fold increase in DFI investments increases labour productivity by between 3.4 to 7.5

<sup>43</sup> Massa, I. (2011) 'The Impact of Multilateral Development Finance Institutions on Economic Growth'. Paper funded by DFID. London: ODI.

<sup>44</sup> Te Velde, D.W. (2011) 'The Role of Development Finance Institutions in Tackling Global Challenges'. Paper funded by DFID. London: ODI. (based on data from CDC, EIB, EBRD and IFC)

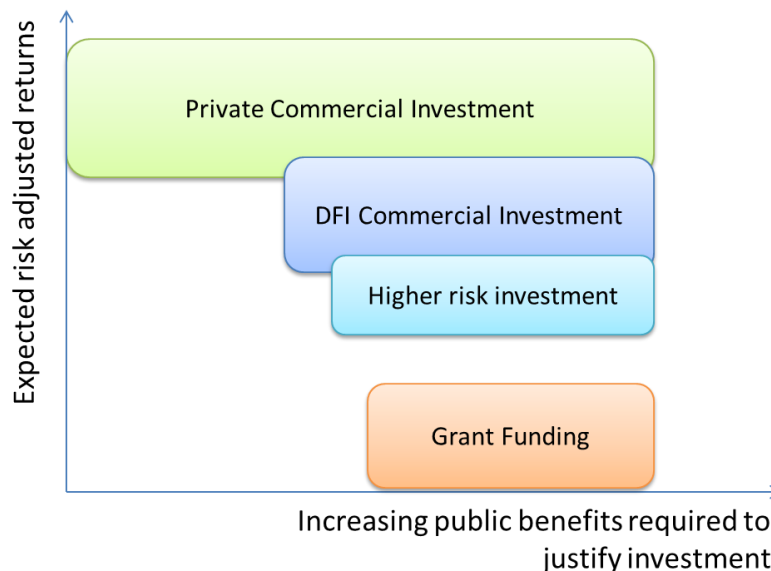
percentage points. Higher labour productivity contributes to higher wages for employees, improves the quality of jobs and helps to transform economies.<sup>45</sup>

39. **Investment by DFIs has grown significantly since 1990.** Total DFI activity has been growing at an average annual rate of around 5%, reaffirming the international consensus of the important role of DFIs for sustainable development and demonstrating the benefit of using investment to recycle capital back into further investments. By 2014 annual commitments by DFIs (bilateral and multilateral) exceeded US\$65 billion. In contrast ODA funding has remained relatively constant in real terms since 1990 around a level of \$140bn (in 2014 prices). **While DFI funding is large in absolute terms, it is dwarfed by the \$2.5 trillion funding gap identified in section 2. The wider DFI system, including the multilaterals, other European DFIs and CDC already play a major role in investing and mobilising investment in Sub-Saharan Africa and South Asia, however there is both the need and capacity to do more.**

### 3.2 Higher risk investment: to support development of unproven markets and sectors

40. Traditionally there has been a gap between the grants provided by donor agencies and the investments made by DFIs which are required to make a return on capital. Paul Collier and other academics have argued the need to create sources of capital that sit between donor grant funding – which lose 100% – and normal DFI returns – which aim to repay 100% of the capital and generate a financial return in addition. DFIs and aid donors have begun to deploy **investments which are willing to bear increased risk<sup>46</sup> and therefore deliver a lower risk-adjusted return than their traditional DFI investments. This greater risk tolerance allows the achievement of impact which would not otherwise be possible** (figure 9).

Figure 9: Spectrum of funding



<sup>45</sup> Jouanjean, M.A and D.W. te Velde (2013), The role of development finance institutions in promoting jobs and structural transformation, A quantitative assessment, ODI Working Paper.

<sup>46</sup> The higher risk is predominately related to the financial risk of the investment, other risks can be lower, higher or similar to commercial DFI investment.

41. **Private sector pioneers<sup>47</sup> seek to innovate and develop new business models in developing countries; they often deliver significant public benefits yet cannot capture the full value of their innovation.** Pioneers face significant first mover disadvantages due to the high set up costs and significant risks involved in their businesses. The first movers take the risk on whether the business or innovation will succeed, but their returns do not reflect this risk because when they are successful others will come into the market and imitate them. These imitators benefit from significant externalities from the pioneer including: (i) proven market demand and business model; (ii) the barriers overcome by the first mover (such as proving how a piece of regulation operates in practice); (iii) imitators will also often hire staff trained by the pioneer. Imitation is good for the economy and society. It helps support economic transformation and growth, create productive jobs, and deliver new goods and services, For example, the Bangladesh garment industry is now worth \$19bn per annum and has grown from the replication of pioneers. But imitation can be bad for the pioneer, which means there are too few pioneers.
42. **Higher risk investment offers opportunities to unlock further development in important areas:**
- a. **Supporting investments in geographies or sectors which face significant exogenous risk:** private investors will typically not bear risks which they cannot control such as investing in very fragile environments or where revenues may be exposed to high political risks. In these cases higher risk capital can bear the additional risk to support early investments in these most difficult markets.
  - b. **Supporting first movers to build markets and sectors –** New markets and sectors are beset by both uncertainty and risk. Business models and demand are unproven, while the ability to execute holds much risk. Capital, which is able to bear this risk and costs of being a first mover, is fundamental to enabling the entrepreneurs and teams to grow businesses.
  - c. **Integrated interventions which address sets of related issues with a commercial mind set –** As set out in paras 14-15, there are many barriers which limit the growth of the private sector or sectors within an economy. Deploying higher risk capital provides the risk tolerance to do business while addressing these issues, while focussing on proving success by building commercially viable businesses and therefore markets.
43. In some cases, higher risk capital may be able to support scaling grant interventions in smaller scale, early stage businesses. It is rare for proven grant interventions (even when appropriate) to transition to self-financing interventions. Often the shift in culture and governance from donor to investor funding can be too difficult as inadequate systems are in place to implement the commercial rigour and change in approach required. Higher risk investment can in certain circumstances provide a staging point which introduces the commercial rigour, but has the patience, input and flexibility to smooth this transition.
44. It is difficult to find precise figures for the current level of higher risk investments being made. There is no single definition used for this type of capital,

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<sup>47</sup> There are many different types of pioneers – their innovations may include expanding proven business models to new regions or sectors, testing innovations in production, supply chains or business models, or repurposing existing businesses for a developing country context. Pioneers will not only be the first business in a particular sector but any business which faces increased risks and costs as a result of innovations it is introducing, which will be of benefits to other businesses

and higher risk investment to date has been deployed as grants from a donor blended together with investment capital from a DFI. This “blending” approach has led many DFIs and donors to refer to higher risk investment as “blended finance”. However, there are also many different definitions for blended finance; and recently there have been attempts to broaden the definition to include a much wider range of activities including commercial DFI investment. For example, the World Economic Forum defines it as “the strategic use of development finance and philanthropic funds to mobilise private capital flows to emerging and frontier markets”<sup>48</sup>. As such the estimates range from less than \$1bn deployed annually by donors and DFIs as blended-finance into the private sector under a narrow definition<sup>49</sup> to the Global Impact Investment Network’s estimate of \$22bn last year in impact investment, a sixth (c.\$3.7bn) of which is categorised as “below market rate returns: closer to capital preservation”.<sup>50</sup>

45. **This business case deliberately does not refer to higher risk investment as blended finance. In conventional blending approaches, the public sector enhances the private investor’s return by (i) de-risking the investment** for the private sector investor through instruments such as first-loss capital or guarantees, thereby immediately leveraging its capital; or (ii) **grant funding to address a funding gap or enhance the return** which was making the project or investment commercially unviable. There is certainly a place for these blended approaches, which, in the right circumstances, can help improve information of market return expectations in the longer-term. However, these approaches generally focus on ensuring a deal happens now rather than focussing on its long-term systemic impact on the market. This can lead to the selection of deals which just fail to make the hurdle as commercial DFI investments, rather than incentivise investors to those investments that can have more systemic impact. Replication becomes dependent on further use of scarce and finite grant funding or there being sufficient change in the risk perceptions over time to reduce and eliminate the need for grant funding. Moreover, as the subsidy is generally provided in the form of grant and available upfront to improve pricing of the deal for the private investor, the alignment between the grant provider, the investor and the investee business can be weak and the incentives to mitigate downside risk once the deal is done and project is underway may be reduced.
46. The \$2.5bn private sector window established through the 18th replenishment of the International Development Association (IDA)<sup>51</sup> (for which the UK has been a key contributor) will support IFC and MIGA to increase their lending and guarantees to the private sector in IDA countries. The IDA Private sector window in certain circumstances allows for pricing that does not fully reflect the risks that IDA is bearing in order for high-impact or pioneering investments in challenging markets to be feasible. There are a variety of forms that this approach might take, including first-loss capital and guarantees.
47. **This business case proposes a different approach from blending where capital is provided specifically for the purpose of making higher risk investments to achieve specific development objectives.** This capital accepts higher risks and lower or uncertain risk-adjusted returns in order to catalyse

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<sup>48</sup> Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders (2015)

<sup>49</sup> It is hard to find precise figures as this is a new space with limited reporting and a proliferation of definitions. A study commissioned by EDFI in 2015 found that European donors have allocated more than €10 billion in ODA since 2002 to more than 100 different “blending funds” focused on private sector projects. Since 1996, the IFC has approved nearly \$407 million in concessional funds for investment and advisory projects. Information for other IFIs and MDBs is not available.

<sup>50</sup> Global Impact Investment Network Annual Report 2017.

<sup>51</sup> IDA is the part of the World Bank Group which provides grants and concessional loans to 74 of the poorest countries in the world, principally focused in Africa and Asia.

investments that would not otherwise occur. The investments are delivered under a single mandate and governance structure which is designed for the purpose of making developmental investments and utilises the specialist expertise of CDC as a dual mandate investor bringing together commercial and development expertise. This can ensure that high risk capital is targeted where it can have the greatest impact. Furthermore the investor has aligned incentives to address risks and barriers to make the investment successful. This means successful deployment of higher risk investment could catalyse markets by pioneering replicable approaches and complementing existing commercial DFI investment. This approach is less prevalent among DFIs and therefore presents an **opportunity for DFID to pioneer an approach to the deployment of higher risk investment, alongside increasing proven commercial DFI investment**, to address the systemic issues that constrain the growth of developing countries.

48. Figure 10 summarises the funding tools which are required to support the growth of the private sector and figure 11 presents how they could be deployed according to the stage of market development. .

**Figure 10:** Higher risk and commercial DFI investment is complementary

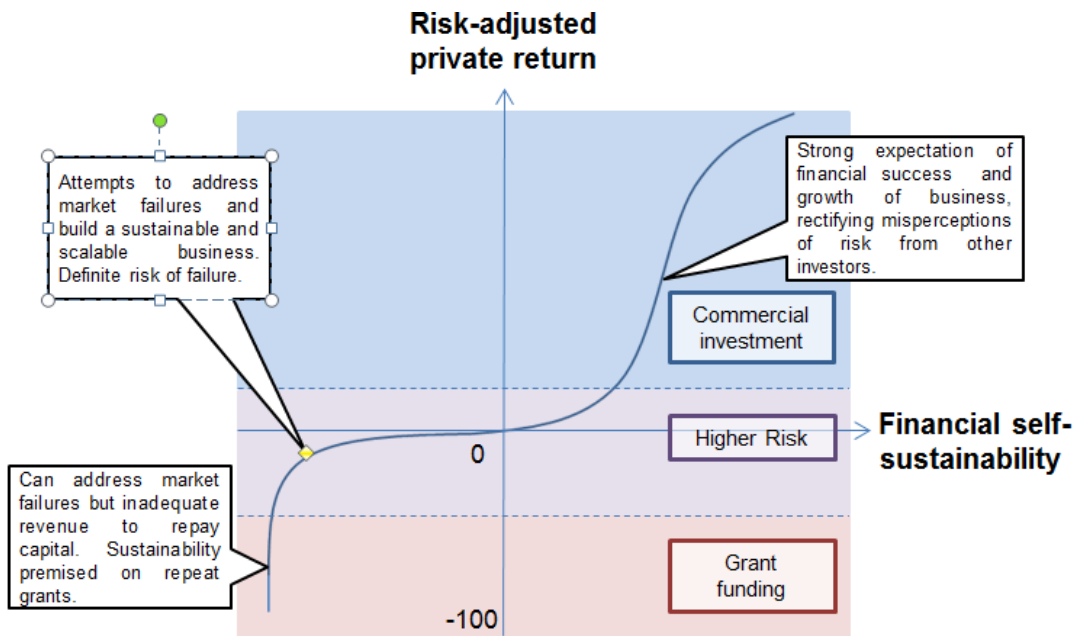
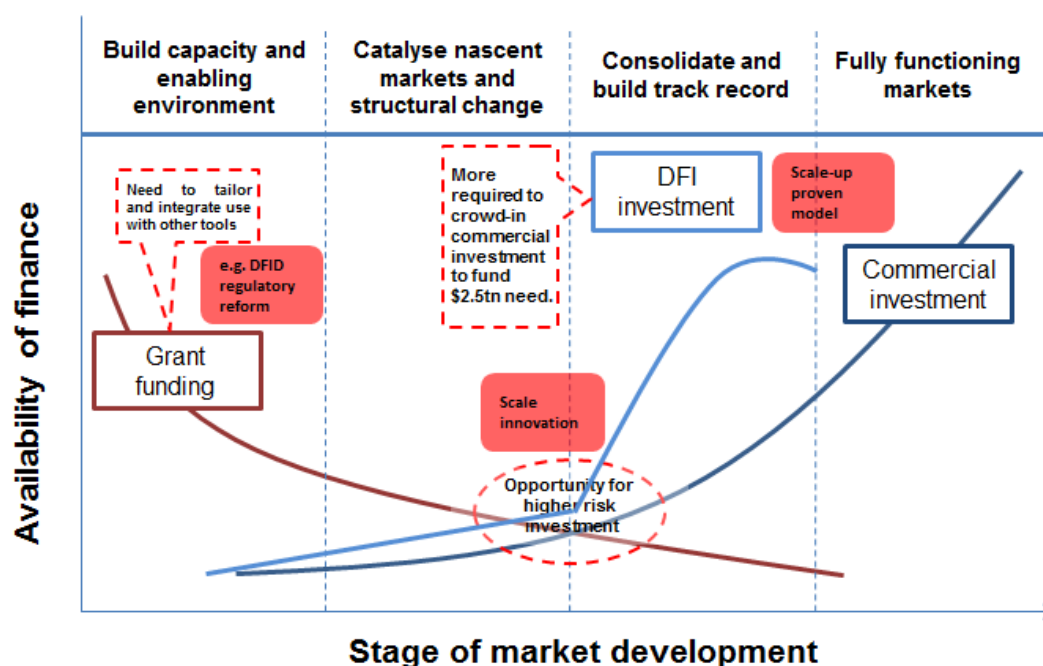


Figure 11: Availability of different tools according to state of market development



#### 4. CDC as partner for scaling up commercial investment and innovation

##### 4.1 CDC's transformation since 2012

49. CDC through its transformation since 2012 and new 2017 strategy – driven by DFID as sole shareholder - is well placed to scale-up its commercial operations and develop new strategies in the higher risk space, complementing DFID's existing grant programmes and investments through multilateral DFIs, particularly the IFC and PIDG. CDC's mission, as set out in its 2017 Investment Policy<sup>52</sup>, is to "support the building of businesses throughout Africa and South Asia, to create jobs and make a lasting difference to people's lives in some of the world's poorest places". CDC's objectives, as agreed with DFID in the Investment Policy, are to:

- a. contribute to **sustainable development and economic growth** that directly or indirectly benefits poor people by investing in businesses and activities, especially when private investors are reluctant to do so;
- b. create **lasting employment opportunities and support economic transformation and market development** by investing in sectors with a high propensity to create jobs or have high growth potential, and activities that address economy-wide barriers to growth;
- c. **demonstrate to private commercial investors that profitable, commercially sustainable and responsible investments can be made** and/or developed over time in these environments and, where possible, mobilise both direct and indirect private investment in CDC's target countries, states or territories

<sup>52</sup> <http://www.cdcgroup.com/Documents/Strategic%20Framework/Investment%20Policy.pdf>

50. Following new objectives agreed with DFID in 2012, CDC has modernised and transformed its approach. The National Audit Office (NAO) confirmed this in its value for money study on “Investing through CDC”, which was published on 28 November 2016. **CDC has outperformed targets set in its 2012 strategy.** The NAO confirms that ‘in each of the four years since the start of the new strategy, CDC has exceeded its target for the financial return from its investments<sup>53</sup>... since 2012, CDC has exceeded the target for prospective development impact it agreed with the Department’. **CDC has achieved substantial development results:**

- **18.4 million jobs:** Supported by CDC's portfolio in 2016
- **Over 1.2 million new jobs:** Number of direct and indirect jobs CDC's portfolio companies helped create in 2016
- **Over \$13 billion in taxes:** Paid to national exchequers between 2012-2016 by companies CDC invested in
- **69,310 Gwh of electricity:** Power generated by CDC's portfolio companies in 2016
- **US\$4.1 billion of private sector capital mobilised** alongside the \$1.7bn that CDC committed to funds from 2012-2016 **Over \$500m of additional capital:** Invested by private investors alongside the \$357m that CDC committed to funds in 2016

*Investment strategy and approach*

51. **Focus on Poorest Regions of the World.** CDC's geographical remit is focussed on Africa and South Asia, with incentives to invest in those countries with the most difficult investment climates. CDC is one of the most geographically concentrated and poverty-focussed DFIs. Investments in the hardest countries (so called ‘A&B countries’) have increased significantly in absolute and percentage terms to 53% in 2012-2016 from 23% in 2009-2011 (table 1).

52. **Focus on job-creating sectors.** CDC is incentivised to invest in the sectors with the highest job creation potential and has seven priority sectors: infrastructure, financial institutions, food and agriculture, manufacturing, construction, health and education. CDC has established sector teams with significant knowledge and relationships in target markets, leading to 74% of investments having been in priority sectors in 2012-2016 compared to 54% in 2009-2011 (table 1). The NAO report acknowledges that ‘CDC has made good progress focusing on its priority sectors’ and that ‘this [portfolio] shift reflects deliberate management action to align CDC's investment portfolio with the Department's priorities.

**Table 1: Shift in CDC's portfolio following introduction of the Development Impact Grid**

Country/sector shifts	2009-2011	2012-2016
Investments in priority sectors	54%	74%
Investments in A/B countries (most difficult)	23%	53%
Investments in D countries (less difficult)	43%	20%

<sup>53</sup> To note that given the investment cycle, CDC's portfolio returns are still mostly driven by its legacy (pre-2012) investments. It is too early to tell whether CDC has exceeded the target for its pos-2012 investments.



53. **Development is core to CDC's operations.** CDC introduced an approach to support the selection of investments on the basis of their potential development impact as well as predicted financial return. This is centred on the use of a Development Impact Grid. (More details on how the grid works are in Annex C). CDC's scoring against this Grid is externally assured annually, with an independent report to the Board confirming whether CDC has met its development impact target. CDC outperformed the development impact target that DFID set in the 2012 strategy, demonstrating CDC's success in investing responsibly in the most challenging places. CDC also measures actual development outcomes and impact through monitoring and independent evaluations. CDC has a team dedicated to assessing development impact and, globally, is unique in its commitment to track and report on total job impacts annually. DFID will work closely with CDC to track development measures beyond jobs going forward (as outlined in the M&E section).
54. **A more flexible investment model.** CDC's model has shifted from being a pure fund of funds investor to becoming a broader investment company that now invests across different instruments (equity, mezzanine, debt and guarantees) directly and indirectly.
55. **Clear additionality guidelines:** CDC's approach to additionality was agreed in 2014 following an external review commissioned from a market expert. It deliberately positions CDC among DFI best practice by approaching this difficult topic with clarity, honesty and objectivity. Based on this external review, CDC developed clear Additionality Guidelines on how to assess additionality for each of the investment instruments throughout the investment process (more details in section 12.2).
56. **Greater transparency.** CDC was one of the first DFIs to make investment information public. It has an online searchable database on its website, allowing users to access information on every investment and fund in CDC's portfolio, including the name, description, location, sector, CDC's commitment, date of first investment, and fund manager associated with the investment. CDC was also the first DFI to sign up to the International Aid Transparency Initiative (IATI) and has since published data for all of the investments it made from 2012 – 2016.

*Organisational changes and operating model*

57. **Changes to leadership and management.** CDC's leadership team were all recruited after 2011 to design and execute the new strategy. This team (summary biographies in Annex D) combines a strong blend of investment experience, knowledge of CDC's markets and backgrounds in developmental organisations. CDC's new CEO started in June 2017, continuing this tradition (more details in the management case).
58. **Changes to the Board.** All bar one of CDC's current Board of Directors, including the Chairman, (summary biographies in Annex E) have joined since the 2012 strategy. They have brought to the Board a strong focus on development issues, as well as expertise in the new lines of business in direct investing.
59. **Fit for purpose organisational structure and headcount.** Investment teams have been created to focus on Direct Equity and Direct Debt, in addition to the existing Intermediated Equity investment teams (funds) covering Africa and South Asia. New operations/transaction support teams have been built covering Development Impact, Business Integrity and Risk. The existing Environmental/Social and Legal/Tax teams have been greatly enhanced, reflecting

the greater responsibilities CDC assumes when it invests directly and projected deal volumes. The number of employees has risen from 49 at the beginning of 2012 to over 240 in 2017.

60. **Efficient and economic operating model:** As concluded by the NAO, which states that “CDC’s performance compares favourably with development finance organisations overseas. CDC’s operating costs as a percentage of portfolio value has generally been lower than, or at the lower of end of, the other organisations when compared to six development finance institutions” The NAO further acknowledges that the revised remuneration framework had the desired effect of controlling salaries and strengthening DFID’s oversight in that area. CDC has also improved its management of cash balances and has introduced and met the targets set in its liquidity policy.
61. **Following the successful implementation of the 2012 strategy, CDC received its first capital increase from DFID in over 20 years in 2015.** DFID provided £735m in additional equity in order to enable CDC to increase the scale of its commercial investment to further build the evidence and track record of investments in South Asia and Africa.
62. **CDC has also been our central partner in the delivery of the Impact Programme managing a higher risk facility and a higher risk fund.** Both the Impact Accelerator and the Impact Fund have helped to test the feasibility and define our overall approach to higher risk investment. In both instances, they indicate that higher risk capital can be deployed to support sustainable and scalable solutions that deliver development impact, that neither grant finance nor commercial capital can achieve. Through implementation, CDC has developed its expertise and capacity to make higher risk investments, providing a strong foundation for further scaling this approach. Examples of investments made can be found in Annex F.

## 4.2 CDC’s 2017 strategy

63. In preparation for agreeing a new strategy and investment policy with CDC in 2017, DFID commissioned **an independent review of CDC’s performance against the 2012-2016 strategy and investment policy which made recommendations on development impact, financial return, responsible investments, additionality and mobilisation.** The review concluded that CDC’s approach to assessing development through the **Development Impact Grid** should be maintained, but that CDC should do more to measure and communicate broader development impact through tracking and reporting a wider range of development indicators and a development thesis for each investment. This has been a key focus of the new 2017 strategy. The review further proposed improvements to reporting of **financial return information to DFID** (e.g. information on returns by investment instrument, net return, effect of currency movements, exits, average holding periods) – recommendations which have been adopted and included in the new CDC – DFID reporting framework agreed with CDC as part of the 2017 strategy process. In terms of **responsible investing**, the review’s main suggestion was to track and aggregate CDC’s environmental & social RAG ratings. While DFID agreed to continue tracking of ratings, we decided to maintain individual ratings as environmental & social incidents are highly context specific and aggregation risks disguising important information. On **additionality**, the review recommended more external assurance and indicators and to track **mobilisation** across CDC’s investment portfolio, all of which have been taken into account.

64. DFID has agreed a new strategy with CDC in 2017 which builds on CDC's success since 2015 and further strengthens its development impact and its accountability. CDC will:

a. Continue to **invest only in Africa and South Asia**. It will prioritise the countries where it is hardest to invest and the sectors that create the most jobs.

b. **Pilot innovative strategies**. CDC's ability to take risk by reducing the return required has been extended; this will enable it to provide higher risk capital to achieve systematic impact. CDC is developing new strategies to address specific market failures and sector problems that hold back development. See box below.

c. **Implement a new more rigorous framework to maximize their impact**. The framework will be designed to select the right investments, manage progress against expectations and measure what they actually achieve. CDC will integrate this with their investment process, publishing the development thesis for each investment and deepening their development expertise.

d. **Women's economic empowerment and climate change**. CDC will work with its investee companies to promote women's economic empowerment. It will assess climate risks and opportunities in potential investments and now provide concessional finance to help investee companies improve water and energy efficiency, and use captive renewable energy sources of power where possible.

f. **Increase transparency, improve accountability and further strengthen CDC's tax policy**. CDC is committed to greater transparency by making more data and information available and ensuring it is easily accessible. DFID worked with CDC to put in place a new, stronger, tax policy (as outlined in the Financial Case). In both areas CDC is among best practice of its DFI peers.

**CDC will address key development challenges in new ways through innovative higher risk investment strategies:**

DFID and CDC have an agreed a vision for higher risk capital that is to bring about new business models, develop nascent or failed markets and, in the long-run, improve the economies of the countries where they invest. They will pursue strategies and individual investments which, if they succeed, will have a transformative effect. In doing so, CDC will apply the same commercial rigor and high standards of responsible investing that they apply in all their investments.

Achieving impact that would otherwise be impossible will be at the heart of CDC's approach. These strategies will be ahead of where traditional capital markets are positioned, and may take a long time to develop to the point where they can attract commercial capital. Implementing these strategies will be challenging, but by accepting higher risks and taking the hard first steps, CDC can increase the speed and scale of sector or market development.

Using concessional capital necessitates a highly responsible approach to avoid undercutting other investors, or enhancing returns in investments that would happen without it. In this respect, CDC will ensure that the principles they apply are at the

forefront of best practice for developmental investors and that each of the strategies address the following issues:<sup>54</sup>

- **Seeking enhanced development impact:** including achieving systemic change (such as removing barriers to development of an economy; creating or enhancing an industry, market or business model; or expanding access to underserved populations) and impact at substantial scale.
- **Demonstrating additionality:** demonstrating that the development aims of the strategy would not be achieved without the use of concessional capital.
- **Targeting a defined market failure:** to deliver systemic changes in markets or sectors CDC will target market failures including: addressing gaps between public and private returns, environmental impacts, research and innovation, information imperfections, capital market imperfections, network externalities and non-market goods and services; improving the economic opportunities for vulnerable groups not served through the market; or effecting structural change in a market.
- **Time bound intervention:** ensuring a long-term sustainable change in markets or sectors requires demonstrating a credible path to a functioning market or institution that no longer requires the use of higher risk capital.

CDC will ensure that individual investments fall within such a strategy. Examples of these innovative higher risk strategies are covered in section 15.

## 5. Impact and Outcome – Theory of Change

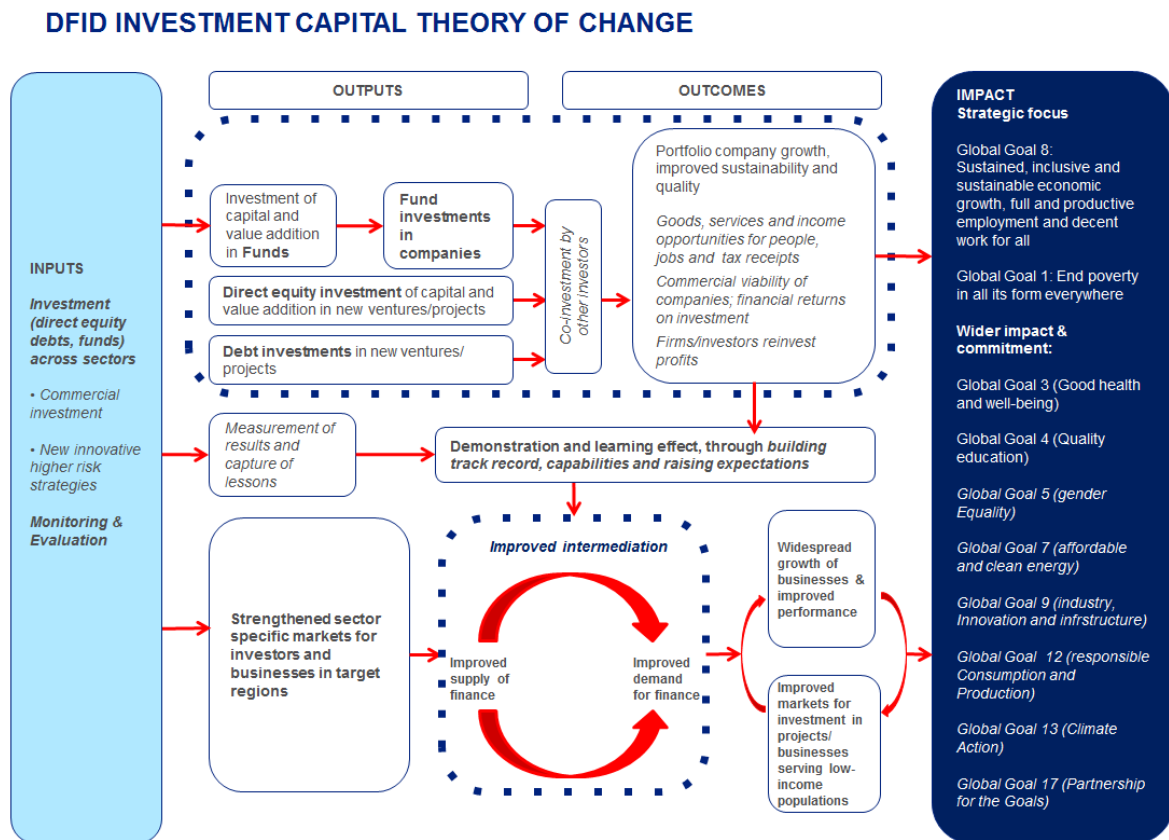
65. Figure 12 sets out how DFID as an investor in its own right (through CDC) where markets fail:

- a. will deploy commercial investment and scale new innovative approaches of higher risk capital - **inputs** as set out in section 4.2
- b. which will provide both much needed capital and expertise to businesses (capacities, skills, practices & standards) as well as strengthen sector specific markets for businesses and investors – **outputs**
- c. which in turn will spur growth in quantity and quality of portfolio companies, building a track record of viable and successful investments to achieve demonstration effects to other investors (improving demand for finance) as well as help building improved markets (improving supply of finance) – **outcomes**
- d. all of which will contribute through jobs, tax receipts and better goods and services to sustainable and poverty reducing private sector and economic development to contribute to a range of the Global Goals – **impact**

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<sup>54</sup> As these higher risk innovative strategies are scaled up, DFID and CDC are focussed on continual learning and improvement. This process of continual learning may lead to an evolution or adaptation of the way these issues are addressed in the relevant strategies to ensure maximum impact and value for money.

Figure 12: Theory of change



## 6. Gender equality Act and counter-terrorism financing

### 6.1 Gender Equality Act

66. The power to provide financial assistance to CDC is found in the Commonwealth Development Corporation Act 1999 (the “CDC Act”) which was amended in 2017 (more details in the management case). The International Development (Gender Equality) Act 2014 does not apply to financial assistance provided under the CDC Act. However CDC considers gender impacts during its investment process and its new five year strategy makes a clear strategic commitment to women’s economic empowerment (more details in section 10.3 in the Appraisal Case).

### 6.2 Terrorism and financing

67. In line with the UK’s legal requirements as well as being a financial institution regulated by the Financial Conduct Authority, CDC has implemented policies and procedures in relation to the prevention of financial crime which includes terrorist financing. These policies and procedures include a robust due diligence and monitoring process in relation to its portfolio companies and their owners and controllers. This process also involves the routine screening of these parties against sanctions lists issued by HMT and by the European Union as well as other sanctions lists which are relevant for the transaction.

## B. Appraisal Case

The appraisal case is structured as follows:

**Section 7: Why CDC is our principal partner for investment, complementing DFID's work with other DFIs, specifically IFC and PIDG**, including how DFID's key investment partners fit together (section 7.1) and why the new 2017 strategy provides a strong foundation for further scaling up (section 7.2).

**Section 8: What level of capital increase is appropriate to meet demand and scale up CDC's impact in a responsible and effective way** (section 8.3), including options for commitment pace (section 8.1) and sensitivity analyses for market conditions (section 8.2).

**Section 9: What economic benefits can be expected from the capital increase and how the capital increase provides value for money**, including analyses on jobs, economic value added and socio-economic benefits (section 9).

**Section 10: How CDC addresses DFID key strategic priorities on fragile & conflict affected states (FCAS)** (section 10.1), **climate change** (section 10.2) and **women's economic empowerment** (section 10.3)

### 7. CDC as DFID's principal partner for investment, complementing DFID's work with IFC and PIDG

#### 7.1. How DFID's key investment partners fit together

68. As outlined in the strategic case, no single intervention or mechanism can address all the underlying causes of low investment levels in developing countries. Alongside measures to strengthen trade and global value chains, improve macroeconomic and regulatory environments, partner with business and influence international financial institutions, DFID can also play an important role by deploying public finance as patient capital to catalyse private investment and create jobs. **Development finance institutions investing DFID's capital are an important part of our comprehensive approach to economic development.**

69. DFID recognises the complexity of investing and managing such portfolios effectively. There are **clear advantages of working with established organisations as specialist development investors with investment management skills, investment processes, systems and controls, and a demonstrated track record.** Working through these organisations helps to ensure capital is properly targeted and risks are well managed. While setting up a new and unproven institution is an option in principle, in practice this would be a high risk strategy to take and demand additional resources and political capital to ensure the right mix of skills, alignment with DFID priorities and complementarities with other organisations. It would also create inefficiencies through additional overheads from replicating the capabilities already available in existing providers.

70. **Potential options for investing DFID capital therefore include:** (i) a capital increase to CDC, the UK's wholly owned Development Finance Institution (ii) further funding to multilateral agencies such as the PIDG or a dedicated investment facility with the World Bank Group's International Finance Corporation (IFC) , (iii) dedicated investment facility with the private sector teams of the regional development banks such as the Asian Development Bank,

and the African Development Bank; (iv) funds under management of other countries bilateral DFIs such as FMO and DEG; or (v) investment through smaller, sector specific investment platforms with a development mandate including AgDevCo and philanthropic institutions with investment capacity such as the Gates and Omidyar Foundations, and Acumen.

71. Three organisations in particular have a strong track record of operating at scale, achieving high quality development impact and delivering value for money. **CDC, the IFC and PIDG have all played an important role in the delivery of DFID's objectives over many years.** All three are DFIs, but each is quite different. IFC's scale, reach and position as part of the World Bank Group give it a central role in the international development finance architecture, PIDG's infrastructure niche allows it to target the frontier in this important enabling sector, CDC invests across a range of sectors like IFC but is geographically the most poverty focused DFI with a unique governance structure that maximises alignment with DFID priorities. **Annex G** sets out their respective comparative advantages and limitations and explains how DFID's investments made through each organisation are complementary.

72. **As sole shareholder, DFID can scale up CDC in a responsible manner and take advantage of CDC's capacities and capabilities to grow in size and innovation.** CDC has the right combination of (i) high quality development focussed investment skills (across all instruments and sectors), (ii) experience and track record for successful innovation (including through its equity focus and piloting higher risk investments through the Impact Programme), and (iii) track record (in building the private equity industry in Africa and in establishing its direct investment capability). It critically also provides strong and effective governance and strong alignment with DFID's priorities (including a closely overlapping geographic footprint) through DFID's 100% ownership. CDC's geographical focus is concentrated on Africa and South Asia. IFC operates in global emerging markets. This means **CDC is best placed to continue to be our principal mechanism and partner to deploy investment at scale for economic development. Given the relative strengths of PIDG and IFC, these DFIs will remain important partners and may receive further complementary DFID investment in the future, which will involve detailed appraisal through separate business cases.** The rest of this Appraisal Case therefore does not quantitatively appraise PIDG or IFC as competing options for this investment. It instead focusses on CDC's new 2017 strategy and the appropriate amount for any additional capital increase.

## 7.2 CDC's 2017 strategy as a framework for scaling up

73. DFID has agreed CDC's new strategy for 2017-21 which sets a framework for maximising its impact, increasing the accountability of its investment and enabling it to increase its impact through increasing its commercial investment and innovation in pioneering higher risk investment. During the strategy process, **DFID and CDC have considered and reviewed various options to maximise CDC's impact, including on geography, sectors, development impact, instruments, responsible investing, tax and transparency.**

74. For example in relation to **India and South Africa**, we have considered whether to restrict new investments by CDC into these countries. We have decided to maintain the focus on the poorest states in India. The DI grid continues to incentivise CDC to invest in the harder states within India which have the lowest average per capita incomes and are the most capital

constrained. We have concluded that a 38% portfolio cap restriction for India is consistent with achieving a balanced portfolio that enables CDC to deliver development impact in India while CDC's exits its pre-2012 investments. With respect to South Africa, under the new Investment policy, CDC will not make any new direct investments into South Africa, except in high priority sectors or where the investment will result in significant immediate or prospective benefit of deprived areas or sections of the population in the relevant country or of neighbouring countries in the region.

75. With respect to investing in **private health care and education** providers, we reviewed the arguments for and against such investments and whether these sectors should be removed from CDC's investment policy. In their new 5 year strategic framework, CDC has set out their vision for achieving sectoral development impact through the investments they make in these sectors. Health and education sectors are major employers and private providers can provide choice and raise standards, therefore contribute to the broader health and education ecosystem and complement other DFID programmes working to improve public sector provision. CDC's healthcare strategy aims to support specific types of companies, e.g. innovative providers that will bring new treatments to market; those finding new ways to serve poorer groups by reducing costs; or medical education providers that can train substantial numbers of healthcare professionals. Similarly for education, CDC will focus on companies that will lower prices or improve quality and can provide new ideas how more affordable education can be replicated at scale.

76. On **tax transparency**, we have considered what would be the consequences if CDC could only make direct equity investments when able to report on the beneficial owners of the investee company. Our conclusion was that jurisdictions (rather than investors) need to drive improvements in beneficial ownership reporting. And that introducing such a requirement for CDC would limit their ability to invest in the hardest places where their capital is most in need. CDC has instead agreed a new tax policy, which includes an additional standard on automatic exchange of information and a commitment to periodically review the policy to ensure it remains at the forefront of international best practice.

Table 2 shows more details on the starting point of the 2012 strategy, options considered and what was agreed in 2017.



**Table 2: Progression from 2012 to 2017 strategy and options considered & agreed**

	2012 Strategy	Options raised and discarded 2017	Outcomes agreed 2017	Rationale
Geography	<p>Investable universe limited to Africa and South Asia.</p> <p>Development Impact Grid incentivises investments into the hardest places. Countries are ranked by difficulty against market size, investment levels and ease of doing businesses.</p>	<ul style="list-style-type: none"> <li>• No or further limiting investment in India and South Africa</li> <li>• only LDCs in Africa/South Asia</li> <li>• LDCs outside Africa/South Asia to be added</li> <li>• DFID priority countries only</li> </ul>	<ul style="list-style-type: none"> <li>• Development Impact Grid revised in line with updated country rankings and now includes DFID's fragility index</li> <li>• Stronger and clearly articulated geography strategy that                             <ul style="list-style-type: none"> <li>(i) focuses on poorer countries,</li> <li>(ii) limits investments in India to 38% of the portfolio,</li> <li>(iii) has a clearer argument about supporting transition and regional investment when operating in L-MICs.</li> </ul> </li> <li>• Commitments on fragile states including strengthened country presence, encouraging regional businesses to expand into fragile states and innovative corporate structures linking together multiple investments in fragile states.</li> <li>• Closer and more strategic DFID/CDC collaboration approach</li> </ul>	<p>CDC has now built up a strong reputation as an Africa and South Asia investor. There are significant risks involved in big changes to geography as this may confuse the market, promoters and other investors. DI grid incentivises harder states within India. There is a strong development case to enable CDC to work with regional players (e.g. in South Africa) to expand in more difficult countries.</p>
Development Impact	<p>Dual objectives of development impact and financial return introduced.</p> <p>CDC uses the Development Impact Grid to screen</p>	<ul style="list-style-type: none"> <li>• Change CDC's core impact focus from jobs and target the poorest directly</li> <li>• Adapt an attribution methodology for job measurement</li> </ul>	<ul style="list-style-type: none"> <li>• Core impact focus on jobs remains, but development impact thesis for each investment to be tracked and published (which will go beyond jobs where relevant)</li> </ul>	<p>Job creation key to accelerate economic transformation and growth of the formal sector which is essential for the eradication of poverty over the long-term.</p>

	<p>investments based on prospective job creation (through the sector it is in) and the difficulty of the country.</p> <p>Remuneration is linked to Grid performance.</p> <p>CDC then measures number of jobs created in businesses it has supported</p>	<ul style="list-style-type: none"> <li>• Limit additionality to only financial additionality (not value additionality)</li> </ul>	<ul style="list-style-type: none"> <li>• Sector metrics to be tracked</li> <li>• CDC working with other DFI' s to improve common methodologies on job quality and attribution,</li> <li>• Indicators on types of additionality for post-2012 portfolio to be tracked and reported; external reviews to assess value additionality for relevant investments.</li> <li>• New cross cutting strategies for women's economic empowerment and climate change to be developed and implemented</li> </ul>	<p>DI Grid as an effective screening tool to provide an objective assessment toll for investment teams.</p> <p>Development thesis and sector metrics to augment development impact assessment, monitoring and communication.</p>
Sectors	<p>Development Impact Grid incentivises investments into sectors which create the most jobs.</p>	<ul style="list-style-type: none"> <li>• No investments in real estate development.</li> <li>• No investments in private health and education</li> <li>• More investment in agriculture</li> <li>• Limiting investment in financial services</li> </ul>	<ul style="list-style-type: none"> <li>• Sector strategies for key sectors to be developed, incl. Power &amp; Infrastructure, Financial Institutions, Manufacturing, Food &amp; Agriculture, Construction, Education and Health</li> <li>- setting out CDC's approach to achieving sector-wide impact and how it will measure success.</li> <li>• Real estate will now only score 'high' on the Grid during the construction phase (and 'low' as e.g. business services during operation)</li> </ul>	<p>Flexibility important to enable mixed-use development (which could include "luxury" real estate alongside affordable housing and integrated urban development, formalising peri-urban areas).</p> <p>Health and Education are important for creating jobs, providing choice and raising standards. These complement wider DFID programmes in health and education.</p> <p>Financial sector is an important way to get into harder markets, financing SMEs and women's economic empowerment.</p>

Instruments	<p>Pre-2012, CDC invested solely via third party funds. From 2012, move towards more direct investment and a balanced equity/debt/fund portfolio.</p> <p>CDC chooses funds that meet its development impact requirements and Code of Responsible Investing.</p>	<ul style="list-style-type: none"> <li>• No new investment via funds</li> </ul>	<ul style="list-style-type: none"> <li>• Better articulation within the new strategy of why fund investments are important for development outcomes</li> </ul>	<p>Investments in funds:</p> <ul style="list-style-type: none"> <li>(i) mobilise private investment</li> <li>(ii) build financial intermediaries – other investors invest through funds,</li> <li>(iii) Support more and smaller businesses and</li> <li>(iv) raise investment standards across the industry.</li> </ul> <p>Independent Harvard study found CDC's fund investments have been transformational.</p>
Responsible Investing	<p>Code of Responsible Investing revised to ensure CDC invests in a responsible fashion and support better business practices in CDC's markets.</p>	<ul style="list-style-type: none"> <li>• Focus on broader range of (emerging) labour practice issues that force the agenda in key areas (for example child labour or living wage)</li> </ul>	<ul style="list-style-type: none"> <li>• Explicit reference to the UN Guiding Principles on Business and Human Rights as well as the Global Goals</li> <li>• More sophisticated approach on climate change, making reference to CDC's Climate Change Policy and Coal Policy;</li> <li>• Includes an updated statement on whistleblowing.</li> <li>• Reflects standards on animal welfare</li> <li>• Code made easier for other investors to understand and apply.</li> <li>• Code checked against other DFIs to ensure aligned and to promote harmonised approach</li> </ul>	<p>Code of Responsible Investing reviewed and updated to ensure CDC remains a leader in the investment community for responsible investing. The new Code is consistent with the UK position during the World Bank Environmental and Social Safeguards Review (which brought those in line with the IFC performance standards)</p> <p>Code aligned with UK legislation (Bribery Act, Anti Modern Slavery Act)</p>
Tax	<p>CDC does not use offshore financial centres to evade tax or hide its investments.</p>	<p>Only make direct equity investments when we can fully report the beneficial ownership</p>	<ul style="list-style-type: none"> <li>• Additional global standard on automatic exchange of information included, making it the first DFI to do so</li> </ul>	<p>If CDC cannot use OFCs, it will find it difficult to structure investments in businesses in countries that do not have</p>

	<p>CDC's use of intermediate jurisdictions is motivated only by its objective of maximising the flow of foreign investment into the countries where it operates and its need to ensure adequate protection of UK taxpayers' money.</p> <p>Published first policy on use of Offshore Financial Centres which followed the policies of other IFIs in using the Global Forum standard.</p> <p>CDC requires companies it invests in to pay the tax required of them and collects data on taxes paid.</p>	<p>of the investee.</p>	<ul style="list-style-type: none"> <li>• Periodic review of policy to ensure it remains international best practice, and</li> <li>• Strengthened the governance of any exception to ensure that it only happens in exceptional situations and the Board signs off and it is communicated to DFID</li> <li>• Will engage with DFID programmes to support development of onshore financial centres.</li> </ul>	<p>strong enough legal and regulatory systems, and mobilise private capital to invest in those countries. Not feasible to pre-commit to standards which have not been agreed. Jurisdictions (rather than investors) need to drive requirement to report beneficial ownership. A significant number of CDC deals would not have happened if this requirement were in place. But CDC's new policy makes it a leader amongst DFIs and the annual review will ensure it stays at the forefront of this fast moving area.</p>
<p>Transparency</p>	<p>CDC was the first DFI to commit to publish data through International Aid Transparency Initiative (IATI)</p> <p>CDC was one of the first DFIs to make its investment information publicly available. It has an online searchable database on its website, allowing users to access information on every investment and fund in CDC's portfolio.</p>	<ul style="list-style-type: none"> <li>• Apply same requirements as conventional aid programmes</li> </ul>	<ul style="list-style-type: none"> <li>• CDC will make increased data available (incl. on tax and development impact) and make it more accessible;</li> <li>• Will increase engagement with and leadership of other DFIs to drive up transparency across the community;</li> <li>• Will work to make this data practically useful to other investors looking to start investing in Africa.</li> </ul>	<p>CDC cannot publish the same data as conventional aid programmes as it has commercial confidentiality restrictions associated with investing in private companies, funds and alongside private investors.</p> <p>But new additions will place CDC well in front of other DFIs.</p>

77. The strategy process, run under established governance processes analysed these options in detail and led to strong and tangible agreements on maximising development impact, best practice on responsible investing and increasing accountability by leading the way among DFI peers on transparency and tax. **This business case and the following option appraisal builds on the conclusion of the 2017-21 strategy process, and focuses on the appropriate scale of CDC's investments to deliver greater impact and the required level of new capital.**

## 8. Scaling up CDC to increase its impact on people's lives

78. The strategic case set out the important role of development finance in catalysing finance to achieve the Global Goals and section 7 outlines why CDC is best placed to be DFID's principal partner in delivering against this agenda and the ambition to maximise its impact and commitments to increase its accountability in the new strategy. The question then becomes **how much additional capital DFID should invest through CDC to respond to opportunities and market demand in target geographies and sectors, while at the same time recognising the constraints on CDC's absorptive capacity.** From 2010-2012 CDC invested \$309million on average per year. Over the past five years, CDC has steadily grown its capability, building the necessary governance and operations systems to respond to demand. In 2015-2016 CDC committed \$1.6bn on average annually. CDC's growth was initially financed by CDC's existing capital, and then in 2015 by a £735m capital increase from DFID. At that time, there was an understanding that CDC would require further capital to maintain its investment pace before receipts from new investments would start to flow back.

79. There are **two key factors which drive CDC's capital requirements:**

- a. The **level of investment commitments.** Section 8.1 below considers the appropriate level of CDC's investment commitments.
- b. The **performance of the markets CDC invests in,** which drives the pace and level of capital reflows. Section 8.2 considers how best to manage the sensitivity associated with changing market conditions.

80. The following analyses are run in US\$ given that this is the default currency of investing in the target geographies.

### 8.1 The appropriate level of CDC commitments

81. **The following factors affect the appropriate level of CDC's commitments** (i.e. how much it decides to invest each year):

- a. **Market demand:** Section 2 in the strategic case highlights that current investment levels are insufficient to achieve the Global Goals, underlining the need for development finance institutions such as CDC to step up and mobilise more finance from private investors.
- b. **Deal supply within the investment mandate:** substantial market demand for finance does not always translate into a corresponding supply of high quality investable opportunities that will deliver development impact, especially in CDC's target geographies. CDC has built market knowledge on investable opportunities with need for long-term capital and has developed proven strategies across its investment instruments, providing a solid basis to generate deal flow:

- (i) **Direct equity:** CDC investment teams pursue the following strategies -

- investing in established, larger partners with capability to deliver multiple projects over time and a desire to expand their operations into poorer regions;
- setting up joint ventures with established players entering new markets;
- high growth companies capable of becoming regional or national leaders; and
- adding smaller, earlier stage businesses through overall portfolio risk management.

(ii) **Debt:**

- filling the gap created by market failures of the banking sector in Africa and much of South Asia;
- stepping up where international banks are withdrawing due to regulatory requirements;
- infrastructure projects in priority areas such as power and transport; and
- lending to financial institutions to increase the flow of credit to SMEs, local corporates, residential mortgages and trade finance.

(iii) **Funds** (intermediated investment):

- reaching more companies of all sizes across the priority sectors;
- focusing on the small and mid-size companies that particularly face a financing gap;
- supporting the investment funds industry in Africa and South Asia during a difficult economic cycle; and
- supporting first-time fund managers pursuing new strategies.

c. **CDC's Ability to scale-up higher risk investment:** Through management of the DFID-CDC Impact Fund and Impact Accelerator, CDC has demonstrated its ability to build high quality teams to deploy pioneering higher risk capital in innovative and impactful ways. As explained in section 3.2 of the strategic case, the ability to deploy more higher risk capital is a vital part of the 'tool box' to address the challenges of economic development. CDC has been a pioneer in this space and developed a growing track record, however, this remains a relatively new approach for all DFIs, and so it is appropriate for CDC and DFID to expand this investment in a phased manner.

d. **Capacity and capability to deliver:** CDC has scaled up in size and built new teams with specialist skills in direct equity and debt as well as stepped up its portfolio management, environmental & social and business integrity functions. CDC's performance in building its capacity over the past five years provides a strong foundation and track record for further growth. CDC will need to continue to grow the organization responsibly to manage the increasing scale of its portfolio. The growth of the portfolio and increased focus in more difficult geographies will mean a significant increase in portfolio management and the need to recruit more staff with the appropriate skills and experience, and expand CDC's presence in country (more details in para 234 the management case).

82. Over the last five years, CDC has **demonstrated that it can increase both quality (as evidenced by the results achieved in para 50) and quantity of investments** under the reformed post 2012 strategy, with annual investments increasing from an average of US\$309million between 2010-2012 to US\$1.6bn in 2016. CDC has also demonstrated its **ability to pilot the deployment of higher risk capital** through the DFID-CDC Impact Fund and Impact Accelerator. In addition to scaling up these funds, CDC has also approved four qualifying strategies (as set out in the financial case) which provide a reasonable expectation for an annual

average of US\$300m to be deployed in this space. It is realistic to expect the range around this average to be reasonably large over the initial years given the early stage of this type of investment.

83. Based on these factors, we consider the **following realistic options for the desired level of average investment commitments and therefore the capital increase to CDC**.<sup>55</sup>

- Option 1: No new capital increase ('do nothing'). Based on projected financial reflows, this would reduce CDC's investment pace to \$950m per annum from 2017.
- Option 2: Maintain the investment pace at an average of \$1.6bn per annum. Do not expand innovative higher risk strategies beyond the existing Impact Funds.
- Option 3: Maintain the core investment pace at an average of \$1.6bn per annum and scale up innovative higher risk strategies to an average of \$300m per annum.
- Option 4: Grow investment pace to an average of beyond \$1.6bn per annum and scale up innovative higher risk strategies to beyond \$300m per annum. (We have not appraised the option to increase higher risk strategies at the expense of commercial operations because both are complementary and because of the relatively early stage of the innovative higher risk strategies compared to the proven track record of commercial investment in delivering development impact and mobilising private investment. It is also important to balance the overall risk of CDC's portfolio).

84. NOTE: We focus on average investment pace as CDC does not set annual volume targets, the quality of investments available from year to year varies, so annual targets create perverse incentives for investment committees and risk poor value for money. To maintain the highest standards of investment selection, the annual investment pace should be expected to show some volatility.

#### **Option 1: No new capital increase ('do nothing') – not recommended**

85. **No new capital to CDC would mean CDC could not maintain current commitment levels.** CDC's average investment pace would drop to \$950m from 2017, a 40% decline on 2016. This would mean:

a. **Market demand:** In light of the unmet demand in CDC's target markets (as described in the strategic case) this would have significant negative impact on DFID's delivery of its Economic Development Strategy. This would reduce our ability to crowd in private sector investment into target geographies and the UK would continue to offer significantly less development finance relative to our total ODA than other countries. In addition, it takes time to scale back CDC's commitment pace as CDC will already be engaged with potential investee companies and pulling out of these deal conversations could be harmful to CDC's market reputation. This would mean CDC's investment volume would need to decline very significantly (below \$950m per annum) in the later years.

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<sup>55</sup> To note that there are a very large number of possible options both between and beyond the options presented. This narrower set of options provides realistic, yet distinct choices over the future scale of CDC to give a clear overview of the arguments. It is not possible to run through every possible combination of options.

b. **Deal supply:** CDC' would not be able to support the full extent of the deal flow which could be generated by its investment strategies, presenting a missed opportunity to support much needed economic transformation in target geographies. CDC may also not have the capital capacity to engage in the largest and potentially most transformational investments.

c. **Ability to scale-up higher risk investment:** Capital constraints and the need to maintain existing commercial pipeline to avoid damaging CDC's reputation and ability to partner with high quality investees means CDC would be likely to only deploy higher risk investments in a very limited manner, if at all.

d. **Capacity and capability to deliver:** CDC has built an organisation that could deliver more. A reduced commitment pace would lead to scaling it back, losing the market knowledge and skills accumulated, reducing specialisation, and a missed chance to take advantage of economies of scale.

**In conclusion, given that this option runs counter to the amount and type of capital required in target markets, does not support DFID's Economic Development priorities and presents clear missed opportunities to take advantage of CDC's organisational capacities, option 1 is not recommended.**

**Option 2: Maintain the investment pace at an average of \$1.6bn per annum. Do not expand innovative higher risk strategies - not recommended**

**86. CDC has shown its ability to deliver high quality commercial investments at a pace of an average of \$1.6bn.** Given CDC's investment in building its teams and its track record, it is sensible to maintain these operations at the current pace. Even though CDC has experience in higher risk investing through the DFID Impact Programme, the relative early stage of this work raises the question of whether CDC should limit its engagement in this space. This would mean:

a. **Market demand:** Market demand in Africa and South Asia justifies the commitment pace and the additional capital that could be mobilised to deliver economic development. The UK would move to a level more comparable with peers of development finance relative to the UK's total ODA.

b. **Deal supply:** CDC has appropriate investment strategies and established networks in place to generate deal flow to invest at this pace as evidence by its track record in 2016.

c. **Ability to scale-up higher risk investment:** Not expanding CDC's use of higher risk investment beyond the existing Impact Programme would limit opportunities to achieve development impact that could not otherwise be achieved and leave a significant gap in the market for a type of capital that is currently very scarce. Given the scarcity of this capital there is a high demand for higher risk investment, as part of the approach to build markets and transform sectors and ultimately economies. This investment can also be highly complementary to commercial investment.

d. **Capacity and capability to deliver:** CDC has a strong organisational set-up, they have demonstrated the ability to deliver deal flow at this level, but will need to continue to grow their team to manage the growing portfolio and deliver against the new strategy. Limiting higher risk investments would mean losing the opportunity for CDC and DFID to become a leader setting high standards in this innovative space.



**In conclusion, this option would allow CDC to increasingly respond to market demand and deal supply delivering economic development outcomes, but would not support the gap in higher risk capital leaving a gap in DFID and CDC's ability to deliver impact; therefore option 2 is not recommended.**

**Option 3: Maintain the core investment pace at \$1.6bn per annum and scale up innovative higher risk strategies to \$300mn per annum - recommended**

87. As option 2, maintaining the average investment pace at \$1.6bn per annum is considered an appropriate level which CDC has demonstrated it can deliver. **Building on CDC's record of the Impact Programme, this option in addition will allow CDC to deploy an average of \$300mn for higher risk investments over the next five years.** This would mean:

a. **Market demand:** As option 2.

b. **Deal supply:** As option 2.

c. **Ability to scale-up higher risk investment:** In addition to the Impact Programme, CDC has developed and approved new innovative qualifying strategies that will scale up its higher risk investment offering (see management case section 21.2). These provide opportunities to bring about new business models, develop nascent or failed markets and, in the long-run, improve the economy in the countries where CDC invests. These strategies and individual investments will seek to have a transformative effect, enabling CDC to achieve impact it otherwise could not and complementing its commercial investment. Expanding these strategies to an average of \$300m per annum would mean a carefully managed expansion of this relatively new area of work enabling time to learn lessons and adapt as CDC expands this work.

d. **Capacity and capability to deliver:** In addition to a strong organisational set-up, CDC has a demonstrated track record in implementing the Impact Programme, hence it is well placed to scale up its higher risk operations in a phased and integrated manner. This option will see CDC significantly increase the volume of investment in higher risk investment strategies and it is prudent to consider the challenge in effectively delivering this scale up. While the growth compared to the Impact Programme is significant, it is reasonable to consider that demand for this type of capital will continue to outstrip supply and that CDC will be able to deploy it effectively. This conclusion is supported by the evidence that CDC has already made significant progress in developing the qualifying strategies detailed in section 15.2 including the expected demand for capital and the most effective way to deliver these investments. Each of these strategies take a different delivery approach. CDC will scale up its operational capacities and put adequate processes in place to deliver this part of the portfolio effectively. In addition the fact that some of the qualifying strategies may deploy larger ticket sizes than the Impact Funds, easing some demand on CDC's delivery capacity per pound of investment.

There are also some risks in adding new elements to the commercial portfolio just five years after CDC has substantially transformed. CDC will certainly face a significant management challenge in managing the growing commercial portfolio, delivering against the increase ambitions and commitments of the new strategy, and expanding higher risk investment. However as set out in section 21.2 in the management case, we are confident that CDC has the right processes in place to manage and mitigate these risks so it can expand and innovate further. We also believe that the combination of commercial and higher risk investment is

complementary both in terms of development outcomes, but also CDC's investment processes and skills.

**In conclusion, this option would enable CDC to increasingly respond to market demand and deal supply and allow for CDC to be at the forefront of higher risk investment expanding its overall impact and delivering DFID's economic development priorities, therefore option 3 is recommended.**

**Option 4: Grow investment pace to above \$1.6bn per annum and/or scale up innovative higher risk strategies beyond \$300mn per annum - not recommended**

88. In the face of substantial market need for more and new types of capital; we have also considered whether CDC should increase its commitment pace beyond what CDC delivered in 2016.

**Option 4 would mean:**

a. **Market demand:** Market demand exceeds what CDC could deliver with a commitment pace of \$1.6bn and the need for capital taking higher risk to address economic development challenges is greater than the managed scale-up of higher risk investment proposed in option 3.

b. **Deal supply:** With further growth of CDC's team its investment strategies could potentially translate into an increased deal supply, however a much higher commitment pace could increase the risks to ensure adequate deal quality. CDC requires deals to meet its high requirements for development impact, ESG standards, business integrity, additionality and financial performance.

c. **Ability to scale-up higher risk investment:** An average of \$300mn for higher risk investment is a careful scale up to reflect the level of uncertainty around these new strategies which have limited track record (compared to commercial investments). While there is significant demand and development potential from this capital, there are also significant risks and uncertainties. Higher risk investments beyond an average of \$300mn per annum would limit the opportunity for learning and adaptation in this scale up phase and would stretch CDC capacity therefore risking quality, it is therefore not recommended.

d. **Capacity and capability to deliver:** CDC has scaled up and transformed significantly over the past five years. From shareholder perspective, maintaining the pace of commercial investments while gradually expanding higher risk operations is a responsible approach to ensure continued effectiveness of the organisation instead of overloading CDC's absorptive capacity.

**In conclusion, this option would allow CDC to further respond to market demand but would pose significant risks for CDC's absorptive capacity and therefore the quality of its impact, as a result option 4 is not recommended**

**Table 3** summarises the assessment of each option against the criteria.

	<b>Option 1</b> No new capital increase	<b>Option 2</b> Maintain \$1.6bn investment pace, no expansion of higher risk strategies	<b>Option 3</b> Maintain \$1.6bn investment pace + expansion of higher risk strategies by \$300m	<b>Option 4</b> Grow investment pace above \$1.6bn and higher risk investments beyond \$300m
Market demand	Significant unmet capital needs not addressed	Not sufficient to meet market demand	Not sufficient to meet market demand	More capital enables better ability to address market need
Deal supply	Missed opportunity to support deal flow	Investment strategies able to generate deal flow	Investment strategies able to generate deal flow	Risks for deal quality
Higher risk ability	Missed opportunity to fill gap for new type of capital	Missed opportunity to fill gap for new type of capital	Managed expansion	Risks from too ambitious an expansion
Capacity and capability to deliver	Scaling back, losing skills & market knowledge	Capability to deliver but lost opportunity to build up higher risk skills	Opportunity for economies of scale & demonstrated track record in higher risk	Risks for CDC's absorptive capacity

## 8.2. Capital requirements depend heavily on market conditions

88. **Having determined the appropriate average commitment pace, CDC's cash and capital needs are mainly driven by the following factors:**

a. **Disbursements** (cash may not be drawn down immediately upon entering into commitments or may never be drawn down in full). Uncertainty here mainly relates to CDC's investments in third party managed funds where money committed can be drawn at any period up to five years from the date of commitment, and longer by agreement. For direct equity and debt deals, amounts are usually disbursed soon after the commitments are made. However, there can be periods between commitment and drawdown depending on the specific deal and conditions precedent agreed with partners.

b. **Valuation** (changes in the value of CDC's investments over time): Individual investments value will change (up or down) over time due to investment performance

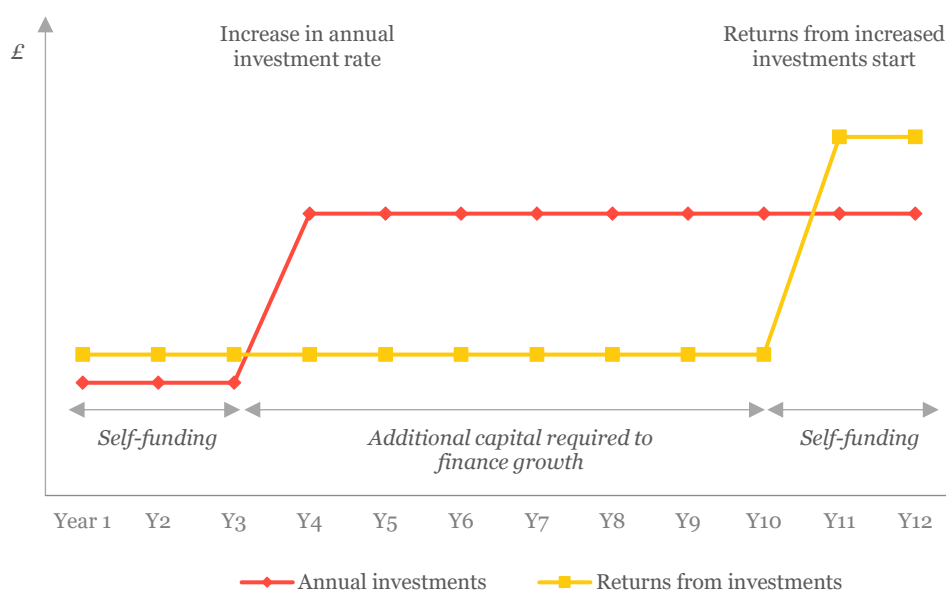
and changing market conditions. Compared to the timing of receipts and disbursements, small changes in valuation in line with the long-run financial targets for CDC have a limited impact on the cash position. There is always the risk of large structural shifts in valuations but the portfolio has concentration limits to offer some protection against large impacts whilst as a long-term investor CDC has the appetite to invest through valuation cycles.

c. **Receipts** (cash received from interest payments or distributions on exits from funds/direct investments): Between 2014 and 2016, as a result of changing market conditions, there was a shift in the profile of receipts from funds which saw an increase in the time taken for funds to exit investments and return cash to CDC. For direct equity, CDC's decision to exit depends on a variety of factors, including (among others) an offer to buy the company from another investor, a change in strategy or co-investor differing from CDC's visions and principles, a successful IPO with strong demand from commercial investors, or a change in strategy which removes the rationale for continued CDC investment. Equally, other circumstances may demand CDC retains investments, including a sustained development need, a need for patience to implement a strategy, the need to provide an anchor role in a shareholder base, inability to sell to a buyer at an appropriate price, etc. Therefore, there is a broad range of potential timings for exits.

89. **CDC's capital requirements are most sensitive to the pace of receipts** (see figure 13) as changes in the timing of receipts can move significantly in short periods of time based on market conditions. However, CDC's development mandate means it should be counter-cyclical on occasion and not step back when market conditions are more challenging and more investment capital is in greater demand. This means that over the aggregate five-year period we assume CDC commitments are held at pace described in para 86-87.

Therefore the following scenarios test the sensitivity of CDC's capital requirements according to variations in the pace of receipts from funds and direct equity receipts (whereas debt follows an agreed repayment profile).

**Figure 13: Cash needs are determined by commitments and receipts, demonstrating a growth in investment levels**



## Scenario 1 (base case)

90. **The pace of receipts is linked to macroeconomic developments both globally and in CDC's target geographies.** According to the latest IMF World Economic Outlook<sup>56</sup>, **global economic recovery after the financial crisis has remained slow, including in emerging markets, and has only recently started to brighten since summer 2016 with a cyclical recovery in manufacturing and trade under way.** However, it also suggests that longer-term potential growth rates remain subdued across the globe compared with past decades due to structural impediments (such as low productivity growth and high income inequality) and significant downside risks continue to dampen the medium-term outlook, including reduced cross-border investment flows from an inward shift in policies, financial tightening and weak balance sheets in emerging market economies and non-economic factors (incl. political tensions, weak governance and corruption, security concerns, extreme weather events). **The growth rebound is expected to be weaker in developing than advanced economies.** Accordingly, global FDI flows are projected to resume growth in 2017 and 2018, but will remain below the pre-crisis peak<sup>57</sup>. **Africa's growth outlook remains positive for the near term future relative to performance,** boosted by expected increases in commodity prices, domestic demand and improvement in macroeconomic and business environments<sup>58</sup>. **Growth in most South Asian countries is expected to accelerate in 2017 and 2018,** driven by growth in exports and investments<sup>59</sup>.

91. **Despite improving fundamentals, the investment outlook for Africa is mixed and investment at the scale needed is unlikely to materialise in the near future given high risk perceptions.** Overall, FDI flows to Africa are likely to return to a growth path as a result of liberalisation measures and planned privatisations. These will mostly likely occur in services (electricity, gas and water, construction, transport) followed by manufacturing industries (such as food/beverages and motor vehicles) as difficult conditions for oil, gas and mining will likely persist.<sup>60</sup> However substantial inter-regional variations are likely to continue. Africa's most industrialised economy, South Africa, has recently re-entered recession, for the second time in eight years, further shaking investor confidence that was already low given political turmoil and structural challenges, such as the high unemployment rate. Despite conflict and instability continuing in North Africa following the Arab Spring (particularly in Libya), the biggest rise in prospective investments are to be expected in North African economies such as Egypt and Morocco.<sup>61</sup> The floating of the Egyptian pound and significant new gas discoveries in Egypt's Western Desert have boosted confidence and are likely to lead to more investment in the future. West Africa is one of the regions most likely to see a fall in private equity inflows as low oil prices and political instability in Nigeria drive investors east to the more diversified economies of Kenya and Ethiopia which have introduced favourable policies especially for light manufacturing and further removal of restrictions

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<sup>56</sup> International Monetary Fund. 2017. World Economic Outlook: Gaining Momentum? Washington, April.

<sup>57</sup> UNCTAD: 'Global Investment Prospects Assessment 2016-2018', No24, 6 October 2016.

<sup>58</sup> African Economic Outlook 2017 [http://www.africaneconomicoutlook.org/sites/default/files/2017-05/African\\_Economic\\_Outlook\\_2017.pdf](http://www.africaneconomicoutlook.org/sites/default/files/2017-05/African_Economic_Outlook_2017.pdf)

<sup>59</sup> World Bank South Asia Economic Focus Spring 2017

<https://openknowledge.worldbank.org/bitstream/handle/10986/26373/9781464810954.pdf?sequence=5&isAllowed=y>

<sup>60</sup> UNCTAD: 'Global Investment Prospects Assessment 2016-2018', No24, 6 October 2016.

<sup>61</sup> Ibid.

on foreign investments.<sup>6263</sup> But more optimistic scenarios also prevail for Mozambique, Rwanda and Tanzania.<sup>64</sup>

92. **FDI flows to some South Asian economies such as India, Myanmar and Vietnam are likely to see some moderate increases.<sup>65</sup> Strong economic growth forecasts coupled with recent tax reforms and the crackdown on “black money” have led to high levels of investor optimism in India** who believe that while demonetisation may affect short-term growth due to the sudden liquidity squeeze, it should have a long-term benefit.<sup>66</sup> The large increase of announced greenfield investments in manufacturing industries may provide further impetus to FDI into the country. Vietnam is expected to continue strengthening its position in regional production in industries such as electronics, while Myanmar is likely to receive increasing levels of FDI inflows in infrastructure, labour-intensive manufacturing and extractive industries<sup>67</sup>.

93. In light of this and based on CDC’s review of past receipt profiles for funds, the base case model assumes an average receipt 9.4 years from date of commitment. For direct equity the assumed average holding period is 10.4 years, in line with CDC’s premise to provide patient capital. Repayment of debt is modelled over 8-15 years (depending on the type of debt). Maintaining a commitment pace as described in paragraph 86 based on the above assumptions of receipts profiles and other central core assumptions around cash flows (disbursements, valuation growth, returns) indicates a **cash need of around \$4,073m or £3,089m (at current exchange rates)<sup>68</sup> cumulative up to 2022.**

#### **Scenario 2 (slower receipt pace)**

94. However, assessing macroeconomic and investment outlooks is inherently uncertain and it is not unlikely that economies in some of CDC’s core markets will perform worse than under scenario 1. This would prolong holding periods and delay receipts. CDC’s existing analysis of its legacy funds has shown that a slower pace of receipts can be expected than originally envisaged. Given that funds invested in the reformed strategy from 2012 are invested in more difficult geographies it is prudent to test the sensitivity of CDC’s capital requirement in scenario 1 against a delay in fund and/or equity receipts.

95. A delay of fund and/or equity receipts would mean the following additional capital needs:

a. Delay in fund receipts by two years: would lead to an increase in capital requirements by \$655m or £496m;

b. Delay in equity receipts by two years: would lead to an increase in capital requirements by around \$575m or £436m;

In the worst case, combined these delays would increase CDCs capital needs to \$5,303m or £4,022m over the period to 2022.

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<sup>62</sup> Financial Times: Private equity looks to east Africa for investment opportunities (19/06/2017) <https://www.ft.com/content/38dacef2-5056-11e7-a1f2-db19572361bb>

<sup>63</sup> UNCTAD: ‘Global Investment Prospects Assessment 2016-2018’, No24, 6 October 2016.

<sup>64</sup> Ibid.

<sup>65</sup> Ibid.

<sup>66</sup> Bain & company: ‘India Private Equity report 2017’

<sup>67</sup> Ibid.

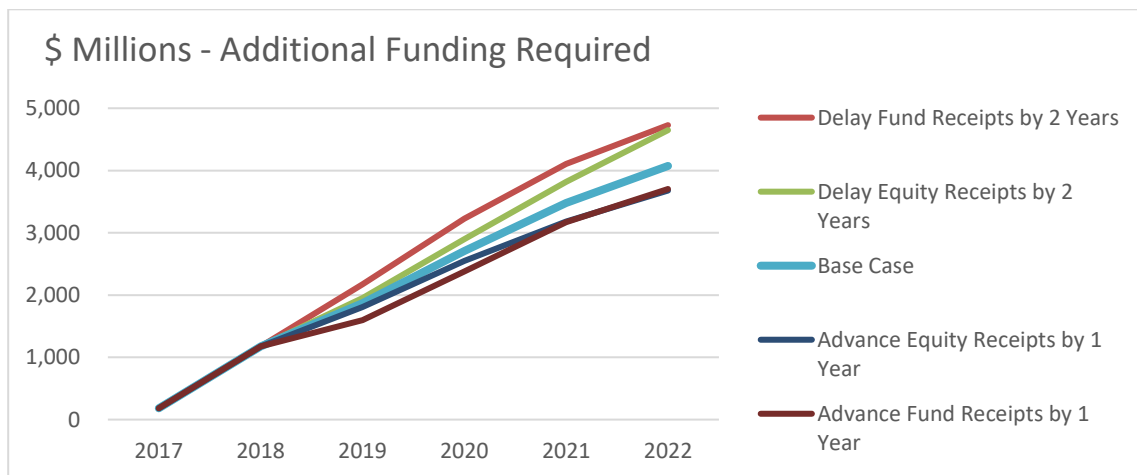
<sup>68</sup> As of 12 September 2017: \$1 = £0.75850

### Scenario 3 (quicker receipt pace)

96. To test sensitivities based on stronger performing economies than expected, modelling of an advance of fund and/or equity receipts by one year mean CDC requires less capital:

- a. Advance in fund receipts by one year: would lead to a decrease in capital requirements by around \$370m or £280m;
- b. Advance in equity receipts by one year: would lead to a decrease in capital requirements by around \$395m or £235m;

**Figure 14: Sensitivity analyses to variations in receipt pace**



### 8.3 A capital increase to enable CDC to deliver impact at scale

97. Taking the above analyses together, the **proposed capital increase is determined by:**

- a. **Option 3 to maintain the core investment pace at an average of \$1.6bn per annum and scale up innovative higher risk strategies to an average of \$300mn per annum** due to substantial market demand, appropriate strategies to generate deal supply and proven capacity & capability to deliver.
- b. **scenarios to determine a minimum and maximum capital increase** in light of significant uncertainties over the macroeconomic performance of CDC's geographies

and the need to structure the growth of operations around the best available assumptions at this point in time.

(i) Using **scenario 1** as the base case for the receipt pace to determine a **minimum capital increase**: \$4,073million at current exchange rate is £3,089m. CDC needs certainty on a minimum level of capital increase in order to credibly source a pipeline in the market and scale up the organisation accordingly. Taking consideration of DFID's capital availability, potential exchange rate fluctuations and the flexibility described in this business case to respond to real world events, we set the minimum capital increase at **£3,100m**. We therefore **recommend committing to this level of funding**.

(ii) Using **scenario 2 (slower receipt pace)** to determine **a maximum capital increase**: In difficult market conditions private investors step back from risky markets. Therefore the need for DFI capital increases, just as their availability of cash flowing back from investments is decreasing. This means that maintaining the commitment pace in worse than expected macroeconomic conditions is important from an impact perspective. This would imply capital increase up to a **maximum of £3.515bn**.

(iii) **We do not use scenario 3 (quicker receipt pace)** as relying on better market conditions than can be assumed at this point in time to determine cash requirements could be considered imprudent from a risk perspective. Given the importance of CDC as a patient investor we would not want to create a situation for forced sales to free up capital, but which are unlikely to provide vfm.

98. In conclusion, **maintaining the commitment pace described in option 3 will require a capital increase of between £3.100bn (base case) and £3.515bn (maximum) to be drawn over the next six years**. A minimum capital increase combined with a maximum limit is the best way forward to manage CDC's need for stability with changing conditions in market demands. **We will manage capital requirements according to actual need responding to real world events and subject to satisfactory evidence of demand, strong pipeline, portfolio performance etc.** We will manage capital needs through our regular governance processes and shareholder meetings, and in order to deal with inherent uncertainties of macroeconomic conditions CDC will provide DFID advice on capital needs two years in advance of placing a Promissory Note<sup>69</sup>, commencing with the PN in 2020/21. Section 14 in the financial case provides more detail on this.

## **9. What economic benefits we expect from the proposed capital increase**

### **9.1 Basis for the assessment**

99. Where possible, we have used a similar assessment to our previous business case for CDC in 2015. These assessments look in particular at economic benefits. It is not possible to know ex ante precisely where or how CDC will deploy the capital over the duration of the programme (other than it will adhere to CDC's Investment Policy and Strategy agreed with DFID). Given this and other uncertainties, the analysis relies on significant assumptions which are referred to in Table 5 below. The results generated by the economic model are indicative of the impact of the capital increase and as such will

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<sup>69</sup> The modelling used for this business case provides this advice for PNs up to 2019, CDC will provide advice in 2018 for the 2020 PN.



not be used as a performance framework or to set targets for CDC. All analysis is in real terms as opposed to nominal.

100. The analysis is done by **assuming a base case for how the capital will be deployed over time and how investments will perform based on CDC's current portfolio** and strategy. This includes an initial allocation of the capital across funds, debt and equity and expanding higher risk investments (commitment levels as shown in Table 12 p70). Investment returns are driven by CDC return expectations by product line.

#### *Leverage and private sector mobilisation*

101. There will be **considerable direct and indirect mobilisation of public** (e.g. other DFIs and IFIs) and **private sector investment by investing through CDC**. Directly mobilised finance includes investment made alongside CDC in specific transactions and is used in the analysis as a proxy for mobilisation.

102. The ultimate objective is the mobilisation of private financial flows into markets that benefit poor people. The **volume of mobilisation varies, depending (among other factors) on whether CDC invests in funds or directly**. With funds, CDC often invests alongside other private finance at the fund level (depending on the nature of the fund – riskier countries and sectors and first time funds will attract less private finance). Then each portfolio investment made by the fund will typically mobilise finance (both equity and debt) in the portfolio company.

103. **Indirect mobilised finance is investment which is subsequently made by the private sector**, in sectors and geographies that CDC has successfully demonstrated it is possible to invest in on a commercial basis.

104. As in the previous business case, the impact of **mobilisation is not considered in the cost benefit analysis**. However, in the event that investment is mobilised, then anticipated benefits could be an order of magnitude higher.

#### *Recycling/compounding effects*

105. As the capital increase will be to CDC's balance sheet and is not time bound, returns will be reinvested and generate continued benefit. **A 25 year time period has been taken which assumes that all funds will be recycled at least once** (the typical tenure is 10-14 years).

#### *Benefits*

106. Three benefits<sup>70</sup> are presented in Table 6 to illustrate the merits of option 1:

- a. **Economic Value Added:** As in the previous business case and based on Standard Chartered Bank research (using input output models)<sup>71</sup>; the model assumes that \$1m of investment is associated with \$1m of Economic Value Added (EVA). EVA is comprised of direct, indirect, leveraged, and induced effects but excludes potential non-market benefits or forward linkages<sup>72</sup>. It therefore can be seen as forming a lower boundary for the analysis of total benefits.

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<sup>70</sup> In the previous business case, we presented results on tax separately. We have not repeated this exercise here; however, the Standard Chartered modelling referred to below suggests that 17% of economic value added (EVA) is through increased payment of taxes, 56% associated with additional household income, and 27% with increased profits.

<sup>71</sup> [https://www.sc.com/en/resources/global-en/pdf/sustainability/Africa\\_impact\\_report.pdf](https://www.sc.com/en/resources/global-en/pdf/sustainability/Africa_impact_report.pdf) . We have discussed the findings with the consultancy Steward Redqueen who generated these outputs for Standard Chartered at the time, as well as with CDC. On the back of those discussions, we have decided to retain this assumption as we are not aware of any more robust and up-to-date publically available information. Estimating the job impact of investment is notoriously difficult, we present these number to give the reader an indication of the real world impact of the EVA created and as such they should be treated as indicative.

<sup>72</sup> Leveraged and induced effects are through households with the additional spending power they earned whilst indirect effects are through jobs and additional income created by suppliers. However, the value only includes backward linkages, i.e. effects on suppliers

b. **Jobs:** This is a subset of (a) as household income is included in EVA. The model assumes that \$1m of investment is associated with 170 jobs on average, based on the same research by Standard Chartered Bank and as per the previous business case.<sup>73</sup> This should not be considered as an explicit outcome but instead is intended to give an indication of the scale of impact associated with EVA in more real world terms.

c. **Socio-economic benefits:** For the last business case, we assumed that \$1m of investment leads to socio-economic benefits of \$2m. This was based on a review of research on Economic Rates of Return (ERR) which suggested a range between 10% and 30%. Reviewing research from the IFC as well as the Millennium Challenge Corporation (MCC) suggests again a wide range of ERRs, but a conservative mean would be around 15% to 20%.<sup>74</sup> For modelling purposes, we take a conservative approach and have assumed 16% over 20 years, which suggests a multiplier of 1.38 (in real terms and after discounting benefits by 10%). As in the last business case, the social-economic benefits are considered as forming an upper boundary for the analysis. However, given our conservative approach to the multiplier, the upper end should be considered relative to our sensitivity analysis in tables 7-9.

107. The Benefit Cost Ratio is calculated based upon the socio-economic benefits.

108. We note that the basis for the jobs estimates in this Business Case (i.e. the Standard Chartered research) differs from data that CDC publishes on jobs supported in a particular year. CDC's reported figures relate to the entire jobs effect of its investee businesses, without attributing this to CDC's share of capital invested into those businesses (because of the inherent difficulties in doing so) and include economy-wide estimates for indirect job impacts resulting from better infrastructure and financial sector loans and advances. These effects are not included here.

## 9.2. Cost-benefit analysis of capital increase of CDC

109. As above, the **analysis of the capital increase** (the base case) uses CDC's current asset allocation and return expectations (as corroborated by wider literature). This assessment is relative to the do nothing case as additionality is accounted for, so this has not been separately assessed. Table 4 sets out the assumptions used in the analysis.

**Table 4: Assumptions in the cost-benefit analysis**

Variable	Assumption
Discount rate	10% – Assumption as per previous business case. This is indicative given the range of countries considered.
Financial additionality	90% – while CDC has industry leading additionality principles in place, we take a conservative approach and assume some non-additional investment to reflect the difficulty in assessing additionality in practice. This is subject to sensitivity analysis in

and suppliers' suppliers. The study sets out that "Although in the utilities sector these backward linkages are still substantial, it is clear that the main development impact of power and water infrastructure is coming from forward linkages, the enabling effect on the rest of the economy."

<sup>73</sup> As above, we have retained the assumption on jobs which is based on the same research by Standard Chartered. We have consulted within DFID, CDC, Stuart Redqueen, IFC, Donor Committee on Enterprise Development (DCED) as well as other M&E experts. Whilst work streams are considering better ways of measuring job creation, there is a lack of robust data that we can rely on for our analysis.

<sup>74</sup> IFC (2011) Annual Portfolio Review FY11, International Finance Corporation, suggests real ERR of 16%. MCC 2015 close out report suggest 15.2% for MCC projects where compact has closed (<https://www.mcc.gov/resources/doc/report-2015-closeout-errs>) and 20.2% for open projects (but heavily driven by one project). Reviewing individual MCC case reports suggest this is usually over a period of 20 years (<https://www.mcc.gov/our-impact/err>)

	the cost-benefit analysis.
Economic value added (\$m per \$m invested)	1.0 – per paragraph 107. We do not have evidence to differentiate the Asia and Africa impact assumptions.
Jobs (per \$m)	170 – per paragraph 107.
Socio-economic benefits	1.38 – per paragraph 107.
Dollar rate used	1.28 <sup>75</sup> – this is held constant over time.
Times Money Back (TMB)	TMB varies for each of CDC’s product lines from 1 to 1.99 (i.e. latter means a 99% total return over the course of the investment life).
Operational costs	1.5% - As illustrated in figure 18 CDC operational costs are expected to be around 1.2 to 1.3% in the immediate future. We use 1.5% for the analysis as a conservative figure as costs could go up as CDC increases its direct debt and equity portfolio relative to its funds portfolio.
<b>Variables subject to sensitivity analysis</b>	
Additionality	95%, 90%, 85%, and 80% – this is to test the benefits of a capital increase if there is diminishing marginal impact of the funds.
TMB	+10%, -10% (not percentage points). So if - for a given product - a TMB of 1.5 is assumed, then a 10% reduction results in a TMB of 1.35.
Socio-economic benefits	1.0, 1.38, 2.0 – this is to test benefits of investments assuming higher and lower levels of socio economic benefit derived from an investment of \$1m.
<b>Variables not considered in cost benefit analysis</b>	
Mobilised finance	As mobilised finance would not have occurred without CDC’s demonstration effect, the BCR would increase by the amount of the additional benefits which can be claimed <sup>76</sup> . This however is not considered in the analysis.

110. Under option 1, DFID would not increase CDC’s capital base. This has not been modelled separately as the base and maximum cases are both relative to a “do nothing option” under which no additional jobs, taxes, EVA, and socio economic benefits would be created.

111. Under a base case (capital increase of £3,100m), **average additional annual commitments made by CDC are \$673m per year over 25 years (in addition to commitments made on the basis of existing capital)**. Under a maximum case (capital increase of £3,515m), the additional capital would now support **average additional annual commitments made by CDC of \$763 m per year over 25 years**.

112. The **cost on a net present basis is £2,600m under the base case** (NPV of £3,100m over the 4 years the Promissory Notes are issued) and £2,952m under the

<sup>75</sup>The market rate on the date this analysis was completed in June 2017.

<sup>76</sup> For example, if the investment mobilised is doubled (it mobilises exactly the same amount through the demonstration effect), the benefits are doubled, but DFID’s share of that investment and what can be claimed is halved. However, the BCR does increase because the mobilised investment is all additional while not all of the initial investment is.

maximum case (NPV of £3,515m). This cost treats all of DFID's capital to CDC as a sunk cost because DFID intends to continue to recycle this capital for the purpose of investing to improve peoples' lives after the end of the 25 year period.

**Table 5: Cost benefit analysis – CDC under current Investment Policy over 25 years**

	EVA (£m)	Jobs	Socio-economic benefits (£m)	NPV Cost (£m)	BCR
Do nothing	0	0	0	0	N/A
Base	4,172	2,408,078	5,757	2,600	2.21
Maximum	4,730	2,730,450	6,527	2,952	2.21

113. These results indicate that providing **£3,515m to CDC will enable it over 25 years to support 2.7m additional jobs (relative to the 'do nothing option')** and **£4,730m of Economic Value Add with an overall benefit cost ratio of 2.21** over and above the do nothing option. The benefits with regards to additional jobs, EVA and socio economic benefits are lower under a base scenario as one would expect given the lower capital increase and compared to a do nothing option, with the BCR unchanged as the model assumes benefits and costs increase directly in proportion.

#### *Sensitivity Analysis*

114. Tables 6-8 shows the results of sensitivity analyses assuming different levels of additionality, financial returns, and socio-economic benefits for the base case. In the event that much of this investment is not additional and the benefits would have occurred anyway the BCR still remains positive. Similarly, the BCR is positive in the below scenarios where returns or socio-economic benefits per \$1m investment are assumed to be considerably lower despite a material reduction in jobs created and economic benefits.

**Table 6 Sensitivity Analysis assuming different levels of additionality under the base case**

Additionality	EVA (£m)	Jobs	Socio-economic benefits (£m)	NPV Cost (£m)	BCR
95%	4,403	2,541,860	6,076	2,600	2.34
90%	4,172	2,408,078	5,757	2,600	2.21
80%	3,708	2,140,514	5,117	2,600	1.97

**Table 7: Sensitivity Analysis assuming different returns (TMB - Times Money Back) under the base case**

TMB	EVA (£m)	Jobs	Socio-economic benefits (£m)	NPV Cost (£m)	BCR
-10%	3,839	2,073,009	5,298	2,600	2.04
Base	4,172	2,408,078	5,757	2,600	2.21
+10%	4,540	2,792,624	6,265	2,600	2.41

**Table 8: Sensitivity Analysis assuming different socio-economic benefits under the base case**

Socio-economic multiplier per \$1m investment	EVA (£m)	Jobs	Socio-economic benefits (£m)	NPV Cost (£m)	BCR
2	4,172	2,408,078	8,343	2,600	3.21
1.38	4,172	2,408,078	5,757	2,600	2.21
1	4,172	2,408,078	4,172	2,600	1.60

*Break-even analysis*

115. We note that any analysis such as the one presented in this business case is inevitably driven by the assumptions that are being made. Therefore, it may also be helpful to consider the point at which the BCR will be at least 1, i.e. break even. In the model under the base case, we break even when \$1m invested by CDC creates at least £630,000 of socio-economic benefits.

*Conclusion of cost benefit analysis*

116. We conclude that a capital increase to CDC provides strong developmental benefits. Our results indicate that providing **£3,100m to CDC will enable it over 25 years to support 2.4m additional jobs and £5.8bn of socio-economic benefit with an overall BCR of 2.21**. When considering auxiliary results of investment mobilised we can expect the benefits to increase.

*Cost benefit analysis and logframe targets*

117. The methodology in this Appraisal Case uses multipliers on the expected investment activity in order to determine the likely benefits. This is a **marginal analysis to impute the impact of the capital increase**. When assessing results in the monitoring framework, the **logframe will use milestones that reflect the methodology which will be used in the monitoring**. This methodology is often 'bottom-up' and based upon reporting by investee companies. In line with CDC's strategy since 2012, the logframe will only apply to CDC's portfolio in Africa and South Asia. This will only represent a subset of CDC's current portfolio, which has legacy portfolio investments in other regions that will be divested over the next five years. This means that the figures presented here are not the expected milestones from the capital increase, but instead seek to model its impact to ensure our investment represents good value for money.

**10. How CDC will address DFID strategic priorities**

**10.1 Fragile and Conflict-affected States (FCAS) – strong footprint and processes**

118. The development impact grid creates an incentive framework for CDC's investment teams to **seek investment opportunities in the most challenging countries** (Annex C):

- a. CDC's DI Grid is based on a measure of investment difficulty which combines five equally weighted indicators, including DFID's fragility index.

b. The other four indicators (GDP, GDP per capita, domestic credit to the private sector, Doing Business ranking) are closely correlated with degrees of fragility.

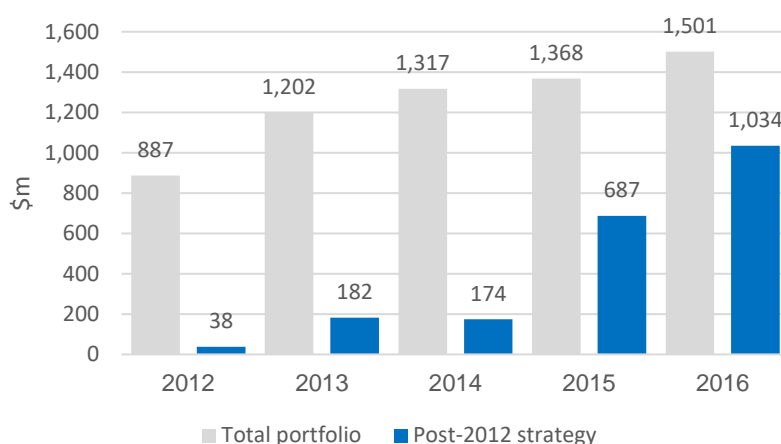
119. This means that there is a substantial overlap between CDC’s priority countries (classified as A and B on the DI Grid) and FCAS countries as defined by DFID<sup>77</sup>. 34 FCAS are within CDC’s investable universe, of which only four are not considered A or B countries by CDC for the 2017-2021 strategy period (Egypt, Bangladesh, Kenya and Cambodia). **Therefore by targeting A and B countries, CDC is incentivised to invest in FCAS**, as reflected by the fact that 91% of CDC’s exposure in A and B countries<sup>78</sup> in its post-2012 portfolio is in FCAS.

120. **CDC’s exposure in FCAS has increased significantly since 2012, in both absolute (figure 15) and relative terms (figure 16):<sup>79</sup>**

a. **Absolute exposure in FCAS** of the total portfolio has grown by **69% since 2012**, driven by the significant size of the post-2012 strategy portfolio in FCAS, which grew from less than \$200m in 2013 to over \$1bn at the end of 2016.

b. **Relative exposure:** The change in strategy in 2012 had a major impact, with 41% of CDC’s post-2012 portfolio exposure being in FCAS at the end of 2016. At total portfolio level, the share of CDC’s portfolio in FCAS has increased from 25% to 32% from 2012 to 2016.

**Figure 15: CDC’s exposure in FCAS, 2012-2016 (\$m)**

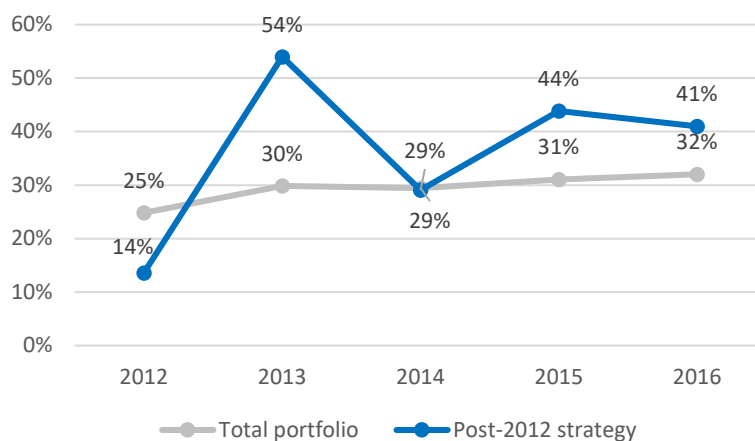


**Figure 16: Share of CDC portfolio in FCAS, 2012-2016 (%)**

<sup>77</sup> At the time of writing, DFID classifies 54 countries as FCAS. This list differs from the World Bank’s list of fragile situations (35 countries in FY 2017).

<sup>78</sup> As classified on the 2017-21 DI Grid.

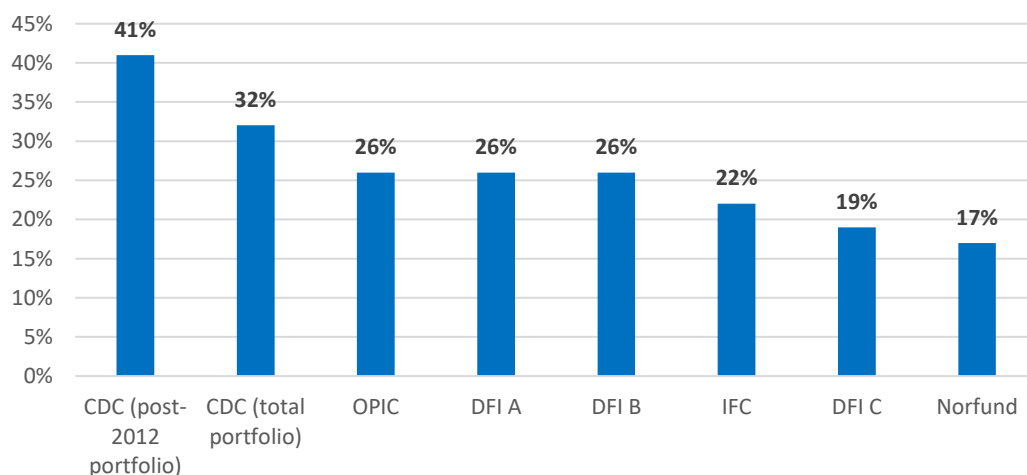
<sup>79</sup> Based on DFID’s 2016 FCAS list. Source: CDC database. Year end estimates. Includes legacy investments in FCAS outside of CDC’s current geographic scope. Does not include investments made by the Impact Programme.



Note: volatility in the relative share of the post-2012 strategy in FCAS in early years (2012-14) is due to the small size of this portfolio in absolute terms.

121. **The share of CDC's portfolio invested in FCAS (as per DFID's classification of FCAS) is high compared to that of other bilateral and multilateral DFIs (figure 17):** 41% of CDC's post-2012 portfolio and 32% of its total portfolio are in FCAS, compared to 22% for IFC or 17% for Norfund. However, DFIs with a larger total portfolio may still have a higher absolute value invested in FCAS (e.g. IFC portfolio of \$52bn, of which \$17bn invested in FCAS).

**Figure 17: Estimated share of major DFIs' portfolios in FCAS, 2016 (%)<sup>80</sup>**



122. **FCAS are a priority for all teams across products and sectors:** 45% of CDC's direct equity exposure under its post-2012 strategy is in FCAS. Recent debt investments have been made in Nigeria, Myanmar and Pakistan. CDC's two biggest sectors (infrastructure and financial services) also have high exposures in FCAS.

123. Investments in FCAS are extremely time-intensive for CDC staff, involve high risks (in everything from staff travel to security to economic risk), can be quite small, and often significantly underperform. In particular, FCAS pose heightened challenges for environmental, social and business integrity risks and CDC has put in place a range of

<sup>80</sup> Source for CDC data: CDC database. Year end 2016 estimates. Excludes the Impact Programme portfolio. Source for DFI data: publicly available commitment databases and privately shared data (in which case the name of the DFI remain confidential). CDC analysis, unconfirmed by other DFIs. Estimates at end of 2016.

processes to address these.

124. **DFID requires CDC to apply enhanced environmental & social (E&S) and business integrity (BI) due diligence and support when investing in FCAS.** Contextual risks in FCAS mean that E&S and BI risks and issues can be significantly more common and complex and difficult to manage (in part, because some issues a company may face lie outside of their direct control, and relate to the generally more fragile and weak governance structures within the country).
125. **During the previous strategy period, the E&S team recognised this risk and put in place appropriate E&S Due Diligence (ESDD)** for direct debt and equity transactions, and to the extent possible engaged on existing and emerging funds operating in FCAS environments to provide additional support and guidance on E&S risks and issues. The E&S team developed guidance for Fund Managers<sup>81</sup>, and engaged with external parties (for example on land rights and related issues) to ensure CDC was fully cognisant of emerging approaches to E&S management (including the broader human rights agenda that has evolved from the UN Guiding Principles on Business and Human Rights). CDC's Code of Responsible Investing has been updated to reflect evolving standards and practices and forms part of CDC's 2017-21 Investment Policy as set out in para 222 in the management case.
126. **Moving forward, IFC's Performance Standards will continue to form the basis for CDC's ESDD and management of investments (including via Intermediated Equity).** These standards provide a robust E&S framework within FCAS but CDC will consider whether enhanced ESDD practices are required on a transaction by transaction basis for debt and equity transactions (and will provide similar guidance and support via intermediated equity deals). For example, additional consideration may need to be given to (amongst other factors) labour practices, supply chain risks and issues, land acquisition, and the use of security personnel in FCAS transactions
127. The E&S team will work closely with deal teams, investees, GPs and others to ensure that risks and opportunities are understood and managed / delivered appropriately, with a **particular focus on contextual risks**. The resource and monitoring implications of investments in FCAS (including the safety and security of CDC staff) will form a specific element of CDC ESDD processes and will be discussed during relevant Investment Committees.
128. **Control and influencing measures** (such as investment agreements, E&S Action Plans, E&S Sub Committees, effective stakeholder engagement and grievance recourse mechanisms, and collaboration with co-investors) will form part of the menu of options that CDC will deploy to reduce E&S risks and drive value in FCAS investments.
129. **Support to Funds operating in FCAS will also continue to be strengthened.** In the previous investment period, CDC's ESG Toolkit was enhanced to include specific guidance on human rights risks as well as guidance on labour practices and supply chain risks which are often more significant in FCAS environments. These efforts will continue under the current investment period.
130. In respect of BI, FCAS tend to experience high levels of corruption as a result of weak capacity within government institutions and potentially uneven enforcement of law. In addition, there can be close links between the political and business elite as well as the use of nominees or complex ownership structures to obscure beneficial ownership. Companies are also rarely able to influence or change this environment, and their competitors may not operate to the same standards of integrity.
131. **The BI team adopts a risk based approach to its due diligence. Heightened**

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<sup>81</sup> <http://toolkit.cdccgroup.com/e-and-s-briefing-notes/human-rights>



**risks in FCAS imply a greater level of intensity and dedication of time and resources to understanding the risks related to the proposed investment.** Additional resources are required due to the increased difficulties which are encountered in FCAS in performing the BI related due diligence. For example, the scarcity of public records in many FCAS, and the lack of reliable independent media sources in some, complicate integrity due diligence research. In addition, companies and fund managers may require extensive help and advice on dealing with BI issues specific to their country or region. These factors represent challenges for the CDC BI team. When relevant, these challenges are raised for consideration in Investment Committees.

132. **As CDC's portfolio in FCAS grows, the BI team continues to enhance its risk assessment methods for bribery and corruption in these markets.** This includes dialogue with external stakeholders familiar with integrity environments in FCAS. The BI team also continues to develop both monitoring processes and guidance for investees to ensure that new developments in FCAS and CDC investees' circumstances are reflected in CDC's overall approach to BI. **The BI team will continue to extend its focus in providing support to portfolio companies and funds to drive change and raise BI standards in FCAS.**

133. **Going forward, CDC will take a number of steps to invest a significant share of its portfolio in FCAS:**

a. **Strengthening CDC's local presence:** CDC is currently appointing in-country representatives in Africa and South Asia. This will strengthen CDC's local presence, fostering its knowledge of local markets and building its credibility, as well as supporting portfolio management efforts. Local teams will also be able to draw on the expertise of DFID country offices. CDC is represented in two FCAS, DRC and Kenya, and is actively considering a presence in Pakistan.

b. **Building networks of future leaders in Africa and South Asia.** In 2015, CDC launched the Africa List, a network based on select communities made up of the future leaders of the top 100 companies in a country. This initiative helps CDC build local knowledge and profile and develop connections with potential partners and investees. The Africa List operates in five countries at the end of 2016, including three FCAS: Uganda, Ethiopia and DRC. CDC plans to launch a similar initiative in South Asia in the future.

c. **Supporting strong regional businesses.** CDC aims to work with regional leaders, such as Globeleq, to support their expansion to the most difficult geographies.

d. **Testing innovative approaches.** CDC will innovate with different corporate structures, so that high calibre people can be engaged across multiple investments in smaller economies.

e. **Strengthening portfolio management capabilities:** To make investments in particularly difficult markets, an ongoing and comprehensive approach to portfolio management is particularly important to make sure risks are adequately managed and the investments will deliver the envisaged development impact

## **10.2. Climate change – a key theme in the new strategy**

134. As set out in CDC's **climate change policy**, CDC assesses climate change risks and opportunities in its direct investments, incorporating climate factors into due diligence processes and undertaking measures to reduce energy and water consumption and potential greenhouse gas ("GHG") emissions through audits and feasibility studies. CDC also has a **coal policy**, which excludes investment in coal-fired power plants except in exceptional cases. The policy is in **line with HMG policy**

**designed for Multilateral Development Banks.** CDC has not made any investments in coal-fired power plants since 2012.

135. The **Paris agreement entered into force in 2016** and charted a new course by setting a framework for governments, investors, businesses and all parts of society to transition to a low-carbon economy to keep global temperature rise well below 2 degrees. Accordingly, CDC's **new five year strategy makes a clear strategic commitment to combatting climate change:**

a. CDC will continue to identify **climate-related opportunities in investment proposals across the portfolio (both mitigation and adaptation).**

b. For **all new infrastructure investments**, CDC will ensure they are **resilient to adapt to the impacts of climate change and take consideration of the low carbon transition.**

c. CDC will **begin to monitor, track and report on indicators** for renewable energy (clean capacity installed, avoided GHG emissions, volume of displaced black carbon from off grid solar home lighting systems), and energy / water efficiency (number of audits, aggregate savings and corresponding GHG emission reductions) for relevant investments. In addition, CDC will report to DFID the share of CDC's portfolio that can be classified as climate-related investments as per an agreed methodology between both institutions.

d. CDC will continue to **engage with the broader investor, DFI and civil society community** to share experiences, learn from others and explore co-investment opportunities.

136. CDC's investments in renewable energy have steadily increased. CDC has committed US\$315m of investment to renewable energy, supporting a portfolio of 5.75 GW of capacity already in operation or currently under construction. CDC has also begun to invest in the growing off-grid energy sector, for example M-KOPA and Energy Access Ventures.

137. CDC's emerging **innovative strategies in the higher risk area respond to some of the key challenges in relation to climate change**, by increased investment in resource efficiency, local currency financing for off grid solar products, and transmission and distribution. More details on those are provided in the financial case.

### **10.3. Women's economic empowerment - a key theme in the new strategy**

138. During the CDC investment process, **CDC's ESG team considers gender impacts.** As part of CDC's annual monitoring, since July 2013, CDC has required all investee businesses to report gender disaggregated employment data.

139. Through the E&S due diligence process in direct investments, the team seek to understand risks such as project impacts on vulnerable groups including women, compliance to the ILO Core Conventions, workplace discrimination, wages, labour and working conditions, access to grievance mechanisms, and the inclusion of women in stakeholder engagement processes and community development programmes. CDC will leverage the lessons learnt on debt and direct equity deals to its intermediated equity businesses to increase the scope and scale of gender impacts.

140. Findings from the due diligence process are (where appropriate) **incorporated into a time-bound ESG action plan**, which serves as a monitoring tool post-investment if there are areas of non-compliance. Where there is evidence of poor practice, these aspects are addressed in the plan and change in performance is tracked over time.

141. **Where CDC invests in funds, CDC requires the fund manager to assess discrimination** (as per ILO requirements). Where evidence of discrimination is evident,

CDC expects the fund to address the issue through an action plan (CDC often provides support to the funds to develop these plans). **CDC has also developed guidance within the ESG toolkit for funds on gender and discrimination** which general partners who manage funds can reference and use as the basis for good practice.

142. **CDC's new five-year strategy makes a clear strategic commitment to women's economic empowerment.** It will continue to address CDC's strong practice of non-discrimination and in addition will look at ways in which CDC's investee companies can actively **create value by promoting women's economic participation in CDC's markets.** To do this, CDC has appointed a Gender lead who will coordinate:

a. **Developing a gender strategy by 2018** and implementation plan based on internal review, existing evidence on the business case for women's economic empowerment and best practice from others, including DFI peers.

b. **Studying and publishing successful examples** of improving women's economic empowerment in CDC's portfolio to add to the evidence base.

c. Support initiatives focused on improving women's economic empowerment, such as **peer-to-peer mentoring.**

d. **Monitor and evaluate** the impact of new gender-focused initiatives where relevant.

## C. Commercial Case

The commercial case sets out:

**Section 11** How **effectiveness** of CDC's operations is ensured – through a proven track record, being wholly owned by DFID and direct links between CDC staff investments and performance hurdles

**Section 12:** How **economy & efficiency** in CDC's operations is ensured – through **recycling of capital for further impact** (section 12.1), **additionality to ensure efficient use of capital** (section 12.2), **tight cost controls** (section 12.3), **a fit for purpose remuneration framework** (section 12.4) and **fully accountable procurement and expenses** (section 12.5)

### 11. Effectiveness through CDC's investment expertise

143. **DFID's focus as an active shareholder will be to ensure CDC meet the targets and conditions agreed in the current 5 year investment policy and that our investments through CDC achieve value for money for the taxpayer. We have confidence in CDC's effectiveness because of the following key factors:**

a. In **CDC, DFID owns a purpose built investment company which has a proven track record** of investing in businesses in developing countries to deliver financial returns and development impact – one that is subject to the UK Companies Act and regulated by the UK's Financial Conduct Authority (FCA). Over the past five years, CDC has consistently outperformed performance targets set by DFID in 2012. It has built up the expertise required to undertake direct investments alongside investments in funds. This includes skills required to source, negotiate and structure deals, analyse company valuations, conduct due diligence (as described in para 225 in the management case), as well as support the growth of portfolio companies once the investment is made and in turn negotiate and execute exits.

b. **Being wholly owned by DFID, CDC is uniquely placed to deliver DFID's objectives.** The Department has a long-standing policy not to appoint its own officials to the CDC board, but it does appoint the Chair and two of the non-executive directors. DFID does not interfere with or veto CDC individual investment decisions, but it does set clear strategic direction for CDC through agreement of the investment policy and strategy. These governance arrangements ensure clear lines of accountability from the executive management of CDC to the Board of CDC, and from the Board to the Department as shareholder. This **level of oversight and alignment of objectives** is essential for the scale of funding proposed, the need to pilot new innovative approaches and the outcomes that DFID hopes to achieve. **The management case sets out detailed governance arrangements for monitoring, assessing and taking action on performance.**

c. **The incentive scheme for CDC staff ensures value for money as it is directly linked to DFID's strategy and the performance hurdles** for development impact and a sustainable financial return.

## 12. Economy & efficiency of CDC's operations

### 12.1 Recycling of capital for further impact

144. **Capital returned (principal and profits) from funds invested by DFID in CDC is reinvested into further businesses**, thereby multiplying the effect of every taxpayer pound to generate further development impact. DFID has never elected to pay itself a dividend from CDC's retained profits. But as sole shareholder this is a potential option and would allow funds in CDC to be repaid and reinvested back into other DFID programmes at some future date.<sup>82</sup>

### 12.2 Additionality to ensure efficient use of capital

145. CDC delivers value for money by making investments happen that would otherwise not occur. If private investors are ready to provide capital on the same terms as CDC, then there would be no additional development impact generated by DFID funds invested through CDC. Ensuring the additionality of CDC capital is central to delivery of DFID's strategic objectives.

146. CDC has processes in place to ensure CDC's capital is additional to, as opposed to crowding out, private finance. **CDC's additionality guidelines clearly state that every investment must be justified on either or both of the following types of additionality:**

a. **Financial additionality:** This captures the concept of providing capital where this is not offered at all by the private sector, or not in sufficient quantity, or not on reasonable terms.

b. **Value additionality:** This concept recognizes that CDC typically provides more than money. The onus is on CDC to show that the value additionality provided is (i) valued by the client (as opposed to being "pushed" by CDC), (ii) not offered by alternative commercial providers of finance and (iii) is likely to result in better outcomes than if CDC had not invested. Value additionality includes

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<sup>82</sup> Any such reflows to DFID would count as negative ODA

- i. **Knowledge & advice** (e.g. CDC providing advice on financial, governance or organisational structures, strategy, or potential partnerships)

**Example:** CDC invested in a hospital chain in India in 2013 and has advised the company on their expansion strategy, helped them to fill board positions and supported substantial environmental and social improvements. As a result of these efforts, the company was voted the best healthcare company in India.

- ii. **Quality improvement** of processes, practices or standards (e.g. CDC supporting the adoption of improved environmental, social, business integrity standards)

**Example:** CDC invested in an African transportation infrastructure company in 2014. CDC provided extensive advice on how to improve the company's environmental and social standards. As a result, the company is now part of the Johannesburg Stock Exchange top 30 sustainability index.

- iii. Support for **developmental strategies** (e.g. taking an existing business to more difficult markets)

**Example:** CDC invested in a bank in India in 2014. CDC is providing technical and financial support on their financial inclusion strategy. CDC worked with the Bank on the development and structuring of these activities, one of which included a financial inclusion and literacy program in rural Madhya Pradesh.

- iv. **Reputational improvement** (CDC's engagement with a client sends an important signal to the market which benefits the client by raising its reputation – this type of value additionality is usually combined with one of the others)

**Example:** CDC invested in an agribusiness company in DRC in 2013. CDC has supported the company through a major commercial, environmental and social transformation programme. These changes helped improve the reputation of the company as a result, and with CDC's help, the company has raised a significant amount of debt from other DFIs since CDC's investment..

147. The additionality guidelines are **fully integrated into the investment process** by:
  - a. Setting out for each instrument line (equity, debt, intermediated) how different types of additionality and sub-categories can be assessed, taking into account the differences of instruments while ensuring consistent application across the organisation
  - b. Requiring investment papers to have a distinct section on additionality
  - c. Tracking and reporting on types of additionality for CDC's post-2012 portfolio
  - d. Commissioning external evaluations to assess value additionality for investments that were justified solely on value additionality to assess whether value has actually been provided in practice.

### 12.3 Tight cost controls

148. **CDC operates its business in a highly cost efficient manner relative to the volume of funds under management.** Investment related operating costs in 2014 represented 1% of CDC's portfolio, 1.1% in 2015, and 1.2% in 2016. This reflects the deliberate change in CDC's strategy towards a growing percentage of direct investments in the portfolio (which are more resource intensive than fund investments). It also reflects a more active portfolio management approach, including on environmental, social and business integrity issues, as CDC makes investments in more challenging geographies and sectors. Key cost drivers are staff, travel and legal

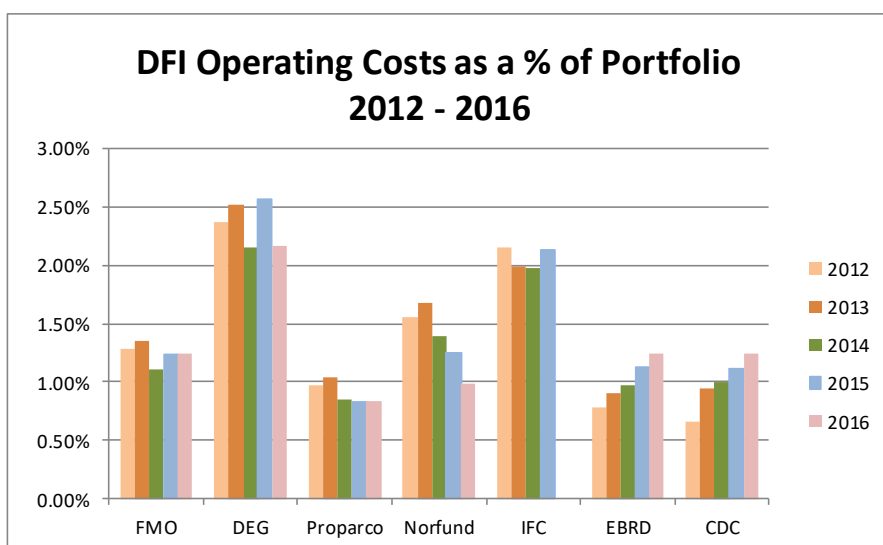
& professional costs. **CDC's operational costs are covered by returns from investments and not DFID, providing value for money.**

149. **CDC strives to ensure its operational costs are effectively controlled through clear governance processes.** CDC's Finance function oversees cost control according to annually set budgets for operational expenses. Annual budgets are approved by the Board and the Finance function coordinates with all departments to establish the forward cost plan and identify efficiency savings. Comparators on operating costs suggest that CDC's procurement and budgeting processes are effective. CDC monitors and improves cost controls and accountability on an ongoing basis.

150. Where CDC invests through funds, it ensures value for money by negotiating management fees (and other value for money elements such as commissions) with fund managers before making any commitment to a fund. Negotiations are based on a detailed review of a fund manager's projected budget for the cost of managing the fund and are compared with other funds in the local and global market to ensure they are in line with market norms. Furthermore, CDC receives annual audited financial statements for each fund in which it invests, which provide further detail on expenses charged to the fund (for example audit costs). The outstanding cost of fund investments (measured as fees as a percentage of invested cost) decreased by 15% between 2011 and 2015.

151. **The NAO concluded that CDC's 'costs relative to the size of its business are low compared with the costs of other development finance institutions'.** At the end of 2016 CDC's operating costs (relative to its portfolio size) were at the lower end of its peer group of comparable European DFIs (figure 18).<sup>83</sup>

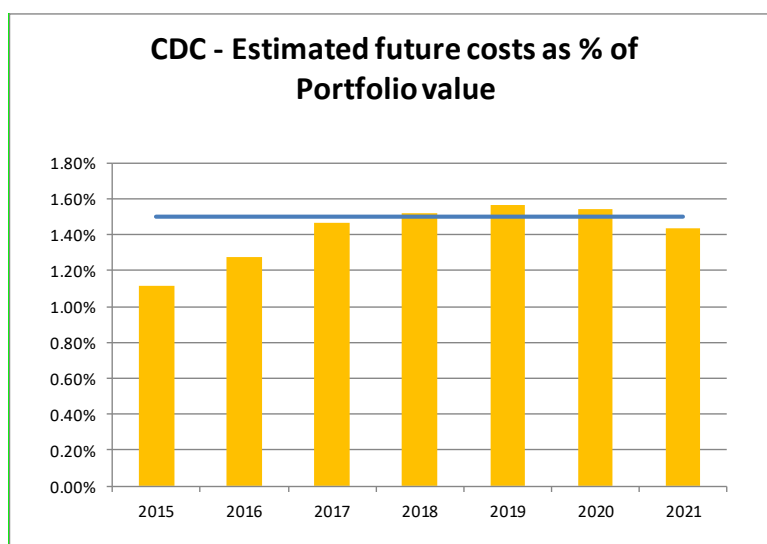
**Figure 18 DFI operating Costs as % of Portfolio, 2012-2016**



152. **Although operating costs are due to rise in line with the new strategy, the ratio is not expected to grow significantly,** The overall ratio is set to remain in the range of 1.5% which is the historic mean across the DFI peer group (2012-2016)

**Figure 19 CDC – Estimated future costs as % of portfolio value**

<sup>83</sup> Based on CDC analysis from respective DFI Annual Reports



a. **CDC's absolute costs will increase as a result of the capital increase, due to the continued shift from funds to direct investing in the most difficult markets and piloting innovative strategies.** Overall, as the portfolio grows and its risk profile increases, portfolio management requirements will rise. These costs will be primarily manifested by increases in headcount, professional services and travel required for increased deal flow and portfolio management.

b. **But in relative percentage terms (as set out above), CDC projects operating costs to remain in the order of 1.5%,** with the additional costs being offset by the growth in the value of the portfolio from the new injection of equity and emerging economies of scale from an existing organisational infrastructure. This presents an additional advantage from scaling up an existing, well established institution as opposed to setting up a new entity or dispersing investment funds among a large numbers of different fund managers/institutions.

153. CDC will benchmark its costs annually against comparator DFIs to give the Board comfort that they provide value for money. **DFID will continue to monitor costs to ensure they remain competitive,** given the nature of CDC's investments and where it operates, and continue to bring more DFID professional commercial expertise to bear in our oversight of CDC's cost management.

## 12.4 Fit for purpose remuneration framework

154. **DFID and CDC agreed a Remuneration Framework in 2012 which set the benchmarks for CDC remuneration against other Development Finance Institutions.** The framework sets out:

- a. the structure and monitoring of remuneration within CDC including limited short- and long-term variable payments linked primarily to long term performance on development impact;
- b. internal remuneration governance, process and authorisation processes within CDC, and monitoring and review mechanisms by DFID and UKGI.

155. **The NAO report in November 2016 noted that 'CDC has addressed Parliament's previous concerns about pay'** and that 'the remuneration framework has had the desired effect on control of salaries' by curbing excessive pay and strengthening DFID's oversight.

156. In March 2017, **DFID and CDC (drawing on advice from HMT and UKGI) concluded an exercise to benchmark CDC remuneration against a peer group of**

**other DFIs and investment entities.** In order to address recruitment and retention challenges, CDC have made adjustments to the existing terms of the framework in line with this.

- a. The organisation still benchmarks at the median to the DFIs, and remains significantly below private equity firms.
- b. In doing so CDC has maintained its approach that staff come to CDC motivated by development impact, whilst offering a realistic remuneration package for people coming from the private equity sector.
- c. The adjustments will enable CDC to manage its ongoing considerable scale up, both with the increase in 2015, and this additional capital, and allow it to hire, retain and motivate the very best people to effectively deliver its mission. There will be a significant head count increase over the coming years, going from 295 in 2017, to an estimated 423 in 2021.

Remunerations levels will continue to be kept under review and be the focus of another benchmarking review in 2020.

## 12.5. Fully accountable procurement and expenses

157. **CDC's policies and processes in other areas are designed to deliver VFM.** is always mindful that it invests and spends taxpayers' money and has developed policies and procedures to address this including its travel and expenses policy, which is published on its website, as well as procurement guidelines to ensure the organisation can demonstrate value for money in that area. These policies and procedures are audited by CDC's internal auditor who reports all audit findings to the CEO and directly to the Audit and Compliance Committee.

## D. Financial Case

The financial case sets out:

**Section 13 How much will it cost and how will it be funded,** incl. providing additional equity to CDC **Section 14 How will the funds be paid out:** incl. issuance of shared in return for equity, and commitment of capital via promissory notes

**Section 15 What will funds be used for:** scaling up CDC's commercial portfolio (section 15.1) and innovative higher risk investments (section 15.2). DFID will manage an M&E contract to evaluate CDC's impact (section 15.3)

**Section 16 CDC's liquidity policy** to ensure adequate management of cash

**Section 17 CDC's policy on offshore financial centres (OFC)** to ensure investment via CDC does not support tax evasion

**Section 18 CDC's processes to manage financial risk and fraud** to ensure taxpayers' money reach to people who need it

**Section 19 Any plans for future investment** which has not been assessed beyond this capital increase

## 13. How much will it cost and how will it be funded?

158. As per the appraisal case, we propose a **base case capital increase of £3.1bn with an option to provide capital up to a maximum of £3.5bn, as there is clear market demand for CDC's investment, strong pipeline and CDC has capacity and**



**capability to do more.** The Appraisal Case further establishes that the capital would be recycled and generate significant benefits. **Up to £20m will be allocated for monitoring and evaluation contracted directly by DFID.** CDC's own administration and operating costs will be covered by the investment returns so there are no separate fees to pay by DFID on top of the capital investment made. As outlined in the Commercial case, CDC operating costs expressed as a percentage of funds under management are forecast to be less than 1.5% representing good value for money for the UK taxpayer.

159. **The funds will be provided to CDC in the form of additional equity.** The amount proposed would increase the total value of DFID equity in CDC from £1.5bn (currently) to £4.6-5.0bn. This is below the £6bn cap on the level of financial support that the UK government is able to provide to CDC under the CDC Act of 2017. Leaving flexibility to provide additional capital in case of severely stressed market scenarios requiring significant counter cyclical investment by CDC.

160. The existing CDC investment has seen strong financial returns and retained profits over the years, meaning that CDC's net assets currently stand at £4.79bn<sup>84</sup>. CDC is reflected in DFID's accounts at fair value in line with accounting standards. The fair value at 31 March 2017 of CDC is £4.79bn which comprises the investment cost of £1.5 bn and a **revaluation reserve** of £3.29bn. This reserve can be used to manage decreases in the fair value should there be any fall in CDC's core value in the future up to the value of the reserve.

161. Sterling financial returns for the portfolio as a whole have shown a high degree of year on year variability, but over the past 5 years have averaged 12.8% per annum. Average portfolio returns are projected to fall over the coming 5 year period, as CDC exits better performing "legacy" investments in China and Latin America and continues the shift introduced in 2012 towards an exclusive focus on more risky markets in Africa and South Asia.

162. As CDC takes innovative higher risk investment on its balance sheet and scales up its use of this higher risk capital it will face increased pressure on its ability to generate returns. To enable CDC to achieve additional impact it needs the capacity to take on a greater level of risk and lower or uncertain risk adjusted returns. **This business case delivers this by lowering CDC's required portfolio return, such that CDC will now be required to remain profitable at an institutional level on a 10 year rolling average (after covering its operating expenses).** CDC is still required to deliver a minimum of a 3.5% return on a 10 year rolling average basis (gross its operating costs) on its commercial portfolio (a target which has become more challenging since 2012 as a result of the low interest rate environment and exit from legacy funds), but bear the additional risk required for the new higher risk portfolio. This increased flexibility means CDC can respond to this opportunity to achieve additional impact. Setting the institutional level target to remain profitable means that CDC does not require ongoing capital injections from the UK taxpayer unless an explicit decision is made by the Government to scale up its activity.<sup>85</sup> CDC invests in highly volatile markets and re-values its whole portfolio every year and therefore annual **portfolio returns can also be expected to be volatile.** To take account of these long-term factors average returns over multi-year periods are used to judge CDC's financial performance.

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<sup>84</sup> Net assets of £4.79bn per the CDC Group Consolidated Statement of Financial Position as at 31 December 2016

<sup>85</sup> As with any investment there is an opportunity cost to CDC's use of its capital in this manner, which is why the governance structure is designed to ensure value for money considerations are taken into account continually over time rather than only at the point of investment.

## 14. How will the funds be paid out?

163. The funds to CDC will be provided in return for CDC ordinary shares being issued to DFID. **Shares will be issued at cost, £1 per share.** According to the CDC Act 2017 **new shares can be issued with the approval of the shareholders, including the special shareholder** (these are the Secretary of State and Treasury Solicitors) at an extraordinary general meeting. HM Treasury consent is also required prior to the share issuance.

**164 Funds will be committed through a series of biannual Promissory Notes (PN)** from 2017 through to 2021. Funds will be lodged at the Bank of England by means of PNs to be drawn down by CDC within an agreed encashment schedule (agreed between CDC and DFID and set out expected dates for the drawdown of funding tranches).

165 The rationale for the use of a PN is that **PNs give CDC the certainty of funding it needs to initiate pipeline expansion, but in advance of the date when the cash actually needs to be drawn down.** DFID has provided 2 PNs to CDC to date, £450m in 2015/16 and £285m in 2016/17. It is expected that both will be fully drawn down by the end of 2017/18. A two-year lag before CDC fully draw down cash against the PN is appropriate<sup>86</sup>.

166 The use of PNs means CDC has the certainty of funding to be able to (i) grow its capacity including hiring additional staff; and (ii) engage credibly with potential investees as it is certain it can follow through. CDC transactions, especially direct investments, require about 18 months from initiation to sign-off; it is unwise for teams to enter into negotiations with counterparties unless they are certain the funds will be available as/when needed. To do otherwise puts CDC's hard build and long term market credibility at risk. PNs provide this certainty over funding together with some flexibility on the timing of the draw down of the cash. As described in the appraisal case, CDC's cash needs are sensitive to changes in market conditions, this means PNs provide an efficient way to manage this sensitivity as CDC only draws down the cash when it is required to finance an investment. **The use of a PN is therefore a prudent and efficient mechanism as it enables CDC certainty to initiate a scale up of its pipeline without the need to hold additional cash.**

167 The timing and amounts for the PNs will be made according to the cash flow and capital demand projections developed for CDC, the forecast is set out below in table 11. These will be kept under close review and any changes agreed between DFID and CDC at quarterly shareholder meetings. To make sure PNs reflect the latest estimates for capital needs and given the impact of changes in market conditions described in the appraisal case (para 88-91), CDC will provide DFID advice on capital needs two years in advance of placing a PN, commencing 2020 as CDC has provided this advice up to 2020 for input into this business case. DFID and CDC will regularly review the capital needs and drawdowns through our shareholder monitoring processes. We are providing CDC significantly less forward visibility than we would ideally like to in 2018 and 2019, this may mean CDC is less able to ambitiously develop pipeline for these years.

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<sup>86</sup> <http://www.nao.org.uk/wp-content/uploads/2015/01/Managing-the-official-development-assistance-target.pdf>

**Table 11: Timing and amounts for Promissory Notes<sup>87</sup>**

£mn	2017	2018	2019	2020 & 2021	Total
Base case	186 <sup>88</sup>	883	897	1,134	3,100

168 CDC's annual accounts close at calendar year end and the audited statements are available as of end March/early April the following year (CDC engage an independent auditor annually). DFID will be able to incorporate the net asset value of CDC into its annual accounts (which follow the UK fiscal year). **DFID's investment in CDC will be measured at fair value as in these accounts.** The DFID programme team will ensure that CDC's audited figures are available to the DFID financial accounting team by mid April each year. The financial reporting framework applied in the preparation of CDC's financial statements is in line with applicable law and the International Financial Reporting Standards (IFRS). The CDC parent company's financial statements are prepared in accordance with the provisions of the Companies Act 2006. The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions, disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006.

## 15. What will funds be used for?

### 15.1 Scaling up commercial portfolio across instruments

169 A capital increase of £3.1-3.5bn plus CDC's recycling of its portfolio will allow total commitments of around £8.9bn (\$11.7bn) over the six years 2017-2022.

170 CDC's **deployment of capital within the parameters of the strategy is agreed with investment teams through five-year investment 'envelopes'**. These are total figures which teams can deploy according to their respective strategies. CDC management fully expects the volume of capital invested in any given year to fluctuate above or below the annual forecast. **Avoiding volume targets is desirable as it removes the risk of poor decision-making** for the sake of deploying capital. CDC is committed to making high quality investment decisions rather than a high volume.

171 CDC will deploy the capital consistent with its Investment Policy, which applies to the whole capital base. **CDC will therefore deploy the new investment capital across the full range of product offerings.** Oversight of the capital increase will be assimilated into existing oversight of the whole portfolio, which includes breakdowns by instrument.

### 15.2 Building on Impact Fund and Impact Accelerator pilots to open new markets through innovative higher risk investments

172 DFID has engaged CDC as an investment manager for the Impact Programme, originally set up in 2012 with a pilot £50m investment component. Following the most recent business extension, approved by the Secretary of State in July 2016, the budget for

<sup>87</sup> .Indicative for 2020 and 2021. CDC will provide DFID advice on capital needs two years in advance of placing PNs in these years. Increases beyond the base case, up to the overall maximum, will be made as required in response to market demand and real world events.

the investment component of the programme is currently £638m.<sup>89</sup> Approximately £100m has now been committed by CDC to impact investing funds and businesses, and thus far disbursements have totalled approximately £33.6m. To coincide with the new capital increase approval process – detailed in this Business case, CDC will also take on ownership of the existing assets under the Impact pilots on its balance sheet and make any new investments using its core capital. The remainder of the £638m of approved budget for the Impact pilots will be combined with additional equity for CDC to determine the total equity injection from DFID to CDC over the coming 4 years. All capital will be available to fund any of CDC’s investment activities.

173 To enable CDC to record the Impact pilot assets on its balance sheet **a capital grant in kind will be completed** to transfer the existing financial assets from DFID to CDC, this is planned to take place at 30 September 2017. This transfer of assets will be recorded using the fair value of the investments at that transfer date based on CDC’s internal valuation. This removes the asset from DFID’s balance sheet. The fair value of DFID’s investment in CDC as at 31 March 2018 (which is based on CDC’s balance sheet at 31 December 2017) will show an increase as CDC will now own the asset with no equivalent creditor offsetting. The net impact on our reserves will be nil. DFID has confirmed with HM Treasury that this transfer will be budget neutral to HMG. The capital grant in kind will be disclosed in the 2017-18 Annual Report & Accounts.

174 The transfer will allow CDC to integrate higher risk operations within the organisation and develop its approach and disseminate lessons learnt. Over the next five years, **CDC intends to deploy an average of \$300m a year on innovative higher risk strategies. In addition to the Impact Fund and Impact Accelerator above, CDC plans to consider higher risk investment opportunities under four new strategies**, CDC will consider other strategies over time. The current strategies are – all with common features of limited upside, greater risk from unproven markets, but potential for additional development impact:

**a. Impact Accelerator:** Through this facility, CDC supports pilots for new, high-impact business models, investment in difficult countries and strategies that target provision of goods or services to the underserved

**b. Impact Fund:** Through this facility, CDC supports investment funds pursuing high-impact strategies such as investing in businesses that provide access to improved goods and services, and income-generating opportunities to underserved groups, or investing in more challenging or fragile regions with limited investment activity.

**c. Improving access to and affordability of health commodities:** In Africa and South Asia, key health commodities, such as medicines and diagnostics, are trapped in a vicious circle of low supply and high prices. Without significant demand, manufacturing will not happen at a scale to bring prices down. To overcome this market failure, this facility will sit between suppliers and buyers of medicines and diagnostics to provide market-based guarantees to underwrite

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<sup>89</sup> The total approved budget of the Impact Programme is £757million, including the two Impact investment funds, technical assistance, market building activities, monitoring and evaluation and programme management costs. Only the two Impact investments funds will transfer to CDC. This funding of £638m was planned over a longer time period than this business case, so it should be expected that less than £638m would be invested in the Impact Funds. As all capital is now provided as core capital the remainder of the funding can be used for other higher risk investment strategies or commercial investment as appropriate. The capital needs of the impact funds beyond 2022 would be considered as part of any future consideration of CDC’s overall capital requirements.

demand – enabling production at greater volumes and lower prices. These guarantees, and the associated market shaping work, will result in expanded, accelerated and more affordable access to essential health commodities.

**d. Tackling challenges in electricity transmission and distribution:** African transmission and distribution networks have suffered decades of under-investment and, unlike power generation, have very few available sources of investment capital. CDC's goal is to establish a structure with the right pool of expertise, capital and mandate to contribute to stronger utilities that will expand energy access and grid stability; reduce power losses; accelerate the introduction of renewables; reduce costs for households and businesses; and improve safety and reduce public and worker fatalities.

**e. Debt financing for off-grid solar:** Grid electricity is unlikely to reach all rural areas of Africa and South Asia for many decades. The off-grid solar market is developing fast with a range of products from small solar lanterns to solar home systems and mini community grids able to support multiple lights, phone chargers and basic domestic appliances. The lack of debt finance offered to businesses, especially in local currency, is a major barrier to the growth of the market. This facility would aim both to provide the capital in the form it is needed, but also promote responsible practices in this important nascent market.

**f. Resource efficiency facility:** This facility will provide finance to our investee businesses to improve their resource efficiency. CDC will provide grants for feasibility studies for energy and water saving measures, and for installation of renewable energy sources for such businesses, followed by low-cost loans to achieve the planned resource efficiency gains as agreed.

175 Following the capital increase, **CDC will steadily build up its business infrastructure to invest, manage and exit a larger portfolio in aggregate.** This requires a major effort in planning, consultation, and execution to do effectively and therefore requires significant lead time. With the assurance of the capital injection and the issuance of Promissory Notes, DFID provides CDC the basis to do so.

### **15.3 Assessing CDC's impact through DFID commissioned evaluations**

176 The business case has a comprehensive evaluation plan (as detailed in the monitoring and evaluation section) with proposals for a new DFID-funded independent evaluation. **An evaluability assessment will be conducted, presently we plan up to a £20 million evaluation budget split as follows.**

a. **£400,000 – Reviews of CDC Strategy** to inform the next strategy review process (2020 and 2024)

b. **£7m – Effective dissemination and promotion of learning**, including activities such as learning from others, gathering additional evidence from other DFIs or other sources, contributing to international debates on measurement and indicators; dissemination activities; ensuring feedback loops and learning into DFID/CDC/other DFIs; collaboration with other DFIs etc.

c. **£12.6m – Evaluating the Development Impact of CDC** through a longitudinal study

### **16. CDC's liquidity policy**

177 CDC needs to have sufficient financial resources to (i) honour short to medium-term commitments as they get called, and; (ii) continue conducting its investment business, including in times of financial downturn or financial constraint. In order to manage this,

CDC has a liquidity policy in place. Under this policy CDC aims to

- a. target cash availability in excess of 80% of CDC's aggregate outstanding contractual commitments (including investment commitments), and
- b. hold cash in an amount equal to between 0% and 10% of its net asset value

178 To meet the first requirement, CDC has negotiated a standby Revolving Credit Facility of \$1.2bn with a consortium of commercial banks. This facility gives CDC access to funds that it could use in the event that a severe downturn limits the market for exits and leaves CDC with commitments that it needs to cover. The presence of the facility, which has remained undrawn, has allowed CDC to steadily reduce the percentage of cash held and, since 30 September 2016, has satisfied both liquidity targets. This means that CDC is able to put more money to work by investing in its markets. As the balance sheet grows CDC expects to continue to review the size of the facility and may look to increase it to ensure that it continues to help CDC reach a balance between prudent treasury management and putting capital to work. Promissory notes which have been deposited but not drawn also provide commitment cover to CDC.

## 17. Offshore Financial Centres and tax

179 CDC revised its policy on the use of intermediate jurisdictions and offshore financial centres (OFCs) as part of the new investment policy for the 5-year period 2017-22. The revised OFC policy reflects developments in international standards since adoption of the prior policy and **places CDC among DFI best practice.**

**180 CDC requires all the companies in which it invests to pay all taxes required to be paid in the countries in which they operate.** Between 2012 and 2016, taxes paid by these companies amounted to over \$13bn.

**181 CDC prefers to invest directly in the country where the investment is located.** Given the weak legal and regulatory systems in some of the countries where CDC invests, CDC sometimes uses OFCs to provide stable financial, regulatory and legal systems for investment to meet its obligations to protect UK taxpayer money and to meet its key objective to maximise the flow of foreign investment into the countries where it operates. **CDC's use of OFCs is not motivated by reducing or avoiding tax liabilities or avoiding transparency.**

182 Recognising that work continues in the area of the use of intermediate jurisdictions, that international standards are evolving and CDC's desire to maintain best practice among multilateral and bilateral development finance institutions, CDC's policy provides that:

- a. CDC will use an intermediate jurisdiction only if:-
  - it is located within CDC's investable universe or
  - it is (i) successfully participating in the Global Forum on Transparency and Exchange of Information for Tax Purposes developed by the OECD with G20 countries and (ii) committed to the automatic exchange of tax information (AEOI).
- b. CDC will review its policy periodically.
- c. Deviation from the policy may be made only in exceptional circumstances requiring the Board of Directors of CDC to make a determination that the exemption is justified and if an exemption is approved, that the decision of the

Board and the reasons supporting the exemption from the policy be reported immediately to DFID.

183 This policy has added the requirement that any OFC that CDC uses to have committed to AEOI. Countries which have committed to AEOI will commence exchanges of information in 2017 and 2018.

184 CDC will apply the Global Forum standard as it evolves. For example, in addition to requiring a commitment to AEOI, the Global Forum is conducting a second round of peer reviews from 2016 through 2020 that include an assessment of their international beneficial ownership standards. In recognition that this area continues to evolve, DFID and CDC will monitor developments and review this policy at least annually with a view to remaining consistent with evolving international standards and the best practice of multilateral and bilateral development finance institutions.

## **18. What is the assessment of financial risk and fraud?**

185 CDC regularly **provides DFID information** (through the Quarterly Shareholder Meeting), how money is used (more details on the reporting framework in the M&E section), e.g. key indicators on commitments, disbursements, receipts, returns, valuation movements, IRR and multiples (for equity), non-performing loans (for debt) as well as an overview of the pipeline (all broken down by geography, sectors and instruments where possible and relevant). In addition, CDC presents information on the cash & liquidity position, management accounts as well as an update on the risk register. CDC has a risk management policy (overseen by the Risk Committee of CDC's Board) designed to assess and manage financial, fraud and other risks.

186 On fraud and corruption specifically, CDC provides information to DFID at QSM regarding its fraud and corruption register (i.e. how many items have been added, resolved, closed etc.). CDC and DFID also have an Information Sharing MOU in place to enhance management of fraud and corruption related risks.

187 Although **fraud against CDC funds cannot be ruled out, considering the inherently risky nature of the markets in which it invests, CDC has strong processes in place to reduce the likelihood as far as is reasonable – both before and after an investment is made**

a. **Focus on upfront due diligence in order to avoid the wrong partners in the first place.** Failing those checks is a prominent reason to reject deals early in the process.

b. **Business integrity checks form an important element of CDCs ongoing portfolio management.** Every quarter, each of the debt, funds and equity teams go through their portfolio and consider risks for each investment

188 In terms of governance, the Board of Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of CDC, and to prevent and detect fraud and other irregularities. The Board is ultimately responsible for CDC's internal control system and for reviewing its effectiveness. The design and operation of the system is delegated to the executive management team. Its effectiveness is regularly reviewed by the Audit and Compliance Committee and the Risk Committee. CDC's internal control system provides the Board with reasonable assurance that potential problems will typically be prevented or detected early with appropriate action taken. Material breaches are reported to the Audit and Compliance Committee and the Risk Committee and are properly actioned. CDC continues to build its business integrity team in line with its increased operations to meet the challenges within the jurisdictions in which it invests. As with any system of internal control, **CDC's system is designed to manage,**

rather than eliminate, the risk of failure and therefore cannot provide absolute assurance against material loss.

189 Further, as a UK entity regulated by the Financial Conduct Authority, CDC is itself required to comply with all applicable UK, EU and international regulations intended to fight financial crime, including money laundering, bribery and fraud. CDC has a full suite of documents (both internal and public facing) which set out its policies on business integrity, anti-money laundering, anti-corruption, whistleblowing and tax and offshore jurisdictions.

## 19. Are there future plans to provide further capital?

190 No decision has been made to provide future capital to CDC beyond this £3.1-3.5bn.

## E. Management Case

The management case provides details on:

**Section 20 DFID's oversight of CDC** incl. an **overview of the governance framework** (section 20.1), the **amended act and modernised articles** (section 20.2), the **updates MoU and Chair's letter** (section 20.3) and **Quarterly and Annual Shareholder Meetings** (section 20.4)

**Section 21 policy framework** incl. for **commercial investments** (section 21.1), **higher risk investments** (section 21.2) and **supporting documents** (section 21.3)

**Section 22 CDC's investment process**

**Section 23 CDC's organisational set-up and capacity for a capital increase**

**Section 24 Management of the programme within DFID**

**Section 25 NAO/PAC assessments**

## 20. DFID's oversight of CDC

### 20.1. A thorough governance framework

191 CDC, as a plc, is governed by a Board of Directors that is answerable to the shareholder (DFID) through the normal company governance process, such as via quarterly and annual shareholder meetings, reports and accounts. DFID appoints the Chair and two of CDC's non-Executive Directors and reviews the matters referred to below in shareholder meetings, but is not involved in CDC day-to-day operations or investment decision-making. This is a long-standing DFID policy designed to demonstrate to the markets in which CDC operates, and to other investors, that CDC goes about its business in a commercial manner and without political interference.

192 Over the course of 2016/2017, DFID and CDC have reviewed and updated all of the **governance documents that set CDCs strategic objectives and define accountability arrangements:**

- a. **Commonwealth Development Corporation Act 1999/2007:** changed CDC from a statutory corporation into a public limited company (plc) (1999) and was amended in 2017 to raise the cap on the amount of financing that government can provide to CDC.
- b. **Articles:** comprise the rules for the running of CDC as a company that have been agreed by the shareholders and the directors.
- c. **Memorandum of Understanding (MoU):** provides details on the broad



governance roles and responsibilities agreed by DFID and CDC.

d. **Chair's letter:** provides additional information for the CDC Chair to understand the priorities of the shareholder, and the personal role and accountability of the Chair for delivering these.

e. **Investment Policy:** sets out CDC's mission and broad objectives, where and in what countries CDC may invest and the financial instruments that it may use.

f. **Strategy:** presents CDC's vision how it will deliver the investment policy

g. **Remuneration Framework:** governing CDC staff remuneration and incentives (as summarised in the Commercial Case)

193. The Department will continue to keep governance arrangements under periodic review but does not intend to change its approach at this time. The governance arrangements were reviewed by the **NAO as part of their study of DFID investments through CDC in 2016 and were judged to be "thorough"**. **The proposed capital increase will not itself give rise to any new governance structures or performance measures.**

## 20.2 The amended Act and Modernised Articles

194. Under **The Commonwealth Development Corporation Act 1999, CDC changed from a statutory corporation into a public limited company (plc)** – "CDC Group plc". The Act sets out the additional requirements that CDC must meet, in addition to those required by the Companies Act and other legislation that applies to CDC.

195. The Act was amended in 2017. The **Commonwealth Development Corporation Act 2017 has raised the cap on the amount of financing that government can provide to CDC to £6 bn** (an additional £4.5bn) and introduced a delegated power to provide for the limit to be raised further by Statutory Instrument up to an upper limit of £12bn. This is the only change made. The CDC Act 2017 has provided the enabling framework for this capital increase, but does not have any implications for existing governance arrangements.

196. CDC's **Articles of Association** set out its governance arrangements. These include the powers of the "special share" held by the Secretary of State, which include the power to appoint and remove the non-executive directors. The Articles restrict CDC's Board and management from making any changes which would go to the core of CDC's mandate without DFID's consent as shareholder. This includes changing the nature of the investment policy and the overall purpose of CDC. The Articles also specify that DFID selects three of the non-Executive Directors, including the Chair.

197. An exercise was undertaken in 2016 by CDC to modernise the Articles to reflect current best practice and changes to corporate law introduced by the Companies Act 2006. This includes the changes in CDC's practices and operations, e.g. procedures for appointing CDC directors). Subsequent to this, CDC and DFID have agreed modernised Articles of Association, which were adopted on 1 August 2017.

## 20.3. The updated MoU and Chair's Letter

198. **The relationship between CDC and DFID is detailed in a Memorandum of Understanding (MoU)** and in a DFID Director-General letter to the CDC Chair (**The Chair's Letter**) which together lay down a framework for how the two parties will behave towards each other.

199. **The MoU sets out the broad governance roles and responsibilities agreed by DFID and CDC, while the Chair's Letter provides additional information for the CDC Chair to understand the priorities of the shareholder, and the personal role**

**and accountability of the Chair for delivering these.** The Chair's Letter covers the role of the Chair in leading the Board, monitoring management and maintaining a strong and close relationship with DFID. The MoU clarifies that the Secretary of State will hold the Board responsible for the delivery of CDC's objectives and performance hurdles as set out in the Investment Policy set by DFID while continuing to leave day-to-day management of CDC, including its investment decisions, to the Board and to the executive management of CDC.

200. **DFID reviewed its oversight of CDC in 2016/2017 in preparation for agreeing a new strategy and Investment Policy with CDC covering the five year period 2017-2021.** The review also benefited from recommendations made in 2016 by DFID's Internal Audit Department and by the NAO's VfM study into DFID investing through CDC.

201. Following legal advice and advice from UK Government Investments (UKGI formerly the Shareholder Executive), **the MoU and Chair's Letter were subsequently updated in Q2 2017 to:**

a. reflect **current practice across government in managing arm's-length organisations** such as CDC;

b. **improve collaboration between DFID and CDC** to increase the joint impact of the two organisations (as detailed in para 208);

c. respond to the NAO's desire to **increase clarity of the arm's-length relationship between the two organisations**, specifically that DFID is not involved in CDC's investment decisions; and

d. signal the importance DFID attaches to the Chair and Board ensuring that **reputational risk is effectively managed.**

202. **In addition and with effect from 2017, the Chair's Letter will be issued annually.** This is now regarded as Corporate best practice. In accordance with the CDC/DFID governance model, these aspirations are not intended to provide direction or guidance on business and operational decisions, but to help inform strategic discussion by the Board.

## **20.4 Quarterly and Annual Shareholder Meetings**

203. DFID, supported by UKGI holds **formal quarterly shareholder meetings to which CDC's Chair, Chief Executive Officer, Chief Financial Officer and Chief Operations Officer attend.** These meetings are used to review and discuss key issues to ensure appropriate shareholder oversight and public accountability and are based on the same monthly information pack that CDC's management uses, including:

a. **Progress against the agreed targets of financial and development return;**

b. **CDC portfolio and financial performance:** including investment levels (commitments and disbursements), receipts, returns, information on individual product lines and the status of the investment pipeline;

c. **Development reporting:** Performance against the Development Impact (DI) Grid (ex-ante). This is complemented by ex-ante and ex-post development reporting through the newly agreed reporting framework set out in paragraph 238;

d. **Operational reporting:** CDC's cash position relative to commitments (demonstrating compliance with CDC's liquidity policy), management accounts and operating expenses, budget and recruitment.

- e. **Risk management:** including a summary of CDC's Environmental & Social performance across the pipeline and portfolio, status updates relating to CDC's fraud and corruption register and a presentation of risks to CDC's impact and operations, including an assessment of impact, likelihood, overall rating and trends
  - f. **Any current strategic matters:** for example, recent agenda items have included plans to pilot new innovative strategies in the higher risk space, CDC's approach to Fragile & Conflict affected states, CDC's emerging sector strategies and updates on CDC commissioned independent impact evaluations.
204. The Annual **Shareholder Meeting** provides an opportunity for a deeper dive into CDC's performance for the year just ended and review of priorities for the coming year. It is attended by DFID's Permanent Secretary as well as the Director General and the full CDC Board.
205. These meetings are supplemented both by other formal meetings (such as annual meeting between each Board Committee and DFID; between the CDC Chairman, CEO and Secretary of State) and also by a variety of ad hoc meetings between DFID officials, UKGI and CDC management as may be required. Furthermore DFID and CDC both operate a mutual '**no surprises**' policy. The objective of this policy is to ensure (to the extent possible in light of political, security or commercial confidentiality reasons), that DFID or CDC shall not be surprised by any circumstances, decisions or actions relating to the other's activities which could have significant adverse economic or political consequences for the respective other organisation.
206. **DFID and CDC share a common understanding that both organisations benefit from close collaboration** where this is relevant for increasing effectiveness of the respective organisations or to advance shared development objectives. Therefore DFID and CDC have frequent interaction beyond the formal governance laid out in its corporate documents, intend to build on, and enhance, existing working relationships and encourage new ways of working together:
- a. **DFID officials hold regular meetings with CDC's Chair, Board Committee Chairs and the CEO and are in regular communication with investment and operational teams** in CDC, including the Development Impact and Environment and Social, business integrity and communication teams.
  - b. **DFID country offices and CDC staff** share information between both organisations aimed at mutual knowledge exchange on sectors, industries and countries of operation. We have also agreed with CDC to **pilot enhanced collaboration in some countries (selection to be agreed)**, to maximise the outcomes from improved collaboration and apply key learning subsequently to other countries.
  - c. **CDC has also recently launched an online CDC/DFID collaboration portal** enabling both institutions to share key documents in one space as well as to provide easy to use access to key country/sector investment portfolio information.
  - d. **CDC and DFID aim to build better visibility, coherence and complementarity between their respective activities.** CDC increasingly engages with DFID on constraints to investment of which it becomes aware during the course of its activities so that DFID might consider how any such barriers might be addressed by DFID's grant programmes. DFID in turn engages with CDC on existing and future DFID programmes to enhance their responsiveness to addressing constraints of investing and mobilising private capital across sectors.

## 21. The policy framework

## 21.1 Commercial investments

207. **Assessment against the Partnership Principles<sup>90</sup> is not required for CDC and its investments as it does not lend to governments.** Nonetheless, CDC is committed to reducing poverty and meeting the Global Goals, and it invests in businesses that can contribute to the achievement of these goals. Through its Code of Responsible Investing (as set out in para 222), all investee companies commit to high standards on human rights, financial management and accountability.

208. The **CDC Investment Policy** is approved by the Secretary of State and by the CDC Board. It sets out **CDC's mission and broad objectives, where and in what countries CDC may invest and the financial instruments that it may use.** The Investment Policy was revised and updated in 2017 and codifies CDC's five year Strategy covering the period May 2017 – December 2021. The Policy contains updates on development impact, anti-corruption, use of offshore jurisdictions and transparency as well as a monitoring and reporting framework (as set out in the Monitoring and Evaluation section). The Policy sets out the **performance hurdles that CDC is expected by DFID to meet and therefore governs how it is incentivised and how its performance is assessed.** Based on a five year strategy review of the period 2012-2016 conducted in 2016 by an independent expert, **DFID and CDC have reviewed the performance targets and agreed to maintain the level of the performance hurdles for the 2017-2021 strategy period for the commercial portfolio:**

a. **A development impact hurdle of 2.4.<sup>91</sup>** The Department has reviewed and agreed changes to the Development Impact Grid – against which CDC measures its Development Impact. Country categories have been updated to reflect the latest available economic data and the DFID fragility index has been included to ensure Fragile and Conflict Affected States are properly prioritised. The prioritisation of sectors in the Grid has also been reviewed. Taken together these changes have increased the difficulty of CDC achieving the target of 2.4, which remains challenging (in terms of geography and sectors) compared to its DFI peers. In comparing CDC DI grid performance against other DFIs and IFIs we found that CDC's DI score is higher than when the methodology is applied to IFC, Proparco, EIB and OPIC which suggest incentives are working well. In addition to the development impact grid the Department has also agreed an improved reporting framework against which CDC will manage progress and measure impacts achieved.

b. **A financial return target of 3.5 per cent.<sup>92</sup>** DFID reviewed the financial return target set for CDC in 2012. CDC's returns over the last 5 years have averaged 12.9%, buoyed by legacy investments made pre-2012 and further boosted in 2016 by a significant foreign exchange gain on investments following sterling's depreciation. Looking forward, CDC's portfolio is increasingly focussed on the poorest countries where risks are high and returns low. Accordingly, the Department's view is that a 3.5% per annum average sterling return remains a suitably challenging target for CDC, particularly in light of global economic headwinds and the fact that returns for fully commercial investors have fallen approximately 2% since 2012.

## 21.2 Higher risk investments

209. **CDC has already piloted higher risk investments.** Since 2012, CDC has

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<sup>90</sup> The Partnership Principles play an important role in the UK Government's decision-making process, helping to inform the extent to which it works directly with partner governments in countries where it has a bilateral aid programme.

<sup>91</sup> Minimum aggregate Development Score for all Investments made during the course of the immediately preceding period of three years weighted by size of investment.

<sup>92</sup> calculated by dividing portfolio value by annual profits and is measured cumulatively over ten years rolling.

undertaken the management of funds under DFID's Impact Programme. This has included two pilots:

- a. **Impact Fund** – A £305m fund of impact investment funds, focused on Africa and South Asia. This was set up in 2012 and has now committed capital of ~£49m to 5 fund managers.
- b. **Impact Accelerator** – A £333m direct investment fund for Africa and South Asia. This began operations in early 2015 and now has committed capital of ~£31m into 5 direct investments in Africa (see Annex F).

210. Both of these funds operate under a mandate to pursue higher risk opportunities. Their activities are governed by separate Memoranda of Understanding (MoUs) that determine the criteria for making investments, as well as financial expectations. The assets and future commitments of each of the pilots is expected to be transferred to CDC together with the capital contribution contemplated by this Business Case as set out in para 175 in the Financial Case.

211. The criteria for selecting investments for the two funds, direct CDC to reach underserved people, support innovative business models and invest in difficult geographies, as well as to create direct and systemic development impact on economies.

212. The MoU directs CDC to employ a commercial approach when it invests Facility capital, using the same rigour in investment choice, design and management as it does when it invests from its own balance sheet. The financial target for this activity is to preserve capital.

213. Management of funds under the Impact Programme has required CDC to build up a commercial team comfortable with this mandate, and to integrate development expertise more comprehensively into deal teams and investment committees to deliver on a more nuanced development mandate.

214. Therefore, CDC has prior experience in successfully implementing these pilot higher risk activities, in adherence to appropriate governance, and in building expertise and capacity to manage capital on that basis. **This makes them well-placed scale up higher risk investments.**

215. To scale up CDC's work in this area, DFID and CDC have agreed a **Letter of Intent that sets out the criteria under which CDC will develop a pipeline of new innovative higher risk strategies (see section 15.2) and begin to scale these.** The Letter of Intent includes:

- a. the **requirements for investments to be made under a 'qualifying strategy'**: which must be approved by CDC's Board and ensures the strategy:<sup>93</sup>
  - i. Delivers **enhanced development Impact**;
  - ii. Is well targeted to **address a clearly defined market failure** and therefore has a broader systemic impact;
  - iii. Is **additional both to private capital and CDC's regular capital**;
  - iv. Is a **time bound use of capital** and therefore sustainable; and,
  - v. Is **consistent with the risk appetite** agreed between DFID and CDC.
- b. **a tolerance for higher financial risks, lower returns and/or a longer holding period** than in the existing Investment Policy, in order to achieve high development impact which could not otherwise be achieved.

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<sup>93</sup> As the higher risk innovative strategies are scaled up, DFID and CDC are focussed on continual learning and improvement. This process of continual learning may lead to an evolution or adaptation of the way these issues are addressed in the relevant strategies to ensure maximum impact and value for money.

c. **a requirement to using the same rigour in investment choice, design and management** as under the existing Investment Policy. To ensure investments can be commercially successful and therefore sustain impact and grow over time.

d. **the CDC Board's approval is required to implement innovative strategies** (as set out in the financial case).

f. **an agreement to develop a blending policy.**

g. it also includes DFID and CDC's intention to reach an **agreement on the planned allocation** of capital between commercial and higher risk capital. The planned allocations are now set out in CDC's Strategic Framework and this businesses case. As noted elsewhere these are planned allocations, which can be adjusted as required by CDC in light of market conditions, performance or other necessary factors.

216. The governance structure for these higher risk strategies is structured to (i) ensure the best alignment of incentives between DFID, CDC and the companies CDC invests in; (ii) provide the flexibility for DFID and CDC to learn lessons and adapt as our experience of implementing these strategies develops; and (iii) ensure there is additional oversight of these new higher risk strategies. As stated in section 3 one of the key challenges for "blended finance" has been to effectively align the incentives between the various actors. By placing capital with a specialist development investor specifically for the purpose of making higher risk investments we can best align the incentives between DFID and CDC because CDC is directly mandated, structured and resourced to seek a greater level of systemic impact through this specific higher risk capital. This avoids the challenges with conventional blending approaches where the DFI seeks deals for their commercial capital, and only seeks blended support for deals which fail to achieve the required return. Instead CDC is equipped to specifically originate deals for higher risk capital which have the potential to achieve systemic impact; and on the basis of the Impact Funds experience this is expected to lead to more consistently high quality and targeted use of higher risk capital.<sup>94</sup>

217. One discipline necessary for deploying higher risk capital is to ensure it does not distort markets, i.e. it is not used to invest in businesses which would attract commercial capital. This is why the qualifying strategies require CDC to determine both that the strategy (as a whole) would not attract other commercial capital and that it justifies the use of concessional capital. This will often require a careful judgement based on the commercial details of the strategy which is why the Board approve the strategies. In addition to this requirement, CDC is also working with other DFIs on this issue and agree common principles and good practice guidance for the use of higher risk investments.

218. **The Letter of Intent will be incorporated into an extended version of the current Investment Policy (the "Expanded Investment Policy")**. While CDC has built experience and expertise in this area through the Impact Funds, both DFID and CDC recognise that this period of scaling up will continue to provide lessons on how to maximise impact through the deployment higher risk capital. As a result the Qualifying Strategy process provides DFID information into CDC's plans in this area and places

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<sup>94</sup> We do not believe there is a risk of CDC using higher risk capital for investments which should be made using its commercial capital. CDC does not use volume targets for its individual teams or instruments, so there is no incentive for CDC to inflate its higher risk investments in this way, if there are insufficient high quality investment opportunities, CDC would simply make less investments. The expected return of an investment is always based on judgement, and will never perfectly match the outcome of the investment. It is to be expected that there will be some marginal cases which require careful judgement on which portfolio they should fall into, this is why the qualifying strategy are approved by the Board and require CDC to justify the additionality of the strategy, including against its commercial portfolio.

additional requirements on CDC and its Board to ensure that higher risk capital is deployed for, and monitors results against the specific objectives set for this capital. The higher risk portfolio will be fully integrated into DFID and CDC's wider governance structure including reporting and shareholder oversight, meaning progress of implementing the strategies will form part of Quarterly and Annual Shareholder Meetings. The DFID Annual Review will include an output specifically on the higher risk strategies which will provide a summary of progress based on the entire reporting, monitoring and governance process. DFID and CDC recognise the importance of continual learning and improvement and this will form part of discussions of these innovative strategies at our regular Shareholder meetings, it should be expected that this process of learning and improvement will lead to evolution and adaptation of the relevant strategies to ensure maximum impact and value for money. In addition DFID and CDC have **agreed to review the progress of higher risk investment at the end of the 2017-2021 strategy period to enable lessons to be incorporated in the next strategy period.**

### 21.3 Supporting documents

219. The **reporting framework** agreed in 2017 is a newly introduced document which brings together all reporting requirements in a single document providing a comprehensive suite of ex ante and ex post reporting across development, financial and operational performance. It also includes the additional areas of reporting we have agreed that CDC will work on over the strategy period including on sector specific indicators and job quality. The document helps respond to criticism from the NAO over the coherence of CDC's approach to reporting and will be a living document which develops over time, particularly as CDC continues to improve its development impact reporting.

220. The **Code of Responsible Investing** forms part of the Investment Policy and sets out how CDC's investments should be managed. It provides **clear ethical, business integrity and environmental and social business principles to guide CDC**, its fund managers and investee companies. The Code also describes those areas of business prohibited to CDC e.g. drugs, military, gambling, pornography and tobacco.

221. DFID have worked alongside CDC to review and update its **Code of Responsible Investing**, to ensure CDC remains a leader in the investment community for responsible investing. The new Code is consistent with the UK position during the World Bank Environmental and Social Safeguards Review. It:

a. explicitly refers to the **UN Guiding Principles on Business and Human Rights as well as the Global Goals**

b. takes a more sophisticated approach on **climate change**, making reference to CDC's Climate Change Policy; and

c. reflects standards on **animal welfare** where CDC will work with relevant portfolio companies to help them understand and implement changes

222. Compliance with the various undertakings contained in e.g. the Investment Policy, MoU and the Chair's Letter, is **tracked during the year via a checklist (List of Undertakings) maintained by DFID** and reviewed on a regular basis with CDC.

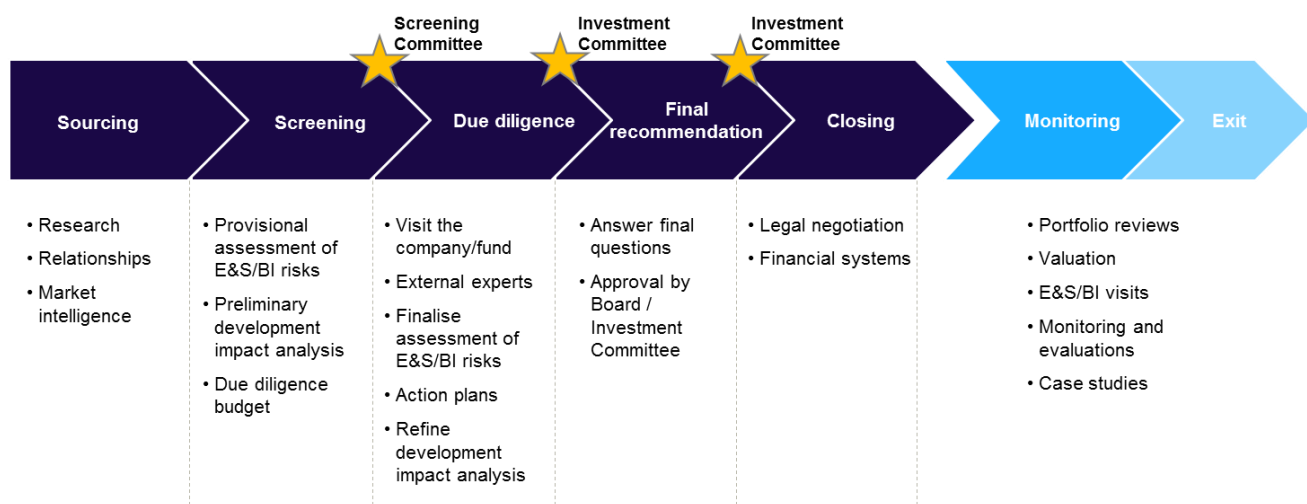
## 22. The investment process

223. The investment process is a multi-stage process until closing with subsequent processes for monitoring and ultimately exit (**figure 21**). Piloting innovative strategies are anticipated to follow the same rigorous process CDC uses for its commercial investments.

- a. **Sourcing:** starts with the origination and logging of new opportunities and the maintenance of a pipeline through research, relationships and market intelligence.
- b. **Screening:** Potential investments which progress sufficiently for the respective investment team to feel they will meet CDC’s objectives for development impact and financial return are then screened by a Screening Committee of the Investment Committee related to that strategy (e.g. funds, debt, equity, infrastructure, financial institutions, Impact) and a due diligence budget will be approved.
- c. **Due diligence:** Proposals which meet initial screening then undergo extensive due diligence, usually involving third party consultants’ reports (including anti-money laundering and know your client checks) and any action plans to raise environmental & social standards of the investee company will be proposed. The proposal then returns to the Investment Committee for an interim review and decision to proceed to final review or not.
- d. **Final recommendation:** After this, the investment team will then undertake final due diligence, and the investment is taken to a final Investment Committee which may, if the investment is above certain Board-specified thresholds or involves particular issues, involve Board members as part of the Investment Committee
- e. **Closing:** If approved, prior to completion, legal negotiations and documentation are concluded.

224. CDC’s E&S, development impact, business integrity and legal teams are involved throughout this process looking at relevant aspects of investments as members of the deal team, working closely with the respective investment teams. Investment documents include opinions from these specialist teams. **The whole process from initial opportunity to completion is long and detailed and (given the complex environment CDC works in) less than 10% of tangible opportunities result in a CDC investment.**<sup>95</sup>

**Figure 20: CDC’s Investment Process**



225. In line with DFID’s long-standing policy, **DFID staff are not involved in the investment decision-making process.** CDC staff occasionally consult DFID staff in country offices on issues of political sensitivity, and where necessary inform DFID of investments that may generate controversy. CDC seeks and welcomes input and guidance from sector teams and country teams at DFID as they often have

<sup>95</sup> Based on an analysis of 655 investment opportunities examined by CDC between January 2012 and September 2015.



complementary knowledge to CDC's, but any decisions if and how an investment proceeds rest wholly with CDC.

226. Within this governance relationship, CDC and DFID intend to build on and enhance existing working relationships and encourage new ways of working together and to build mutual understanding and share information. These intentions around strengthened collaboration are set out in more detail in the 2017 MoU between CDC and DFID. DFID has also issued up-dated guidance to Posts on working with CDC.

227. CDC's Investment Policy serves as a framework for CDC's investment selection. **CDC continues to refine and improve its investment processes.** In 2014, it reviewed the makeup of its investment committees. It added further external expertise onto each committee in order to match the needs of each committee with the skills of its members. These high calibre and highly experienced investors complement the internal members of the investment committee.

228. CDC has comprehensive monitoring and management arrangements for its investments. Formal team discussions about the portfolio they are responsible for occur quarterly and incorporate financial and development performance, E&S and business integrity. The oversight and engagement the investment and specialist teams make after an investment is made, and during the investment, are often at least as important to the quality of investment outcomes as the original investment process. This applies across financial return, development impact, E&S and business integrity.

229. **Exits:** CDC expects to exit from its investments, and to achieve a financial return as well as to have contributed to the achievement of CDC's development mission. An anticipated exit strategy is typically identified for each transaction during the deal development process. CDC has the capacity to deploy "patient capital" (i.e., capital which can be held in investments for extended periods of time, including in excess of 10 years). Funds typically have an agreed life span, with specific investment and exit terms identified, although these can usually be extended under certain circumstances under the term of the investment agreements.

### 23. CDC's organisational set-up and capacity for a capital increase

230. **Following an extensive review at end 2015, CDC's organisation was remodelled to ensure it was structured efficiently for growth.** CDC's organisation is made up of four types of teams:

**a. Investment teams**, which originate and manage CDC's investments

**b. Transaction Support teams**, who provide support to investment teams in specific areas (Environmental & Social Responsibilities, Business Integrity, Legal, Development Impact)

**c. Operations teams**, who ensure the smooth running of the organisation (HR, Finance, and Business Services)

**d. Corporate teams**, who provide corporate management advice and support to the Executive Committee (Strategy, Communications, Risk and Internal Audit and Portfolio Analytics)

231. **Investment teams are structured first by product:** Direct Equity, Intermediated Equity and Debt. Each team reports to a Managing Director who sits on CDC's Executive Committee along with the CEO, CFO and COO. Each product requires a different skill set, which explains why the substructure of each team differs:

**a. The Direct Equity team** is made up of sector teams which reflect CDC's priority sectors: infrastructure, financial institutions, consumer services (covers food & agriculture, health and education) and Industrials (covers manufacturing and construction).

**b. The Intermediated Equity team** is split between two geographical teams aligned with the two regions where CDC invests: Africa and South Asia.

**c. The Debt team** is split into three sub-product teams, reflecting a need for deeply specialised skills: project finance, corporate debt, and financial institutions and trade finance.

232. The **Impact Programme** is divided into two teams, the Impact Fund which sits within CDC's broader Intermediated Equity team, and the Impact Accelerator which sits within CDC's broader Direct Equity team.

233. **CDC is currently present in four countries** (South Africa, DRC, Kenya and India). Staffing in countries is currently driven by portfolio management needs. CDC's Head of Africa and Head of South Asia are in charge of managing CDC's presence overseas. They are based respectively in Johannesburg and Bangalore and sit on CDC's Executive Committee.

234. CDC has grown rapidly over the last five years to increase its annual investment rate. Over the next five years, CDC anticipates that the organisation will continue to grow, albeit at a slower pace. **CDC will continue to deepen its sectoral and geographic expertise and to develop its in-country presence in South Asia and Africa. The growth in the investment teams will be matched with commensurate growth in the transaction support teams, but there will be lower growth in the corporate teams due to economies of scale.**

## 24. Management of the programme within DFID

235. The management of this programme will be integrated into the oversight of DFID's shareholding of CDC. This **coordinated by a dedicated A1 Lead Adviser in the Private Sector Department's Investment Team and supported by four Advisers, an A2L Policy manager and two B1 Deputy Programme Managers.** There will be supervisory and quality assurance inputs from the Head of the Private Sector Department and Director for International Finance and Director General for Economic Development. The Lead Adviser will be the Senior Responsible Officer, accountable for managing delivery, and oversight of all DFID relationships with CDC. **The team consults with advisers from other cadres where relevant on specific policy discussions** (including engaging others as part of the Annual Reviews where relevant) e.g. conflict advisers on CDC's work in fragile countries, gender advisers on gender, Climate and Environment Department on climate change policy, IFID on additionality, and the Chief Economist's office on development impact.

236. Monitoring the implementation of CDC's 2017-201 strategic framework will be a key part of the oversight of this capital increase. In addition to outputs on the performance hurdles in the Investment Policy (development impact and financial return), the logframe will also include outputs on qualifying strategies, sector strategies and implementation of the strategy overall. Indicators will be refined in the first six months following approval of this business case and their ongoing review will form part of the Annual Review process.

## 25. NAO report and assessments

237. **In 2009, the National Audit Office reported on DFID's oversight of CDC<sup>96</sup>, which led to a Public Accounts Committee hearing, and subsequently a PAC report<sup>97</sup>.** The recommendations in these reports led to DFID making a number of changes to the

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<sup>96</sup> Comptroller and Auditor General *Investing for development: the Department for International Development's oversight of CDC Group plc* (HC 18, Session 2008-2009)

<sup>97</sup> Committee of Public Accounts (2009), *Eighteenth Report of 2008-09: Investing for Development: the Department for International Development's oversight of CDC Group plc.*, (HC 94, 2008-09)

strategy and operations of CDC as [outlined in paragraph 242]. In 2013 the NAO undertook a light touch review of DFID's oversight of CDC

238. **In 2016, the NAO decided to undertake a full value for money study on CDC as a follow-up to their 2008/2009 report.** The NAO report, "Investing Through CDC," was published on 28 November 2016. It shows that DFID and CDC have responded positively to the recommendations made back in 2008/09 and that DFID has met 7 out of 10 recommendations from the last PAC report, with the other 3 all on track. Specifically, the **NAO highlights key aspects of CDC's transformation and DFID's strengthened oversight since 2012, as outlined throughout the relevant sections in the business case:**

a. **A stronger alignment between CDC's investment portfolio and DFID's priorities** on the poorest countries in South Asia and Africa and those sectors with the highest propensity to create jobs; **(strategic case)**

b. **Performance targets** that set a framework for CDC to make investment decisions **based on development impact and financial return, which CDC has consistently outperformed** over the past 4 years under the new strategy; **(strategic case)**

c. **DFID's governance arrangements, which are 'thorough'** and confirmation that DFID does not get involved in CDC's investment decision making process; **(management case)**

d. Recognition that **DFID made a convincing business case for the £735 million capital increase in 2015**, which was properly quality assured

e. **CDC has an efficient and economic operating model in place.** Changes in organisational management have been put in practice to respond to the new strategy. CDC now has a separate team to assess development impact. It has lower operating costs as a percentage of total portfolio value than other development finance institutions and a remuneration framework, with strengthened DFID oversight, that has had the desired effect to curb excessive pay; **(commercial case)**

f. **Improved management of cash balances.** CDC is meeting the targets set in its liquidity policy. **(financial case)**

239. The **NAO identified five areas where they recommended further improvements.** DFID accepted these recommendations and the appropriate actions have **either been undertaken or are currently underway, as set out in the relevant sections throughout the business case.** These cover the following:

a. **DFID and CDC should do more to capture CDC's development impact** and provide more consistent reporting of actual development indicators: The NAO suggest that CDC needs to make more progress on measuring quality of jobs and attribution of jobs created to CDC's investment.

DFID and CDC have agreed a new strategy and new investment policy for CDC covering the next 5 years. These expand CDC's approach to development impact to capture the broader impact of CDC investments over and beyond the indicators including jobs created and tax generated that CDC currently report on. CDC also has a further set of evaluations underway and DFID is commissioning a long-term evaluation on CDC, for which the tender process is currently underway. **(Monitoring and Evaluation section)**

- b. **DFID and CDC should embed introduced practices to better capture and record allegations of fraud and corruption:** The NAO recommends for CDC to introduce a central register to consolidate allegations.

CDC and DFID has implemented this recommendation to consolidate systems and produce a centralised fraud and corruption register. CDC and DFID have also agreed a requirement for CDC to report quarterly to DFID an update on the register and have put in place a MoU setting out a basis to confirm and strengthen cooperation between DFID's IAD Counter Fraud section and CDC's Business Integrity functions. **(Management Case)**

- c. **When agreeing the new investment policy from 2017-21, DFID should review the performance targets set for CDC:** The NAO bases this recommendation on the fact that CDC has consistently exceeded both financial and development impact performance targets set in the investment policy.

The performance targets were reviewed as part of setting the investment policy and strategy for the period 2017-2021. **(Management Case)**

- d. **DFID should commission the planned evaluation of CDC's impact on mobilisation,** using the budget approved as part of the 2015 capital increase business case.

The longitudinal study has been tendered for and DFID is in the process of reviewing proposals to take the work forward. **(Monitoring and Evaluation section)**

- e. **DFID should clarify the policy that DFID and other Government Departments are not involved in CDC's investment decision making.** The NAO is clear that there is no evidence of involvement, but that the policy which is already applied in practice should be clearly communicated.

Officials have confirmed the non-involvement policy in the refreshed 2017 governance documents and have also issued guidance to ensure all Government Departments are clear about how DFID and other Departments work with CDC. **(Management Case)**

240. **The NAO report was followed by a Public Accounts Committee (PAC) hearing on 8 February 2017.** In addition to similar recommendations on reviewing performance targets, the need for a strong evaluation plan and agree the evaluation contract of the previous business case, the PAC also asked for a detailed rationale for the current governance arrangements and recommended to agree an approach to recruitment and retention as well as broader staffing alongside the revised remuneration framework and to engage external advisers on the business case. Most of these recommendations have been either already been implemented (review of performance targets and governance arrangements) or will be completed by the end of the year at the latest (evaluation plan, evaluation contract, staffing approaches). Given that this business case follows the same quality assurance process used for the 2015 CDC business case, which the NAO concluded "made a convincing argument for the need for the additional capital": we have not engaged external advisers. DFID has the expertise necessary in house to develop, challenge and quality assure a business case like this (like capital increases to MDBs), incl. the established internal quality assurance processes through the Quality Assurance Unit is overseen by the Chief Economist, the ability to draw on further independent challenge and advice from UK Government Investment (UKGI) and the fact that the business case will also go through Departmental Value For Money Scrutiny processes from HMT.

## F. Monitoring and Evaluation

Robust approaches to monitoring, results reporting and scaled up efforts to generate evidence and knowledge through evaluation will be a critical pillar of our oversight of CDC. Monitoring and evaluation will take place at three different levels, as set out in the following sections:

**Section 26 Internal CDC monitoring** and reporting to DFID, incl. on **investment portfolio and financial performance** (section 26.1), **operations & risk** (section 26.2) and **development impact** (section 26.3)

**Section 27 Internal DFID oversight and monitoring of CDC performance.**

**Section 28 Independent external evaluations of CDC's work and impact** incl. **CDC-led evaluations** (section 28.1) and **DFID-led evaluations**, incl. an assessment of strategy implementation and longitudinal studies on mobilising capital and development impact (section 28.2)

### 26. Internal CDC monitoring and reporting to DFID

**241 CDC undertakes monitoring at a number of levels** and reports back formally to DFID through the quarterly shareholder management reports, annual audited financial statements, a risk management report, an annual report including development results, and independent evaluations. A **new reporting framework**<sup>98</sup> has been agreed for the strategy period 2017-2021. It brings together all reporting requirements in a single document (including the additional areas of reporting we have agreed CDC will work on over the strategy period) providing a comprehensive suite of ex ante and ex post reporting across development, financial and operational performance. It is a living document which will develop further over time, particularly as CDC continues to improve its development impact management systems.

The reporting framework covers the following areas:

- A. Investment Portfolio and Financial Performance**
- B. Operations and Risk**
- C. Development Impact**

242 The reporting provided by CDC **ensures appropriate shareholder oversight and public accountability**. It provides DFID with the relevant information to (i) assess CDC's implementation of the Investment Policy, (ii) assess the development impact of CDC's investments, (iii) assess the economy and efficiency of CDC's operations, and (iv) understand the nature and extent of CDC's risk exposure.

243 As outlined in section 20.4 in the management case, DFID, supported by UKGI, discuss this information with CDC at quarterly shareholder meetings (QSMs) and agree appropriate actions where needed.

#### 26.1 Investment Portfolio and Financial Performance

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<sup>98</sup> Insert quest reference? Will this be published?

244. CDC reports to DFID quarterly information about **the structure and financial performance of its investment portfolio**. QSMs provide DFID with the opportunity to update **our understanding and interrogate CDC's geographical and sectoral exposure, as well as the nature and extent of CDC's financial risk exposure**. Going forward, this reporting will be supplemented with an annual 'deep-dive' to provide DFID with a more extensive review of CDC's portfolio performance. This will take place once a year at an extended shareholder's meeting. CDC's financial reporting covers the following elements:

- Pipeline overview
- Commitments
- Disbursements
- Receipts
- Gross and net returns
- Valuation movements
- Portfolio limits
- Exits and disposals
- Information related to product lines

Where possible and relevant, information will be broken down by geography, sectors, strategy and products (debt, direct equity, intermediated equity).

## 26.2. Operations and Risk

245. CDC's **operational reporting** enables DFID to **assess the economy and efficiency of CDC's operations, and the value for money of its investment into CDC**. This reporting is quarterly and with annual audited figures provided in April/May. It covers the following elements:

### Financial management

- Cash & liquidity position (demonstrating compliance with CDC's liquidity policy outlined in section 16 of the financial case)
- Management accounts, including:
  - Balance sheet
  - Profit & loss statement
  - Cash flow statement
- Operating expenses (with a breakdown by type, and indicating progress against budget)

### Risk management

- Summary of CDC's Environmental & Social performance across the pipeline and portfolio
- Status updates relating to CDC's fraud and corruption register
- Presentation of risks to CDC's impact and operations, including an assessment of impact, likelihood, overall rating and trends (in biannual risk report)

246. In addition to these standard reports, as per paragraph 155 in the Commercial Case CDC will **annually conduct a benchmarking exercise of operating expenses** of a peer group of institutions and report the outcome of this benchmarking exercise to DFID.

## 26.3. Development Impact

247. **CDC assesses both the potential (ex-ante) and actual (ex-post) development impact of its investments**. This enables feedback loops into CDC's future investment decision making and activity. The following elements enable CDC to demonstrate and communicate impact at all stages of the investment lifecycle:

### *Measuring potential development impact (reported quarterly)*

248. A number of factors and methods are used by CDC to assess the *potential* development impact of an investment. These are used to help CDC make a decision about where to invest capital and to give DFID confidence that CDC has the right systems in place to make the best investment choices.

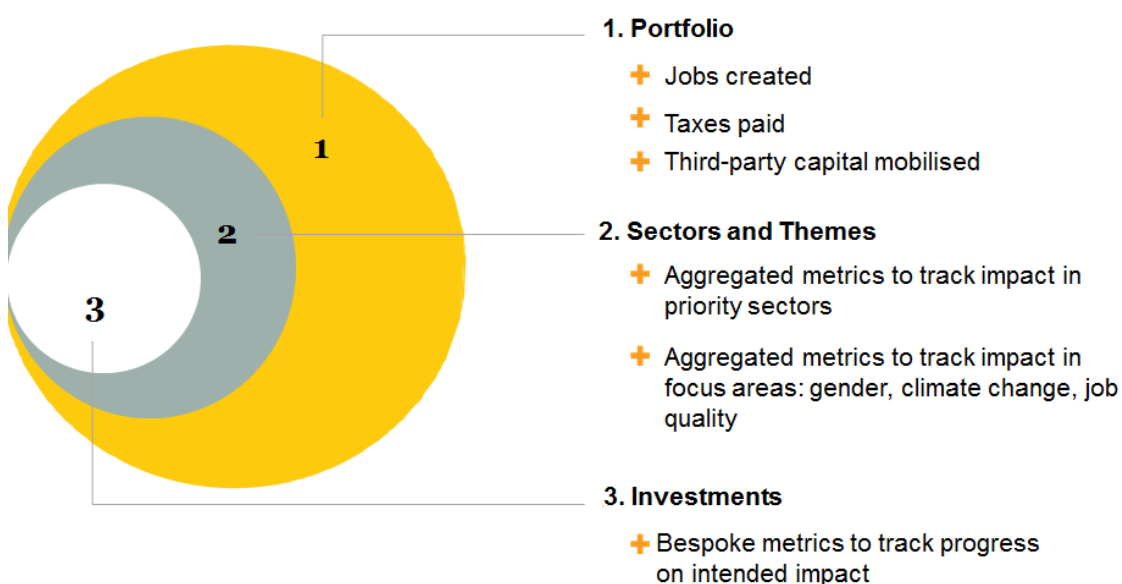
- a. **Performance against the Development Impact Grid** – as detailed in paragraph 120 in the appraisal case and Annex C this gives each investment a score based upon an assessment of its development impact potential (in this case sectoral propensity to create jobs balanced with the difficulty of investing in a given country).
- b. **Impact of individual investments** – under the new strategy, each individual investment and fund commitment will have a clearly articulated development impact ‘thesis’. The development impact thesis is a simple, clear statement of the intended impact of an investment. It is supported by a development ‘case’, which is a credible, compelling and concise argument that explains what impact is sought through the investment, how this impact will be achieved, and what evidence supports these claims. Development theses and cases will be focused on the most significant impacts of the investment. They will build on the specific context of the investment, will be aligned with the core business strategy of the investee company or fund, and will aim to present a balanced and realistic picture of what impact will be achieved.
  - i. To generate a body of evidence to produce the development thesis and case for an investment, CDC may, for example:
    - Review the prospective investment against team and sector strategies
    - Review recent evidence and literature from DFIs / IFIs / academia / development agencies
    - Review what has been achieved in comparable investments
    - Discuss with the investee company; and conduct due diligence where appropriate
  - ii. The results of CDC’s evaluations, as well as DFID’s research and analysis publications and evaluation reports, will form part of the evidence base where appropriate.
  - iii. Development theses and cases will give a more in depth understanding of CDC’s intended impact and will supplement the DI Grid score in CDC’s investment decision making process. The development thesis of each investment and fund commitment will be published, post-commitment, on the CDC website providing a clear and accessible statement to all stakeholders. For each investment and fund commitment, one or two appropriate metrics will be selected to track the actual impact achieved over time. These metrics will be tightly linked to the development thesis of the investment. CDC will monitor the impact of each investment and fund commitment over time through its portfolio management processes.
  - iv. CDC is strengthening its Development Impact function in order to deliver these enhancements.
  - v. CDC will take a proactive approach to the management of development impact at investment level, exploring opportunities for more value addition activities. This approach will help CDC improve their understanding of the impact they can generate, informing future investment strategies. The details of CDC’s approach to defining, tracking and supporting development impact in this way will be finalised during 2017 and first development theses will be published by early 2018.
- c. **Additionality** – As detailed in section 1 CDC capital is intended to mobilise private sector funding, not to crowd it out.
  - i. Additionality assessment is a critical element of CDC’s investment approval process. During deal screening, preparation and negotiations, deal teams

- ii. CDC will track and report on the additionality of its investments, breaking down investments by category and subcategory of additionality (as set out in CDC's Additionality Guidelines).
- iii. In order to ensure CDC actually provided the value that forms the basis for additionality, CDC will commission independent ex-post assessments for each investment which was justified solely on value additionality. This will help to guide CDC's identification and delivery of value additionality.

*Measuring actual development impact (reported annually)*

249. CDC tracks and reports against a number of indicators that assess the *actual* development impact of each investment – at **portfolio and sector/theme level**. All employment, financial and other data used for reporting purposes is collected directly from CDC's investee companies and fund managers. Quality control is conducted to detect, flag and challenge discontinuities, and data provided is also cross-checked against sources in the public domain, such as annual accounts and investor materials.

**Figure 21: CDC's approach to measuring actual development impact**



*Portfolio metrics*

- a. **Number of jobs supported and created by CDC's investee businesses:** CDC reporting of jobs covers actual direct jobs created, in addition to an estimate of indirect jobs created in the wider economy as a result of the investment. CDC has worked with Steward Redqueen, a recognised expert consultancy in this field of economic impact to develop a methodology<sup>99</sup> to estimate the number of indirect jobs created and supported by investee businesses, alongside direct measurement of the businesses' employees. This tool captures total employment effects from:

<sup>99</sup> Measuring Total Employment Effects: a lean data methodology for a portfolio of investments in developing countries  
Alex MacGillivray, René Kim, Tias van Moorsel, and Alice Kehoe, February 2017



- direct jobs at the investee level;
  - supply chain effects within the investees' direct and indirect suppliers;
  - induced effects; due to the spending of wages earned by employees of the investee and its direct and indirect suppliers;
  - economy-wide effects of financial institutions lending to businesses and individuals; and
  - economy-wide effects of power generators and distributors supplying electricity to businesses to increase productivity.
- i. The calculation of indirect jobs is based on an input/output multiplier-based methodology that relies on social accounting matrices (SAM), which describe the financial flows of all economic transactions that take place within an economy. The literature on SAMs originated in developed nations, but recent input-output tables are now available for 120 countries, including developing countries. Although there are some disadvantages to this type of approach<sup>100</sup>, it provides a methodology that allows jobs data to be aggregated across the portfolio. The methodology has been reviewed by DFID, Let's Work partners and a selection of NGOs.
  - ii. CDC and DFID are currently actively working with a number of different stakeholders on the development and refinement of methodologies used by DFIs and multilaterals to calculate indirect jobs created. This includes the 'Let's Work' initiative. 'Let's Work' is a global partnership to create more and better private sector jobs. It has a specific workstream to develop and refine three methodologies for estimating indirect, induced and secondary job effects: macro-economic models; tracer studies; and value chain approaches. Tracer studies and value chain approaches allow more granular study of the effectiveness of interventions in terms of job creation and the creation of high quality jobs and can be used to help verify the results of macro-economic models, such as that used by CDC. Consistent methodologies for these three approaches are being developed during 2017.
  - iii. Going forward, DFID will require CDC to develop ex-post results impact estimates of jobs supported using a combination of value chain surveys and tracer studies on a sample of its investments and use these to validate and continuously refine the ex-ante model's parameters. In parallel CDC and DFID will actively work together with other stakeholders, including other DFIs and within and outside 'Let's Work', to develop a consistent framework to be used by DFIs, MDBs and bilaterals to ensure jobs impacts are being treated consistently across the international development system and that the set of tools used for specific instruments and interventions are fit for purpose. A particular focus of this work will be infrastructure and financial lending which generate the largest indirect jobs multipliers in the current methodology.
  - iv. CDC is also engaging with the Let's Work partnership on issues pertaining to job quality. In 2016, Let's Work published a DEG study on 'Bridging the skills gaps in developing countries' and will continue to produce guidance on issues such as decent work going forward. Through its methodology development on value chain analysis and

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<sup>100</sup> Miller, R. & Blair, P (2009). 'Input-Output Analysis: Foundations and Extensions', Cambridge University Press.

tracer studies, Let's Work is also providing insights on issues such as attribution and possible displacement effects.

- b. Taxes paid by investee businesses:** The taxes paid for investee companies are crucial to fund essential services provided by governments. Only with a strong tax base can developing countries begin to reduce their dependence on aid. The data provided allows DFID and CDC to begin to assess the wider economic impact of investments. Reported tax payments are cross-checked where possible against income statements and cash flows, and CDC also conducts discontinuity tests against revenue and earnings data, and prevailing rates of corporation tax.
- c. Third-party capital mobilised:** CDC aims to crowd in additional private finance through its investments. This is both directly within individual deals it concludes, and indirectly by demonstrating to other private sector investors that deals in developing countries are viable and profitable. CDC currently monitors direct mobilisation of third party private capital into the intermediated equity funds that it supports. CDC and DFID will continue to work together on an improved methodology for CDC to report on finance mobilised from public and private sources across CDC's operations. CDC and DFID will agree an indicator in 2017 which will become part of the formal reporting framework. CDC will align (to the extent possible) with international efforts to agree common methodologies between Development Finance Institutions and Multilateral Development Banks.

#### *Sector and thematic metrics*

- d. Sector metrics:** CDC is currently working with its investment teams to select metrics to track its impact in its priority sectors (infrastructure; financial services; manufacturing; healthcare; food and agriculture; construction; and education). These metrics will be agreed in 2017 and the data provided will enable CDC to capture its impact at the sector level, supplementing the data CDC is able to collect and report across the whole portfolio. Where possible these metrics will be harmonised with those of other IFIs/DFIs to allow more consistent reporting across the development finance community.<sup>101</sup> These sector metrics would, for example, cover the increase in electricity capacity and actual units generated and supplied; and increased supply of financing for productive purposes through investment in financial institutions.
- e. Gender:** DFID and CDC believe that women's economic empowerment can improve the performance of investments and increase development impact. Additional information on CDC's approach to gender can be found in section 10.3. CDC's gender strategy will be finalised in the first half of 2018. CDC will track and report the following:
- Gender disaggregated data at the portfolio level for direct jobs created by investee businesses. (Over time, more granular data may be reported, such as the types and quality of jobs)
  - Impact of bespoke value addition activities created to promote women's economic empowerment

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<sup>101</sup> <https://indicators.ifipartnership.org/indicators/>

f. **Climate change:** DFID and CDC recognise the critical role of private sector investment in mitigating and adapting to the impacts of climate change, and in financing low carbon and climate resilient infrastructure. Detailed information on CDC's approach to climate change can be found in section 10.2. Under its new strategic framework, CDC will work with its portfolio companies to improve resource efficiency and use of renewable energy sources (through the Resource Efficiency Facility discussed in para 176f). Where relevant, CDC will track and report:

- renewable energy (clean capacity installed; avoided GHG emissions; volume of displaced black carbon from off grid solar home lighting systems)
- energy/water efficiency (number of audits, aggregate savings and corresponding GHG emission reductions).

CDC will also report to DFID annually the share of CDC's portfolio that can be classified as climate-related investments, applying the appropriate International Climate Fund classifications. [to insert sentence on ICF reporting]

g. **Job quality:** CDC is working to define the aspects of job quality relevant to private sector investors in the context of the SDG Goal 8, and to supplement its existing focus on compliance with core labour standards with an increasing focus on issues such as staff retention, contractual arrangements, wages and job quality in supply-chains, as well as better communication of health and safety statistics. CDC is currently scoping what interventions to prioritise, something that should be complete by Q1 2018. Following this, CDC will report from 2018 onwards on the learnings from its interventions.

## 27. Internal DFID oversight and monitoring of CDC performance

250. DFID's detailed oversight and monitoring arrangements are set out in the management case. Monitoring will also be formalised within a logframe which is derived from the theory of change as articulated in the Strategic Case. It includes three levels: impact (national level GDP growth, investor perceptions), outcomes (CDC's contribution to economic development through job creation, taxes paid, and private finance mobilised as well as progress against ambitions set out in CDC's higher risk qualifying and sector strategies) and outputs (CDC's development impact and financial performance plus progress made by CDC in piloting innovative investment approaches under agreed qualifying strategies, sector strategies and implementing the new strategic framework).

251. The output level indicators on **development impact and financial performance are the two performance targets set in the Investment Policy**. Each is audited by external experts. The Chair of the CDC Board formally confirms achievement against each target to the Secretary of State by 30 April each year. Once the confirmation and assurances are issued, they are disclosed to the public by CDC. CDC will also prepare an annual report detailing progress made in Qualifying Strategies

252. In addition (as set out in the Investment Policy), CDC will report to DFID in a written statement at the end of each financial year the following **compliance measures**:

- financial performance (including a portfolio breakdown between post-2012 Commitments and total Commitments and its operating costs against the annual budget and investing against the annual projections (or ranges);
- compliance with the Investment Policy;
- compliance with the Code on Responsible Investing;

- compliance with all other CDC operating policies and procedures;
- additionality of new Investments (with a breakdown by type of additionality);
- any refinement of the Development Impact Grid;
- an assurance on compliance with the Remuneration Framework of CDC
- a financial and non-financial risk assessment/mitigation report.

## 28. Independent external evaluations of CDC 's work and Impact

253. Independent evaluations of CDCs impact are critical to help DFID better understand how and in what contexts CDCs investments deliver tangible, sustainable development impact on people, businesses and the economy. Independent evaluations will be commissioned by both CDC and DFID, giving us more in depth information to fill critical evidence gaps; capture and synthesise lessons learned to inform portfolio management and investment decisions; and support transparency and accountability.

### 28.1 CDC led evaluations

254. To date CDC has commissioned a number of evaluations to provide both accountability and learning. In 2015, Harvard Business School evaluated the impact of CDC's funds business 2004-11; in 2016, Steward Redqueen and Research Partners Africa evaluated the link between electricity and jobs in Uganda 2011-14; and in 2017 Imperial College London evaluated the impacts of investments made in healthcare services in India.

255. **CDC will commission at least a further 10 independent evaluations** over the next five years to better understand important themes, such as the impact of investments on firm productivity and the affordability of products and services to poorer segments of society. Evaluation topics are set by the Board's Development Impact Committee each year, and terms of reference for evaluations are drawn up to ensure competitive bids from independent experts. CDC requires evaluations to be peer reviewed and published. These evaluations will bolster CDCs knowledge, guide future investment strategies and contribute to the wider understanding of the development finance community. They will be key pieces of work that will help build DFID's understanding of aspects of the development impact of CDC's investments.

### 28.2 DFID led evaluations and assessments

256. DFID led evaluation will be at three levels:

- a. an **independent assessment of the implementation of CDC's 2017-2021 strategy ahead of the next 5 year strategy review cycle;**
- b. an **independent external longitudinal evaluation of the effect CDC has on mobilising private sector capital;**
- c. an **independent external longitudinal evaluation of CDC's development impact.**

#### ***a. Assessment of the implementation of CDCs 2017-2021 strategy***

257. CDC will implement its new strategy from 2017-2021. This strategy will further enhance CDC's development impact and reach, including through the scaling of new

innovative strategies with different risk/return profiles than the investments made under its current investment strategy. **DFID will commission an external assessment of CDC's strategy in 2020 to inform any adjustments and changes for the strategy period afterwards.** The assessment will evaluate and learn lessons from the scaling of CDCs innovative strategies detailed in section 7.2 of the appraisal case and inform strategic decisions on whether this higher risk approach should be formalised into the new Investment Policy. Amongst other sources, this report will draw from the early findings of both the mobilisation and development impact evaluations detailed below.

### ***b. Longitudinal study on mobilising private sector capital***

258. **DFID is in the process of contracting a supplier to undertake a longitudinal study focussed on the extent to which CDC crowds in private sector investors.**

The funding for this study was approved in the 2015 CDC Capital Increase Business Case. The study will test CDC's theory of change and collect evidence over a 10 year period from a mix of methods (panel surveys, interviews, case studies and econometric analysis). A longitudinal study will enable us to capture changes in investment markets that occur over time and assess whether CDC activity creates systemic changes on investor perceptions in the markets in which it invests. The study will test CDC's theory of change and collect evidence over a 10 year period from a mix of methods (panel surveys, interviews, case studies and econometric analysis) to answer the following two questions:

- a. To what extent has CDC successfully mobilised private sector investment at the co-investment and follow-on stages?
- b. What, if any, have been the systemic impacts of CDC on the private sector investment market?

259. The exact methodological approach will be agreed with the supplier during an inception phase once the contract is awarded in 2017. As well as collecting new data to better understand how CDC has effected changes in investor perceptions and behaviours over time, the study will also help to enrich our understanding of collective DFI impacts. It will produce and disseminate evidence and deliver policy relevant recommendations about what works when it comes to mobilising private sector investment in the most challenging markets

### ***c. Longitudinal evaluation of development impact***

260. **DFID will commission a further evaluation in 2017 with panel data and tracer studies focussing on deepening our understanding of the long term development impacts of CDCs investments.** Given the size, complexity and sectoral breadth of CDC's portfolio a full evaluability assessment will be carried out to refine the evaluation questions and most appropriate methodological approach, including how we can incorporate the use of counterfactuals. The study is likely to include a mix of methods which look at individual investments, sectoral impacts and market level changes over time. It is envisaged that the evaluation will broadly assess the extent to which CDC's portfolio of investments have:

- a. created, either directly or indirectly, sustainable and decent jobs;
- b. created or contributed to sustainable business growth;
- c. contributed to transformational change within a sector or economy;
- d. contributed to economic growth;
- e. contributed to human development and poverty reduction.

261. The DFID led evaluations will be classed as 'priority evaluations'. The Private Sector Department is recruiting an Evaluation Adviser to provide guidance and oversee the process, supported by external advice as appropriate.

262. This is a comprehensive evaluation strategy for CDC that has the potential to significantly increase our understanding of the long term impacts of DFIs such as CDC. A full and detailed evaluation plan which elaborates the approach to be taken and pulls together the different evaluation strands will be developed by early 2018. A key challenge will be to ensure that the information and lessons emerging from the evaluations are fully integrated into investment planning and decision making and disseminated effectively to other DFIs and interested stakeholders. To this end, the involvement of CDC in the design and implementation of the evaluations is critical. An Evaluation Steering Group comprising DFID and CDC, together with external independent experts, will meet periodically to guide design, implementation, dissemination, encourage sharing and harmonisation of approaches with other DFIs and the integration of findings into both CDC and DFID decision making processes.

## **G. Risk and mitigation**

### **29. Categories of Risk**

263 Risk is an inherent component of CDC's activities as an investment company investing in some of the world's poorest countries. CDC has agreed policies, procedures and controls in place to identify, mitigate and manage the following 6 broad categories of Delivery and Fiduciary risk:

- a) **Financial Risk** – underperformance or unacceptable volatility of the investment portfolio return, as well as liquidity risk
- b) **Development Impact Risk** – failure to achieve CDC's development objective to create jobs and make a lasting difference to people's lives in some of the world's poorest places
- c) **Environmental and Social Risk** – a business in which CDC has invested materially damages the environment, causes death or serious injury, fails to deliver appropriate working terms and conditions, or causes social harm
- d) **Business Integrity Risk** – CDC, or a fund manager or portfolio company in which CDC has invested is involved in fraud, corruption, money laundering, terrorist financing, breaches of international sanctions regimes or breaches of other regulatory requirements
- e) **Operational Risk** – loss or other damage to CDC resulting from inadequate or failed processes, people and systems at CDC, including legal risks
- f) **Strategic & External Risk:** The strategic and external risks at CDC are those risks which arise from the context in which CDC is operating and the strategic decisions that CDC has made. They are often long term in nature and frequently outside CDC's direct control

264 In addition, there is an overarching **Reputational Risk** faced by CDC and DFID if management of any of the above is, or is seen to be, inadequate.

### **30. Roles and Responsibilities with regard to management of risks**

265 CDC is structured as an operationally independent public company in order to: (i) ensure that the CDC Board is accountable for delivering objectives agreed with DFID; and (ii) demonstrate to the markets that CDC's investment decisions are commercially driven and are independent of political involvement. This arm's length arrangement is set out

clearly in CDCs governance documents (Act, Articles, MOU, Chairman's letter and Investment Policy):

**a. CDC's Board** is responsible for ensuring that CDC funds are used for the intended purpose (as set out in CDCs strategy and Investment Policy) and are properly accounted for (in accordance with requirements of UK Companies Act). The Board are responsible for approving appropriate risk management policies to manage the above set of risks and deliver the strategic objectives agreed with DFID. A dedicated Board Committee (RiskCo) has been established to oversee risk management and make recommendations to the board on risk management policy and risk appetite. RiskCo is also responsible for identifying the principal risks facing CDC and escalating risk matters to the full Board, when and where required. Other Board committees have specific responsibility for overseeing Remuneration, Nominations, Audit and Compliance and Development Impact.

**b. CDC's Management** is responsible for the design and implementation of the risk management policy and framework within their respective areas of responsibility. Management is responsible for monitoring levels of risk and developing action plans to reduce risks to within appetite (if appropriate) and escalating risk matters to the Board and relevant Committees for their consideration. Management may assign responsibility for the management of specific risks to individuals within the firm. Management is also responsible for setting 'tone at the top' in respect of risk management culture.

**c. DFID** sets CDC's strategic objectives and appoints the Chair of the Board and two of the Non-Executive Directors. But DFID is not directly involvement in CDC's day to day operations or investment decision making. Under this arm-length governance arrangement agreed between DFID and CDC, responsibility for identifying and managing **Fiduciary Risks** and **Delivery Risks** (including those related to **Safeguarding**) is transferred to CDC's Board and management – to those best placed to manage these risks. DFID hold quarterly shareholder meetings (QSMs) with the Chair, CEO and other members of CDC's top management team to exercise ongoing oversight. DFID also obtain assurances from the Board and meet with the chairs of Board level Committees (including RiskCo) at least once a year to review high level risks and how they are being managed.

DFID retain responsibility for managing **Operational Risks** that relate to our capacity and capability to exercise due oversight as shareholder. DFID also retains responsibility for **Reputational Risks** that arise should CDC fail to adequately manage any of the above risks in the manner set out in the Investment Policy (and related codes and frameworks agreed between CDC and DFID).

266. **The following Risk Table details the measures undertaken (i) by CDC to manage Fiduciary, Safeguarding, Reputational and Delivery risks, (ii) by DFID to oversee CDC's management of these risks as well as (iii) the measures DFID has in place to directly manage its own Operational and Reputational Risks in respect of CDC.**

### 31. Risk tables

267. For each identified risk, our understanding of the nature of the risk, including the potential triggers and impact, has been used to assign a relevant mitigation and monitoring plan to reduce each risk to a tolerable level. Risks have been evaluated on the basis of the severity of the risk and the likelihood of the risk occurring, using the following categorisation - in line with DFID wide risk management guidance (tables 1 and 2).

<b>Table 1</b>	<b>Severity of Impact</b>
Insignificant	The outcomes would be limited and fairly manageable
Minor	The outcomes would be slightly damaging
Moderate	The outcomes would be moderately damaging
Major	The outcomes would be damaging
Severe	The outcomes would have a severe negative impact
<b>Table 2</b>	<b>Likelihood of Risk</b>
Rare	Very low probability of occurrence
Unlikely	Low probability of occurrence
Possible	Medium probability of occurrence
Likely	High probability of occurrence
Almost certain	Highly substantial probability of occurrence

Risk	Mitigating Actions by CDC	Additional Mitigating Actions by DFID	Residual Impact	Likelihood	Residual Risk Tier
<b>INVESTMENT RISK</b>					
<p>1. Poor Investment Decisions</p> <p>The risk of poor investment decisions and/or inadequate ongoing monitoring leading to under-performance of the investment portfolio return over the long term, decreasing any demonstration effect to private investor and therefore failing mobilisation objectives.</p>	<p>CDC employs experienced investment professionals to assess investment opportunities and oversee post-investment activity at investee companies.</p> <p>Extensive due diligence is undertaken on proposed deals alongside a multi-stage investment decision making process by CDC's investment committee. Management expertise is supplemented by external subject</p>	<p>DFID oversight actions focus on Quarterly Shareholder Meetings (QSMs) and discussions with the CDC Board.</p> <p>The QSM reporting pack includes detail on APRs and rolling average portfolio returns.</p> <p>At QSMs, the CFO presents Return Attribution analysis, which includes the impact of foreign exchange rate</p>	Moderate	Unlikely	2



	<p>matter experts who form part of the investment committee.</p> <p>Individual investments are monitored on an ongoing basis including periodic formal review meetings (generally quarterly) which allow for issues to be highlighted and proposed courses of action to be discussed and agreed.</p> <p>Portfolio and product level analysis of performance, including performance against the agreed APR target, is conducted and reported to management and the Board on a regular basis.</p>	changes on returns.			
<p>2. Macro-economic risks</p> <p>Systemic shocks negatively impact CDC's financial returns – resulting in medium term impairment, write-downs and write-offs.</p>	<p>Single investment, country and sector triggers are set to ensure that CDCs portfolio is well diversified to reduce impact of shocks. CDC's management monitors exposures against these triggers and there is an agreed review process if a trigger is breached.</p> <p>Portfolio and product level analysis of performance, including performance against the agreed APR target, is conducted and reported to management and the Board on a regular basis.</p>	<p>Quarterly review of performance and portfolio diversification at successive QSMs.</p> <p>As a patient investor, DFID has given CDC the mandate to better withstand such conditions and invest in ways that are counter-cyclical.</p>	Major	Unlikely	3
<p>3. Lack of investible deals</p> <p>Shortage of investment opportunities with the potential to deliver appropriate returns in target geographies and sectors.</p>	<p>CDC has strengthened its investment teams by creating sector teams and recruiting regional and country based investment officers to build the networks required to identify relevant opportunities and oversee portfolios.</p>	<p>DFID uses QSMs to review both CDC's returns and its pipeline of investible opportunities.</p>	Moderate	Unlikely	2

<p>CDC is directed by DFID to invest in some of the most challenging countries in the world – with weak private sectors, limited management capacity, uncertain regulatory frameworks and thin demand from consumers who have a low ability to pay.</p>	<p>Commitment expectations are set on a five-year basis, which allows flexibility to commit when appropriate opportunities arise. CDC's pipeline and progress against commitment expectations are monitored via a monthly report and issues escalated to Management for consideration.</p>				
<p>4. Lack of Liquidity</p> <p>CDC does not have sufficient financial resources to enable it to meet its commitments as they fall due, or can only secure such resources at excessive cost.</p>	<p>CDC prepares cash forecasts to assess capital needs. It has a liquidity policy against which it reports, including a minimum threshold of availability against undrawn contractual commitments.</p> <p>Promissory Notes from DFID are issued based on cashflow projections. These provide CDC with multi-year certainty against which teams can develop future pipelines and drawdown as needed.</p> <p>CDC has also arranged a Short Term Committed Borrowing Facility from a consortium of commercial banks in case of further need.</p>	<p>DFID monitors CDC's liquidity position and forecasts at Quarterly Shareholder Meetings and receives presentations on key determinants, such as the pace of pipeline development and the value of new Investment Committee approvals and commitments.</p>	Major	Rare	2
<b>DEVELOPMENT IMPACT RISK</b>					
<p>5. Failure to meet the DI Grid score target</p> <p>CDC fails to meet the DI grid score target, designed to assess potential development impact.</p>	<p>The Development Impact Grid (DI Grid) and Development Thesis framework focus CDC deal teams at a very early stage on the potential DI of each investment.</p> <p>CDC has a dedicated DI team that tracks the DI of its investments and portfolio, overseen by a dedicated Board Committee (DevCo) chaired by</p>	<p>DFID has full and regular oversight through meetings with the Chair of the DevCo and Quarterly Shareholder Meetings. The Quarterly Shareholder Meetings reporting pack includes mappings of new investments against the DI Grid, trend data and presentations on deals that are at lower and higher ends of the DI continuum.</p>	Moderate	Unlikely	2

	<p>a NED.</p> <p>DI grid scores of individual investments are considered as part of the investment decision making process, and aggregate DI grid scores are reviewed by management and DevCo on a regular basis.</p>				
<p>6. Failure to deliver DI outcomes</p> <p>CDC's ex ante development impact (DI) methodology is inadequate to drive and measure acceptable development impact.</p> <p>Ex post impact assessments do not feed lessons back into investment decisions.</p>	<p>CDC's DI methodology has been carefully designed with external consultants and academics to ensure there is a robust signal ex ante of likely development impact.</p> <p>Ex ante CDC will also articulate the "Route to Impact" of each investee in a defined framework to strengthen the development case for each investment which will be tracked over time.</p> <p>The new reporting framework also sets out development impact indicators at portfolio, sector and individual investment level and requires indicators on women's economic empowerment and climate change.</p>	<p>CDC's mandate is highly developmental, and its Board and Executive Committee are committed to delivery in this area.</p> <p>DFID will continue to work closely with CDC (the Board Development Committee and DI Director) and with other DFIs, to refine DI methodologies both ex ante and ex post. These will be complemented by CDC's and DFID's evaluations.</p>	Moderate	Unlikely	2
<p>7. DI methodologies</p> <p>CDC's methodologies for measuring and reporting development impact are not credible as evidence of impact.</p>	<p>The Board expects CDC to develop best in class methodologies for measuring and reporting development impact,.</p> <p>Periodic assessment and review of CDC's DI methodologies, overseen by the Development Impact Committee</p>	<p>DFID engages closely with CDC on their methodologies, particularly to ensure best practice among DFIs is shared and harmonised where possible.</p>	Moderate	Unlikely	2

<p>8. Market distortion</p> <p>CDC's higher risk investments distort the market, displacing commercial investment and/or do not have additional development impact.</p>	<p>Higher risk investments require different (systemic) impact to be achieved and require higher risk capital (additionality). Investments which achieve systemic impact but do not need higher risk capital would be done under commercial portfolio.</p> <p>Qualifying strategies require CDC to determine the additionality of the approach including that it is additional to commercial DFI (including CDC's) capital. As with any additionality assessment, this will often require a careful judgement based on the commercial details of the strategy which is why the Board approve the strategies.</p> <p>CDC is also working with other DFIs on this issue and agree common principles and good practice guidance for the use of higher risk investments.</p> <p>Route to Impact framework will track development impact of individual investments.</p>	<p>DFID has full and regular oversight of CDC's Additionality through reporting at Quarterly Shareholder Meetings.</p> <p>Phased increase of higher risk approach under qualifying strategies allows a full framework to be developed over time, taking into account lessons learnt.</p>	Moderate	Possible	2
ENVIRONMENTAL AND SOCIAL RISKS					
<p>9. E&amp;S implementation risk</p> <p>Risk that under-performance or breaches in compliance with E&amp;S standards at CDC or a business in which CDC has invested results in material damage to the environment, causes death or serious injury, fails to deliver appropriate working terms and conditions, or causes social harm.</p>	<p>CDC has a long track record of investing in developing countries with weak E&amp;S rules and regulations. CDC has a Code of Responsible Investing, agreed with DFID, which reflects international standards and practices and has recently been strengthened to include modern slavery and animal welfare.</p>	<p>DFID receives a detailed update on E&amp;S issues and progress against ESAPs at Quarterly Shareholder Meetings for each individual direct investment and fund investment.</p>	Moderate	Unlikely	2

	<p>CDC has invested in building up its E&amp;S capability (its core team now numbers 10) to support investment due diligence, monitoring and training its fund managers to use an E&amp;S toolkit.</p> <p>E&amp;S issues are reviewed during the investment committee due diligence stage. Where businesses are not fully compliant with the Code at the date of investment, CDC (or its Fund Managers and Financial Institutions) will work with the investee to develop an Action Plan (ESAP) to ensure it becomes compliant over time. The ESAP is written into the legal agreement between CDC and the investee company, and is monitored closely.</p> <p>Progress is reported to both the Executive Committee and Development Committee.</p> <p>Serious incidents at investee companies are reported to CDC and the E&amp;S team will provide support and guidance for remedial action.</p> <p>CDC has a Complaints Mechanism, which allows anyone to lodge a complaint about CDC - on a breach or suspected breach of the Code or any other aspect related to CDC's work.</p>				
<p>10. Climate Change CDC invests in countries which are</p>	<p>CDC's new five year strategy makes a clear strategic objective to combatting climate change, committing CDC's</p>	<p>DFID will work with CDC to continue to assess best practice in taking advantage of climate opportunities</p>	<p>Moderate</p>	<p>Unlikely</p>	<p>2</p>

<p>most impacted by climate change so its investments could be impaired as a result of climate change events or contribute to increasing climate change related risks.</p>	<p>new infrastructure investments to be climate-resilient and in line with the low-carbon transition.</p> <p>CDC will continue to implement its Climate Change Policy. CDC will continue to identify climate-related opportunities in investment proposals across the portfolio, continue to improve monitoring through new climate indicators and respond to climate changes through some of its new innovative strategies.</p>	<p>and addressing climate risks.</p>			
<p>11. Gender inequality</p> <p>CDC investments do not contribute to reducing gender inequality and increasing women's economic empowerment - objectives that are set out in the International Development Gender Equality Act (2014).</p>	<p>CDC's new five year strategy makes a clear strategic commitment to gender equality and CDC has appointed a Gender Lead.</p> <p>CDC has committed to develop a gender strategy by 2018, reviewing its portfolio; studying and publishing successful examples of improving women's economic empowerment; and developing relevant evaluation systems for new gender initiatives and enhancing current monitoring of gender.</p>	<p>DFID will work with CDC on the gender strategy to ensure emerging best practice is incorporated.</p>	Moderate	Unlikely	2
<b>BUSINESS INTEGRITY RISK</b>					
<p>12. Business integrity</p> <p>CDC or a fund manager or portfolio company in which CDC has invested is involved in fraud, corruption, money laundering, terrorist financing, breaches of international sanctions regimes or breaches of other regulatory requirements.</p>	<p>CDC's Code of Responsible Investment sets out minimum requirements, which CDC, its fund managers and investee companies must comply with, and CDC has a dedicated Business Integrity and Compliance Team.</p> <p>CDC's three stage investment</p>	<p>CDC alerts DFID immediately of any material cases of fraud as and when they arise, which are immediately passed on to DFID's Counter Fraud and Whistleblowing Unit (CFWU). Historically, cases have been low in number.</p> <p>Movements in the number of cases on</p>	Moderate	Unlikely	2

	<p>process and due diligence is designed to identify those deals with business integrity issues that are deemed too risky to progress. CDC's Business Integrity team also monitors the investment portfolio on an ongoing basis.</p> <p>CDC has implemented Business Integrity Policies that take into account CDC's status as an entity regulated by the UK's FCA and seek to ensure compliance with applicable UK, EU and international regulations in this area.</p> <p>CDC has a whistleblowing policy to encourage employees and others to come forward with fraud and corruption allegations without fear of reprisal. CDC also has a Complaints Mechanism, which allows anyone to lodge a complaint about CDC - on fraud, corruption or any other aspect related to CDC's work.</p> <p>CDC has a centralised log which it uses to consolidate reports of material fraud and corruption and record follow up action taken. This log also helps better identify trends and improve risk identification across the portfolio</p>	<p>CDCs fraud and corruption log are reviewed at QSMs.</p> <p>To gain additional assurance on the effectiveness of CDC's controls in this area, DFID meets with the Head of the Business Integrity and Compliance Team periodically.</p>			
<b>OPERATIONAL RISKS - CDC</b>					
<p>13. CDCs capacity to scale up</p> <p>Increased investment activity exceeds CDC's implementation capacity.</p>	<p>CDC have proved their ability to ensure operations are fit for purpose for increase in capital and changes in business model since 2012. This includes CDC successfully recruiting</p>	<p>DFID has full and regular oversight over CDC's progress against the new strategy through Quarterly Shareholder Meetings and weekly meetings and will be aware of any</p>	Moderate	Unlikely	2

	appropriate staff numbers with the right skills (commercial and development impact), increasing the capacity of their operational support teams in E&S and BI, ramping up portfolio management as well as risk processes. CDC will continue to do so going forward, also hiring more people with the right skills for their higher risk operations and increasing their country presence.	issues as they arise.			
14. CDCs capacity to innovate and move into higher risk space  CDC has only recently changed its strategy towards more direct investments, adding more and more innovative forms of capital overburdens the organisation, leading to sub-optimal development results.	CDC has almost 70 years of experience investing to achieve development impact. Under the 2012-16 commercial investment strategy, CDC exceeded its targets scoring an A++ in its last Annual Review. CDC has successfully built a new team with a new focus.  Through implementation of the two higher risk pilot funds, CDC has developed its expertise and capacity to make higher risk investments, providing a strong foundation for further piloting this approach.	DFID will monitor CDC's ongoing performance against each qualifying strategy through QSMs and an Annual deep dive.	Major	Unlikely	3
15. Staff retention and recruitment  CDC cannot retain and motivate investment professionals and key employees, thus delaying investments.  CDC is expanding rapidly – from around 50 staff in 2011 to over 200 at the end of 2016. However, CDC will need to continue to expand in order to meet the higher investment pace and	CDC Management and the CDC Board both recognise that staffing is a critical bottleneck to expanding and evolving CDC. Staffing levels, attrition and progress in recruiting key posts are closely tracked.  CDC Board have benchmarked salaries and on this basis, have made targeted adjustments to its staff remuneration framework with agreement from DFID. CDC	DFID monitors staffing levels through Quarterly Shareholder Meetings, including vacancy, recruitment and attrition rates and their impact on the business.  In addition, DFID meets with the chair of the Remuneration Committee periodically.	Major	Unlikely	3



portfolio size anticipated as a result of this business case.	addresses also non-salary aspects of recruitment and retention, i.e. benefits package overall and implementing associated action from the staff survey				
16. Excessive staff remuneration	<p>In 2017, DFID and CDC concluded an exercise to benchmark CDC remuneration against a peer group of other DFIs and investment entities. In order to address recruitment and retention challenges, CDC have made adjustments to the existing terms of the framework in line with this.</p> <ul style="list-style-type: none"> <li>• The organisation still benchmarks at the median to the DFIs, and remains significantly below private equity firms.</li> <li>• In doing so CDC has maintained its approach that staff come to CDC motivated by development impact, whilst offering a realistic remuneration package for people coming from the private equity sector.</li> </ul>	<p>DFID draws on advice from UKGI and HMT, e.g. for 2017 benchmarking exercise.</p> <p>Remunerations levels will continue to be kept under review and be the focus of another benchmarking review in 2020.</p>	Minor	Unlikely	1
<p>17. Operating costs</p> <p>Other operating expenses and overheads (besides salaries) are excessive.</p> <p>CDC's key operating costs include travel, legal and professional services, communications, IT and premises.</p> <p>CDC'S absolute operating costs are set to increase in the future due to:</p> <p>(i) an increase in the scale of its</p>	<p>CDC manages its costs through a standard set of financial controls: budgets, policy guidance (in areas such as procurement, travel expenses), delegated authorities and approval limits.</p> <p>The overall operating cost ratio is set to remain below 1.5% which is the historic mean across the DFI peer group. This is monitored by CDC's Finance Team and reported to Management and the Board on a</p>	<p>DFID receives a presentation on the Board approved budget in the first Quarterly Shareholder Meeting of each year, and reviews reasons for increases in last year actuals and benchmarking relative to other DFIs.</p>	Minor	Unlikely	1

<p>operations (ii) an increase in direct investments compared to funds and; (iii) a continued push to do more deals in more difficult geographies.</p>	<p>quarterly basis.  CDC will conduct benchmarking of operating cost on an annual basis to ensure they remain in line with the peer group of other DFIs.</p>				
<p>18. Use of OFCs  CDC or CDC supported Fund Managers invest through offshore financial centres that exploit international tax loopholes, leading to reputational risks.</p>	<p>CDC has a policy on the use of intermediate jurisdictions and offshore financial centres (OFCs), which sets out the circumstances under which use of intermediate jurisdictions and OFCs would be considered appropriate. This policy was revised as part of its new investment policy for the 5-year period 2017-22 to reflect developments in international standards since adoption of the prior policy.  CDC will review its policy annually and will apply any additional criteria incorporated into the Global Forum standards as a result of these additional reviews or otherwise.</p>	<p>DFID will continue to engage with CDC on their annual review of the policy.</p>	<p>Minor</p>	<p>Rare</p>	<p>1</p>
<p>19. Poor coordination between CDC and DFID Leading to missed opportunities for closer cooperation, reduced impact, and the potential for reputational risks caused by the lack of alignment.</p>	<p>The formal governance arrangements require regular communication and exchange of information between DFID and CDC.  Beyond the formal governance, DFID and CDC have frequent interaction intended to enhance working relationships and encourage new ways of working together:  1. DFID officials hold regular meetings with CDC's Chair and the CEO and are in regular</p>	<p>DFID will continue to implement the new collaboration activities with CDC to build better visibility, coherence and complementarity between the two.  Guidance has been issued to DFID country offices and XHMG on ways of working with CDC. This guidance will be kept under review and updated as necessary.  CDC increasingly engages with DFID and other HMG departments when it encounters constraints.</p>	<p>Moderate</p>	<p>Unlikely</p>	<p>2</p>

	<p>communication with investment and functional teams in CDC.</p> <p>2. DFID and CDC also recently launched a CDC/DFID collaboration portal enabling both institutions to share key documents as well as to provide easy to use access to key country/sector investment portfolio information.</p>	<p>DFID in turn engages with CDC on existing and future DFID programmes to enhance their responsiveness to the concerns of investors to ensure they unlock flow of much needed private capital across sectors.</p>			
<b>OPERATIONAL RISKS - DFID</b>					
<p>20. Board Oversight</p> <p>DFID appointees to the Board lack the skills and experience to provide effective and independent oversight of the CEO and other members of CDC's Senior Management Team.</p> <p>The Secretary of State appoints the Chair and two of non -Executive Directors.</p>	<p>An effective Chair of the Board is a key control for DFID. DFID's other board appointees also play a critical role in chairing key board committees, approving policies, reviewing progress and holding top management to account.</p> <p>All new DFID appointments to the Board are recruited through an open, transparent, and competitive procedure based on merit:</p> <p>3. Appointee terms of reference are tailored to fill skill gaps required by the Board to fulfil its mandate.</p> <p>4. The Director General at DFID chairs the recruitment panel.</p> <p>5. The UK Shareholder Executive provides expert advice. In circumstances of consistent and/or extreme under-achievement of the Performance Hurdles, the Secretary of State may ask the Board to make appropriate changes in the CDC management appointments and</p>	<p>DFID's Director General and PSD Head of Department regularly engages with Board members - typically monthly and at each Quarterly Shareholder Meeting.</p> <p>A performance appraisal of the Chair is undertaken by the Senior Independent Director of the Board each year.</p>	Minor	Rare	1

	structure, and/or review the composition of the Board.				
21. DFID resourcing  DFID has insufficient staff resource or expertise to perform adequate oversight.	N/A	<p>CDC is a priority for DFID, forming a central plank of DFID's Economic Development Strategy.</p> <p>DFID's CDC team has increased from two full time advisors and one B1 support staff in 2015 to include a balance of financial and development experience, with high engagement from the Head of Department, Director and Director General. The team also draw on other staff where necessary – e.g. legal experts. In addition, the UK Shareholder Executive (ShEx) provides expert advice attending Quarterly Shareholder Meetings and inputting to reviews of results, risk management and the Remuneration Framework.</p> <p>DFID will keep the size and skillsets of the core team under review and assess the case for additional resources as required.</p>	Minor	Unlikely	1

## Annex A: Investment Types

1. This Annex provides more **detail on the types of** investment and instruments that CDC uses.

### Time horizon - short to long-term

2. Investment can be **characterised as long term (generally more than 5 years) or short term investment**. Long term investment (especially patient capital where returns are far off), is often regarded as having the greatest value because:
  - a. it is key for building infrastructure (such as energy, transport and communication infrastructures, industrial and service facilities, housing and climate change technologies);
  - b. needed for growth and also for education and research and development that boost innovation and competitiveness<sup>102</sup>.
  - c. avoids the disruption for businesses that re-financing causes
  - d. minimises cyclical investing and thus volatility of prices
  - e. engaged capital which encourages active voting policies, leading to better corporate governance and improves the performance of the business<sup>103</sup>.
3. Although long term finance is often regarded as the finance having the most developmental impact, **short-term finance can have developmental impact**, especially where there are specific time-based liquidity needs in a market. Trade finance is one such example. Importers and exporters who are often many thousands of miles apart are reliant on tried and trusted means such as letters of credit issued through networks of banks which enable the exporter to know that he will be paid and the importer to know he will get the goods. Systems of on-demand bank guarantees that rely on the bank's promise to pay are also a critical part of the procurement chain. Such products can reduce risk, save the traders' vital time (as they do not need to travel to check/verify goods), improve the liquidity and cash flow of trading parties, and provide local firms with hard currency needed to finance exports or imports necessary for exports (such as cotton for garments). Banks have a limit on the amount of trade finance exposure they can have to a specific country and sometimes a sector. Thus CDC has provided financing in the past to underwrite defaults on trade finance instruments issued by a bank for a country. Via such an instrument for example banks can be able to issue more trade finance documents for the Bangladesh garment sector.

### Types – risk/return spectrum

4. Investment falls into different types – **equity, debt and hybrids of the two (mezzanine)**. These in turn then have different levels of risk, senior debt is repaid before junior debt for example, and return (debt has a certain return, equity has an uncertain one). All types have a role to play in supporting businesses and they have key interfaces between each other. CDC's additionality policy means that it will focus on providing finance of which there is a shortfall in the sector/country.

### Equity

5. Traditionally CDC has developed a reputation as a high quality patient equity provider. This is both because it is more scarce and often more developmental. **Equity investors take more risk** – they are paid last both in terms of financial returns and in the event of insolvency. This makes equity hard to find when businesses need to grow beyond

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<sup>102</sup> Long-term financing of the European economy, Green Paper, OECD

<sup>103</sup> [www.oecd.org/finance/lti](http://www.oecd.org/finance/lti)

friends and family investors. The fact that equity investors wait for their returns makes their capital particularly essential to a business with a longer pay-back period or where returns are uncertain – debt generally requires early payment and has fixed, certain returns. Sometimes debt also demands collateral which can be hard for businesses to find. Without sufficient equity, businesses cannot also take on debt as loan financiers require certain ratios to be in place. Further, by taking a stake in businesses, equity investors are able to improve how the business operates, bringing outside expertise to improve governance, management and technical capacity, which is often lacking in developing countries.

## Debt

6. Loan or debt finance is less risky than equity. It **enables the business to undertake activities that have a good expectation of success earlier than the business would otherwise have been able to** do so if the business had just used existing revenue and cash balances. Debt can be senior (this debt must be paid first in an insolvency) or subordinated to other debt (paid after other debt). It can be secured (with collateral) or unsecured. Where CDC takes a subordinated position this can mobilise senior debt, often from commercial banks. CDC includes requirements (so-called “covenants”) in its loan agreements that borrowers must comply with ESG standards. Through its lending CDC demonstrates to the market that responsible lending to the relevant sectors/regions can be commercially viable at reasonable rates.

## Form – direct or intermediated

### Private Equity funds

7. **CDC has developed an expertise in supporting private equity funds, particularly in the last two decades.** These are effectively pools of equity investments. A fund typically invests in 15 to 20 enterprises which spreads the risk, although fund managers usually have a geographic or sector expertise. A fund manager will usually have a staff of between 5 and 15 members, most of who are on the ground in country – thus offering CDC country expertise where it is not available in house. Private equity funds have been pioneers in emerging markets and particularly frontier markets. With the exception of extractive companies and telcos, large corporates do not venture into frontier investment countries whereas PE funds do. They can take on challenging mandates requiring considerable skill and resource, often working closely with senior management and family businesses or with small-scale power developers.
8. Like IFC, CDC has been a strong supporter of funds where the manager has never managed a fund before but has a promising and often pioneering strategy and a high quality team. These are often diaspora of the country or region who have gone abroad for business school and worked in an investment bank, private equity house or management consultancy but then returned to invest. Such **managers are key in frontier countries and often seek out more innovative and new transactions than traditional funds.** Similarly CDC often supports first time funds. More traditional investors are wary of such funds and thus CDC has strong additionality here – it is critical in getting the fund to financial “close”, sometimes acting as the first investor or anchor investor, thus having a strong signalling effect to the rest of the market and mobilising greater private finance.
9. One advantage of private equity fund investments is the mobilisation effect. When CDC invests in the top fund, that not only sometimes mobilises other private finance as co-investors in the fund but also then additional finance is mobilised in each transaction in which the fund invests. **The private equity fund will typically take a 20% equity stake in a transaction, so other equity and debt financiers come in alongside.** In addition the influence of CDC’s requirements around ESG standards is greater as each portfolio company in the PE fund must also comply with ESG standards in its business.

10. Data on the existence and performance of private equity funds is available to other investors and published in databases such as Preqin. This **track record information is critical for CDC to have a demonstration effect.**

## Annex B: CDC's Development Impact

**Table 12:** Direct jobs supported by CDC investee companies in Africa and South Asia

	2012	2013	2014	2015	2016
Direct jobs supported in Africa and South Asia	402,000	512,000	632,000	605,000	649,000

**Table 13:** Taxes paid by CDC investee companies

	2012	2013	2014	2015	2016
Taxes paid (\$bn)	2.19	2.14	2.34	2.60	4.10

**Note:** the increase in the 2016 figure is largely due to new investments and broader reporting in the portfolio.

### Examples of the Development Impact from a selection of CDC investments

#### Equity

11. **UNICAF:** Africa/Education, 2016, CDC investment \$11.7m
- Founded in 2012, UNICAF is a blended online and physical higher education company dedicated to making international standard higher education available in Africa, at a substantially reduced cost. UNICAF partners with western universities, and offers its own, locally accredited degrees to Africans who are looking to study largely online.
  - CDC's investment supports the introduction of UNICAF higher education learning centres across African cities, including finalising the establishment of a university campus in Malawi. The investment is expected to lead to the creation of around 1,000 jobs.
12. **Feronia:** Democratic Republic of Congo/Agribusiness, 2013, CDC investment US\$43.0m
- Feronia is a 105-year-old agricultural production and processing business focused on palm oil plantations and arable farming in two of the poorest provinces of the DRC.
  - CDC's impact:** The investment was the only way to secure the employment of 9,000 people and the livelihoods of many more. With CDC's support, Feronia has embarked upon a significant, long-term investment programme to return the company to commercial viability, whilst implementing an Environmental and Social Action Plan to enhance key community infrastructure.

#### Debt

13. **Sirajganj 4 power project:** Bangladesh/Infrastructure, 2017, CDC investment US\$103.0m
- The Sirajganj 4 power project is the construction of a greenfield dual-fuel

combined-cycle power plant in the Sirajganj district of Bangladesh.

- f. **CDC's impact:** There are currently 222 workers on the site. When operational, the plant will make a material contribution to reducing power outages in the country. The persistent lack of electricity in Bangladesh is a major barrier to growth and reducing poverty. This project, with a capacity of 414MW, will support Bangladesh's vision for continued growth and development, and provide cost-effective and reliable energy to the country. CDC's investment will enable the construction work to begin and will help deliver a vital energy project with the potential to transform millions of lives.

14. **Indorama Eleme Fertiliser & Chemicals Ltd:** Nigeria/Manufacturing, 2013, CDC investment US\$40.0m

- g. A loan to build and operate a fertiliser production facility near Port Harcourt in Nigeria, and the pipeline to supply the gas required for production. CDC's investment is part of a wider financial package to create the world's largest urea fertiliser manufacturer.
- h. **CDC's impact:** The investment is expected to employ 3,500 people directly during the construction phase, and the business itself will create 360 direct jobs and 250 indirect jobs. Construction of the new plant is now underway. The plant is expected to produce 4,000 tonnes of urea a day, potentially benefiting up to 15 million farmers.

### Intermediated equity

15. **Medpharm Holdings Africa:** Ethiopia, CDC invested through the Ascent Rift Valley Fund, 2015

- i. Medpharm is a holding company for International Clinics Laboratories, the leading provider of laboratory services in Ethiopia – a country that needs increased access to healthcare and this type of services. Medpharm serves over 260 healthcare centres and conducts a range of over 2,000 tests.
- j. **CDC's impact:** Under the investment fund manager's guidance, the company recently opened two wellness centres and introduced new services by setting up a pathology department. It is also expanding its public private partnerships with local hospitals. The company's ambition is to become the most advanced laboratory in the East African region.

16. **Ananta Apparels:** Bangladesh; CDC invested through local fund manager Brummer and Partners (Frontier Fund), 2010

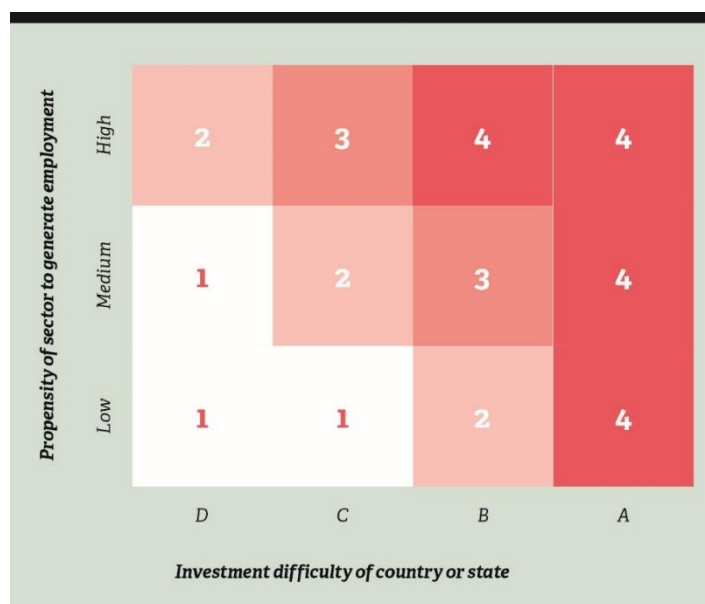
- k. One of the largest garment export businesses in Bangladesh.
- l. **CDC's impact:** Direct employment has increased from 2,000 in 2006 to 17,862 in 2015, with several new factories recently opened. The company makes substantial efforts to ensure its workers, many of whom are women, work in a safe environment. Workplaces have improved considerably – all floors have industrial fans and lights, and factories comply with fire safety regulations and can evacuate workers in minutes. There are also healthcare facilities in each factory, training on health and hygiene, day care facilities for children, and vaccination visits.



## Annex C: CDC's Development Impact Grid

17. CDC's current **Development Impact Grid (DI Grid)** incentivises CDC to make **investments in harder geographies and in sectors which have the highest propensity to create jobs**. It has been a useful tool to focus CDC on targeting and understanding its development impact and driving cultural change. An important aspect of a single proxy indicator and an objectively measurable methodology is to limit gaming by not creating multiple objectives and to concretely link development to CDC staff remuneration.
18. Before investing, each business is given a development impact score based in its sector and geography. To score well, an investment must be located in a country or state that is difficult to invest in and operate in a sector that has a high propensity to create jobs. Combining the two results generates a score from 1 to 4, as shown below. DFID agrees with CDC a target score which it must meet to allow staff to access to long term performance payments. The current target score is 2.4.

**Figure 23:** The Development Impact Grid



19. The CDC DI Grid has two axis:
- m. **Axis X: Investment Difficulty of Country-** an equally weighted index combining: (i) market size (GDP PPP); (ii) income level (GDP/capita PPP); (iii) credit to the private sector (as % of GDP); (iv) Doing Business rankings and (v) a composite measure of fragility designed by DFID.
  - n. **Axis Y: Propensity for Investment to Generate Employment-** an equally weighted index combining: (i) the skilled employment to capital ratio; (ii) the unskilled employment to capital ratio; (iii) the local procurement to capital ratio, measuring supply chain employment and; (iv) economy-wide employment effects of essential infrastructure to remove business constraints, calculated from amalgamated national input-output tables.

**Table 14:** DI Grid classification of CDC’s investment geography

<b>D</b>	<b>C</b>	<b>B</b>	<b>A</b>
Mauritius\$ Morocco\$ South Africa Tunisia\$ Vietnam\$	Algeria\$ Bangladesh\$ Bhutan\$ Botswana Cambodia\$ Cape Verde\$ Egypt, Arab Rep.\$ Gabon\$ Ghana\$ Kenya Lesotho\$ Namibia Maldives Rwanda\$ Seychelles Senegal\$ Sri Lanka Zambia\$	Angola\$ Côte d’Ivoire\$ Equatorial Guinea\$ Lao PDR\$ <sup>①</sup> Libya\$ Mozambique\$ Nepal\$! Nigeria Pakistan\$ Swaziland\$ Tanzania\$	Afghanistan\$ Benin\$ Burkina Faso\$ Burundi\$ <sup>①</sup> Cameroon\$ Central African Republic\$ <sup>①</sup> Chad\$ <sup>①</sup> Comoros\$ <sup>①</sup> Congo, DR.\$ <sup>①</sup> Congo, Rep.\$ Djibouti\$ <sup>①</sup> Eritrea\$ <sup>①</sup> Ethiopia\$ <sup>①</sup> Gambia, The\$ Guinea\$ Guinea-Bissau\$ Liberia\$ Madagascar\$ <sup>①</sup> Malawi\$ <sup>①</sup> Mali\$ Mauritania\$ Myanmar\$ Niger\$ <sup>①</sup> Sao Tome e Principe\$ Sierra Leone\$ Somalia\$ <sup>①</sup> South Sudan\$ <sup>①</sup> Sudan\$ Togo\$ Uganda\$ <sup>①</sup> Zimbabwe\$
Andaman & Nicobar Islands Chandigarh Delhi Goa Gujarat Haryana Himachal Pradesh Kerala Maharashtra Puducherry Sikkim Tamil Nadu Uttarakhand	Karnataka\$ Nagaland\$ Punjab\$ Tripura\$	Andhra Pradesh\$ Telangana\$	Arunachal Pradesh\$ Assam\$ Bihar\$ Chhattisgarh\$ Jammu & Kashmir\$ Jharkhand\$ Madhya Pradesh\$ Manipur\$ Meghalaya\$ Mizoram\$ Odisha\$ Rajasthan\$ Uttar Pradesh\$ West Bengal\$

Red countries indicate those becoming harder since the update in 2012. Green denotes countries becoming easier. Purple indicates new additions to CDC’s investment universe.

Note: The index is based on 2015 data accessed in November 2016. The index will be re-calculated at five-yearly intervals for the duration of CDC’s Investment Policy.

!: Although Nepal would have been a C country, CDC has refrained from making such a change in this five-year cycle because of the economic effects of the 2015 earthquake that are not fully reflected in the 2015 data.

**Figure 22:** Summary of Axis to Y – Propensity for Investment to Generate Employment

<b>Low</b>	<b>Medium</b>	<b>High</b>
Business Services Communications Services* Financial Services* Mineral Extraction	Agriculture Trade*	Construction* Food Processing (including Agribusiness) Infrastructure (incl. Power) * Manufacturing Health & Education (Public Services)

20. Sector categories are subject to the following exceptions:

**Figure 23:** Exceptions to the usual DI Grid sector categories

<b>Sector</b>	<b>Category</b>	<b>Exceptions</b>
Construction	High	Only applies to the construction phase of real estate projects. Operational phase scored as relevant sector category (e.g. business services).
Financial Services	Low	Countries (& Indian states) marked with \$ due to poor access to finance (% of adults with formal accounts &/or firms citing finance as a major constraint), where category is promoted to High.
Communications Services related to Mobile Telecommunications	Low	Countries marked with <sup>o</sup> due to low mobile phone penetration, where category is promoted to High.
Trade	Medium	Categorized as High if >60% of procurement is local (domestic or from other country of higher or equal DI score); categorized as Low if <20% of procurement is local.

21. In the case of investments for the benefit of multiple geographies and/or in multiple sectors, a blended score is calculated using a weighted average based on the amount of the investment allocated to a certain geography and sector.

## **Annex D: Backgrounds of CDC Leadership Team**

### **Nick O'Donohoe, Chief Executive Officer**

Nick O'Donohoe joined CDC as its Chief Executive in June 2017 and is also a member of the CDC Board. He was previously a Senior Adviser to the Bill and Melinda Gates Foundation where he specialised in the use of blended finance models to support the work of the Foundation. Prior to taking this role, Nick co-founded, with Sir Ronald Cohen, Big Society Capital (BSC). He served as its Chief Executive Officer from 2011 to December 2015. BSC is an independent financial institution established by the UK Government as "the world's first social investment bank" and is capitalised with unclaimed UK bank accounts and investment by the largest UK banks.

Previously Nick worked at JP Morgan, latterly as Global Head of Research. He was a member of the Management Committee of the Investment Bank and the Executive Committee of JP Morgan Chase, as well as the senior sponsor for JP Morgan's Social Finance Unit. Nick co-authored "Impact Investments: An Emerging Asset Class", published by JP Morgan and the Rockefeller Foundation in November 2010. Prior to JP Morgan, he spent fifteen years at Goldman Sachs.

Nick served as Chairman of the UK Dormant Assets Commission which reported in March 2017. He is also a board member of the Global Impact Investing Network (GIIN) and Deputy Chairman of the Global Steering Group on Impact Investment.

Nick has an MBA from the Wharton School and a BA in Mathematical Economics and Statistics from Trinity College, Dublin.

### **Colin Buckley, Chief Operating Officer and Head of Corporate Strategy**

Prior to joining CDC, Colin held senior positions at the Children's Investment Fund Foundation, the Millennium Challenge Corporation and the International Finance Corporation. After the Russo-Georgian war of 2008, he advised the Prime Minister of Georgia on the country's economic reconstruction.

Prior to his work in international development, Colin practiced as a US attorney and a UK solicitor in Boston and London.

### **Clive MacTavish, Chief Financial Officer**

Clive was appointed Chief Financial Officer in September 2015 and has management responsibility for CDC's finance, business services and OD/HR teams. He is also a member of the CDC Board. Clive joined CDC after 3 years at Expedia Inc. where he was CFO of Expedia's Global Lodging Group, comprising websites Hotels.com and Venere.com as well as the Lodging Partner Supply business which secured and managed the supply of hotels for all the Expedia businesses.

Prior to Expedia, Clive was Finance Director, EMEA for Dow Jones where he also ran Sales & Marketing and Operations for their consumer media business. This followed over 6 years at the Financial Times where he held a number of roles including Head of Strategy, Global Financial Controller and Finance Director EMEA. Clive joined the FT from parent company Pearson plc where he worked in their head office on FP&A, M&A and corporate strategy.

Clive started his career with PwC and is a qualified accountant (ACA). He also holds an MBA from Duke University and an MA from Cambridge University.

### **Mark Pay, Managing Director, Direct Equity, Sector and Regions**

Mark re-joined CDC in 2012 to lead the firm's plan to increase equity investments. Mark's career has primarily been in private equity and has encompassed making, developing and exiting investments in Africa, India, the Americas, China and the UK.

He has also helped to found and build two private equity businesses, Barclays Ventures, an SME - focused investor in the UK and Actis, a leading PE investor across the emerging markets. He has overseen several funds and, as an Investment Committee member, has been involved in more than a hundred investments and exits in private equity, infrastructure and property funds.

### **Holger Rothenbusch, Managing Director, Debt**

Holger re-joined CDC in 2012 as Managing Director to build CDC's new Debt business. Holger has over 20 years of experience in development finance in Latin America, Africa, Asia and Eastern Europe across a broad range of industries. Before his current role, he was with DEG, the German Development Finance Institution, where he was responsible for building DEG's equity and mezzanine team and held various senior management positions. He previously worked as a commercial banker with Deutsche Bank.

Holger holds Masters degrees in Economics from University of Freiburg in Germany and Wayne State University, USA.

### **Murray Grant, Managing Director, Intermediated Equity**

Murray joined CDC in January 2015 from Actis LLP where he was a Partner. He has a long history of working and investing in Africa and began his career as an engineer on the Kiambere Hydro-Electric Scheme in Kenya in the early 1980s. Murray subsequently spent 13 years at 3i in the UK before joining CDC Capital Partners in 2001.

When Actis was spun out from CDC in 2004, he was one of the founding Partners of Actis with responsibility for the development of its Africa business and the Africa team. Murray's investment and NED track record has covered most sectors and regions across Africa. He is also a board member of AMREF UK Ltd.

Murray has a BSc (Hons) in Engineering from Edinburgh University and an MBA from London Business School.

### **Ketso Gordhan, Managing Director and Head of Africa**

Ketso joined CDC in April 2016 as the Head of Africa. He previously spent several years as Chief Executive Officer of PPC Cement, one of Africa's largest cement companies. He helped the business expand into Sub-Saharan countries such as Rwanda, Ethiopia and DRC.

Ketso spent almost 10 years leading RMB's private equity business. He has also held a number of public sector roles, including City Manager of Johannesburg and Director General of the Ministry of Transport, where he led major infrastructure projects such as the South Africa's N4 Toll Road.

He has a keen interest in the provision of low-cost education, and was a founder of Spark Schools in South Africa. Ketso was the ANC Campaign Manager for Nelson Mandela's election to President of South Africa in 1994.

### **Srini Nagarajan, Managing Director and Head of South Asia**

Srini re-joined CDC in June 2013 and is currently Head of South Asia and based out of

Bangalore. In his current role he is CDC's representative on the ground and responsible for its investments in the region.

Previously Srimi was Director with a global PE fund Actis and focussed on Private Equity deals in the Financial Services sector in South Asia. Prior to this Srimi was focusing on deal origination for Actis in India and also managed a portfolio of CDC investments in South Asia for value. Srimi spent close to eight years in Sub Saharan Africa with both CDC and Standard Chartered Bank.

Srimi has a Masters degree in Economics and a post Graduate in Business Administration from Warwick School of Business.

## **Annex E: Background of CDC Board**

CDC Board includes the Chairman, CDC's CEO and CFO as well as six non-executive Directors.

### **Graham Wrigley, Chairman**

Graham was appointed Chairman of the Board in the summer of 2013.

Ever since visiting Nepal and India in 1981 Graham had wanted to work in international development. So, ten years ago he quit his business career and decided to "retrain" for a new career by completing an MSc in Development Economics at SOAS. Since then, he has worked in a variety of roles with SME and Microfinance organisations in sub-Saharan Africa, Nepal and the poor states of North India, with a personal goal of helping these companies become sustainable and help their countries' economic development.

Graham's first career was in business. He was a founder partner of Permira and a member of the firm's management board as it grew into one of the world's leading private equity firms, with over \$20bn under management. Prior to that he worked for Bain & Co.

Graham studied Law and Economics at Cambridge University and has an MBA from INSEAD, one of the world's leading business schools, where he is a visiting professor. He also works with several charities, including Sir Edmund Hillary's Himalayan Trust UK, where he serves as Chairman, and has volunteered for them for over 35 years.

### **Wim Borgdorff, Non-executive Director**

Appointed in September 2014, Wim Borgdorff is senior advisor and co-founder of AlInvest Partners, a private equity investment management firm with €37 billion of fund, co- and secondary investments under management. Wim is a non-executive board member of the Bernard van Leer Foundation, a long-standing Dutch privately endowed charity dedicated to early child development globally.

From 2000 to 2013 Wim was head of fund investments at AlInvest Partners which became part of The Carlyle Group in 2011. He is currently a senior advisor to the firm and a member of the investment committee. In 2008 he defined the AlInvest ESG policies and made AlInvest an early subscriber to the UN Principles for Responsible Investment.

Prior to AlInvest, Wim founded ABP Investments' alternative investments unit. Previously he was a Managing Director at ING Real Estate. Wim received an MSc cum laude from Delft University of Technology and an MBA from Erasmus University Rotterdam.

### **Valentine Chitalu, Non-executive Director**

Appointed in May 2010, Valentine Chitalu is an entrepreneur in Zambia and southern Africa specialising in private equity and local private sector development.

Before becoming an entrepreneur in 2004, Valentine worked for CDC Capital Partners in London and Lusaka, focusing on identifying investment opportunities in southern Africa and portfolio management in Zambia and Malawi. Valentine was formerly Chief Executive Officer at the Zambia Privatisation Agency where he was responsible for the divestiture of over 240 enterprises. He worked for KPMG Peat Marwick in the UK and Meridien Financial Services in Zambia in his early career.

Valentine is Chairman of the Phatisa Group, a US\$300 million private equity fund manager, focussing on the food and housing sectors in Sub-Saharan Africa.

Valentine continues to be at the forefront of promoting both local and foreign investment into Africa and he holds several board positions in Australia, South Africa, the UK and Zambia and is a Chairman of Zambian Breweries, MTN (Zambia) Limited and Albidon (Zambia) Limited.

Valentine is a UK qualified accountant and holds a Masters Degree in Development Economics from Cambridge University.

### **Michele Giddens, Non-executive Director**

Appointed in December 2014, Michele Giddens is a Partner and Co-Founder of Bridges Ventures, a specialist fund manager dedicated to sustainable and impact investment. She has over 20 years of experience in impact investment and international development finance.

Prior to co-founding Bridges in 2002, Michele spent 8 years with Shorebank Advisory Services (now Enclude). She ran small business lending programmes in Russia, Central and Eastern Europe, advised on microfinance in Bangladesh, the Middle East and Mongolia and worked on the US community development finance sector. In the early 1990s, she was with the International Finance Corporation, the private sector financing arm of the World Bank Group. Whilst there she worked on international joint venture investments during the process of private sector development in Eastern Europe.

Michele was an adviser to the Social Investment Task Force and Chair of the Community Development Finance Association (CDFA) between 2003-2005. She has recently been appointed as Chair of the UK National Advisory Board to the Global Social Impact Investment Steering Group, as established by the G8.

Michele has a BA Honours in Politics, Philosophy & Economics from Oxford University and an MBA from Georgetown University, Washington, DC.

### **Keki Mistry, Non-executive Director**

Appointed in September 2014, Keki Mistry is the Vice-Chairman and CEO of Housing Development Finance Corporation in India. HDFC has been a pioneer in the housing finance industry over the last 25 years and has helped provide thousands of Indians with financial assistance to own a home.

Earlier in his career Keki was a consultant to CDC to help evaluate the operations of mortgage financial institutions in Asia. He holds a number of directorships in India, including Sun Pharmaceutical Industries Ltd, HCL Technologies Ltd and Torrent Power Ltd.

He is a fellow of The Institute of Chartered Accountants of India.

### **Laurie Spengler, Non-executive Director**

Appointed in July 2016, Laurie Spengler is President & CEO of Enclude, a global advisory firm dedicated to building inclusive, sustainable and prosperous local economies.

Laurie has over 25 years' experience in strategy and transaction services, specifically capital raising, M&A, and private equity transactions. She has developed a particular expertise in structuring and launching investment vehicles that align different types of capital to allow operating enterprises, financial institutions and funds to generate positive social, environmental and development outcomes while delivering appropriate financial returns.

Previously, Laurie was founder and CEO of Central European Advisory Group. She also worked as an attorney at White & Case. Among her active board engagements are the Executive Committee of the Aspen Network of Development Entrepreneurs and she has recently been appointed to the UK National Advisory Board to the Global Social Impact Investment Steering Group, as established by the G8. Ms Spengler is also a member of the Council on Foreign Relations.

Laurie has a JD from Harvard University and an undergraduate degree from Stanford University.

**Sam Fankhauser, Non-executive Director**

Appointed in April 2015, Professor Samuel Fankhauser is Co-Director at the Grantham Research Institute on Climate Change at the London School of Economics.

He is also an Associate Director at the economics consultancy Vivid Economics. Previously Sam served as Deputy Chief Economist and Director, Policy Studies, at the European Bank for Reconstruction and Development (EBRD). Prior to that he worked at the World Bank and the Global Environment Facility.

Sam has studied Economics at the University of Berne, the London School of Economics and University College London.



## Annex F Impact Programme Investments

These are some examples of higher risk investments made by the Impact Fund and the Impact Accelerator.

### Impact Fund (IF) investments

- **Novastar Ventures East Africa Fund I** (\$15 million, 2014) seeks to improve access to affordable goods and services through businesses targeting bottom of the pyramid (BoP) customers. Novastar is a venture capital fund focused on developing and growing breakthrough businesses, in sectors including education, agriculture, energy and sanitation that can transform consumer markets at the base of the pyramid in East Africa. Existing investments include Bridge International Academies, a chain of low-cost primary schools in Kenya and Sanergy who offer hygienic sanitation through franchised sanitation centres in slums and collect waste which is processed into fertilizer, electricity and other by-products.
- **Injaro Agricultural Capital Holdings** (\$15million, 2014) is a West African agriculture focused investment fund which aims to improve livelihoods through access to markets and improved inputs. Injaro's mission is to make sustainable investments in small and medium enterprises (SMEs) operating along the agricultural value chain in West Africa in order to alleviate poverty and improve food security. The target populations for impact are rural smallholder farmers and low-income producers and consumers. Injaro's investment strategy is focused on Ghana and Côte d'Ivoire and also includes Mali, Burkina Faso, Niger and Sierra Leone.
- **Energy Access Ventures Fund (EAV)** (€16.5 million, 2015) invests in small and medium size enterprises active in the generation and/or distribution of electricity in the region to improve access to affordable energy for rural and peri-urban populations. The aim of the fund is to provide improved, reliable access to energy for one million low-income households by 2020. It focuses specifically on off-grid rural electrification, starting with companies active in East Africa before expanding to other African countries.
- **Insitor Impact Asia Fund** (\$10 million, 2016) invests in Myanmar, Cambodia, India and Pakistan. Insitor backs promising businesses in these countries that provide essential goods and services to low-income households in sectors such as education, agriculture, energy and healthcare, where there is a large, unmet demand.
- **InFrontier** (\$15 million, 2016) is Afghanistan's first private equity fund. The fund will support job creation and build local investment capacity by offering growth capital to SMEs in a fragile context. InFrontier will focus on companies that will be vital for underpinning the economy, such as financial services, healthcare, IT and telecoms and consumer businesses.
- **The Fund for Agricultural Finance in Nigeria (FAFIN)** (\$15 million, 2017) is an agribusiness focused fund targeting equity / quasi-equity investments in SMEs across the agricultural value chain in Nigeria. FAFIN aims to address the need for flexible capital for agricultural SMEs in Nigeria, a space neglected by most investors and which has the potential to improve value chains, food security and increase livelihoods in rural communities.

- **The Medical Credit Fund** (\$10 million, 2017) aims to improve access to capital for small and medium sized healthcare providers in Sub-Saharan Africa by providing flexible local currency debt financing through risk-sharing partnerships with local financial institutions (FIs). MCF also provides support and expertise to improve the business management and quality of services delivered by these healthcare providers, which reduces the risk of loan default.

### Impact Accelerator (IA) investments

- **Africa Improved Foods** (\$10 million, equity, 2015) is a solid public-private partnership of Royal DSM (a leading nutrient manufacturer as the operator), CDC, IFC, FMO, the Governments of Rwanda (to be followed by Ethiopia) looking to develop scalable solutions to address malnutrition. The business produces nutrient-rich food for infants and pregnant & lactating mothers in Rwanda using locally-sourced raw materials (improving smallholder livelihoods through access to a reliable offtaker) to service WFP and local government contracts, as well as commercial marketing routes. The product had previously been imported from Europe.
- **Virunga Energy** (\$9m, debt, 2016) is a hydroelectric power business backed by a UK Charity, The Virunga Foundation to provide clean, renewable electricity to communities living in and around Virunga National Park in North Kivu, Eastern DRC. The investment will support the development of the existing electricity grid and the construction of two new plants resulting in almost 50MW of total generation. Sustainable energy supply will boost business activity and provide sustainable livelihoods in an area recovering from years of civil unrest. Investment will offer an attractive alternative for at-risk youth through skills development and employment opportunities. A patient and flexible approach (leverage CDC contacts and deploy TA funds) to enhance managerial and commercial capacity, improve internal processes, and enhance community engagement will help a previously grant-dependent organisation to build revenues and attract future commercial investors.
- **14 Trees** (\$5.5 million, equity, 2016) is a joint venture that IA entered with Lafarge-Holcim to produce DuraBric, a low-carbon, environmentally sustainable brick alternative to traditional burnt clay brick, to help countries to reduce construction-driven deforestation and meet the growing housing demands of the population. The team are testing an impact-linked financial structure, which aims to incentivise the JV to maximise impact. IA has supported 14Trees to develop a franchisee model to drive rural penetration of product (with potential to address rural and youth unemployment).
- **Jacoma Estates** (\$8 million, equity, 2016) is an inclusive agribusiness which will expand its production of high value macadamia nuts, birds eye chili and paprika in northern Malawi. The investment will unlock additional capital from other impact investors benefitting local stakeholders through offtake from out-growers and the provision of irrigation infrastructure for neighbouring smallholder farmers. Jacoma provides inputs and extension services to out-grower farmers in order to boost yields and improving agricultural practices. Prices paid to contracted farmers are up to 50% higher than minimum prices set by the government and premiums are paid for higher quality.

## ANNEX G: Complementarities and differences IFC, PIDG and CDC

	<b>IFC</b> Scale and reach give it a central role in the international development finance architecture	<b>PIDG</b> Infrastructure niche allows it to target the frontier in the sector	<b>CDC</b> Geographically the most poverty focused DFI with a unique governance structure that maximises alignment with DFID priorities
<b>Geography</b>	<p>Operating in most countries across all emerging markets. Allowing considerable reach of its operations, but also means it is less aligned with DFID priority countries.</p> <p>Given the size of the portfolio, high absolute exposure in FCAS, but lower in relative terms.</p> <p>As part of the IFC's new strategy, they have committed to grow the levels of investments (own account and catalysed into) in low-income countries and fragile states.</p>	<p>Significant focus on DAC I/II countries and FCAS in Africa and South and South East Asia.</p>	<p>Only DFI focussed on Africa and South Asia only, closely matches with the footprint of DFID's country programmes and supports efforts to ensure that its operations complement DFID's bilateral work on private sector development.</p> <p>Development impact grid incentivises to invest in the most difficult countries, high relative exposure in FCAS.</p>
<b>Sectors</b>	<p>Investing across a range of sectors, therefore allowing for a more comprehensive approach to economic development.</p> <p>IFC is currently developing an ex-ante development impact tool to drive interventions that build new markets.</p>	<p>Unique focus on private sector infrastructure development and financing. It covers the full project cycle (from early stage development to operation of assets). PIDG pushes the frontier in the sector, e.g. in terms of greenfield infrastructure provision and early-stage project development.</p>	<p>Investing across a range of sectors, allows for a more comprehensive approach to economic development than PIDG.</p> <p>Clear, objective and externally assured ex-ante development impact tool drives investments into sectors which create the most jobs.</p>
<b>Instruments</b>	<p>Instrument mix (equity,/debt/guarantee) , with a higher proportion of debt</p>	<p>Specialised PIDG facilities provide different instruments: PIDG develops projects and provides equity for these projects; it offers long-term debt to projects, as well as local currency guarantees and technical assistance (including viability gap funding).</p>	<p>Equity focused, provides opportunities to exert greater influence over investee companies. Substantial track record in building private equity funds industry in Africa. Increase in debt funding going forward to enable greater flexibility to structure the most appropriate support.</p>
<b>Scale</b>	<p>Portfolio of \$52bn provides opportunities for substantial mobilization from the private</p>	<p>Investment portfolio of £1.1bn (in addition to these investments, PIDG also provides</p>	<p>Portfolio of \$4.7bn provides capacity &amp; capabilities for scaling up.</p>

	<p>sector, but less exposure in DFID's priority regions (16%, of portfolio value in sub-Saharan Africa: 13% in South Asia)</p> <p>Due to its scale and size, the IFC is more likely to set global, cross DFI practices (e.g., IFC Performance Standards are the benchmark across DFI for investment standards)</p>	Technical Assistance) <sup>104</sup>	
<b>Financial return<sup>105</sup></b>	<p>Return on average assets (GAAP basis): 1.1% since 2012, 0% in 2016</p> <p>Return on average capital (GAAP basis): 3.9% since 2012, -0.1% in 2016</p>	0.2% in 2016 <sup>106</sup>	Average portfolio return of 7.4% since 2012 5.2% in 2016 (largely driven by legacy investments),
<b>Development results</b>	<p>IFC clients provided 2.4 million jobs and generated power for 48 million people in 2015/2016.</p> <p>IFC mobilised \$8 billion of capital from other investors, mainly through syndicated loans<sup>107</sup></p>	<p>PIDG has supported 154 infrastructure projects to financial close, of which 78 in fragile and conflict affected countries and 84 are now fully operational. These projects have or are expected to provide access to new or improved infrastructure to 222m people.</p> <p>The \$1.3bn committed by PIDG Members to the PIDG Facilities since 2002 has leveraged almost \$21bn in private sector investment.</p>	<p>CDC's portfolio companies helped create 1 million new jobs in 2015 (41% Africa and 59% South Asia) and generated power for the needs of 28 million people.</p> <p>Other investors invested over £700m of additional capital alongside the £289m that CDC committed to funds in 2015.</p>
<b>Rating</b>	<p>AAA rating places major constraints on liquidity and capital management</p> <p>On the flip side, credit rating enables IFC to unlock cheap funding / attract an investor</p>	Most PIDG facilities are not subject to these constraints and opportunities. However, the PIDG facility GuarantCo is rated due to its nature as a guarantee provider, and PIDG facility Emerging Africa Infrastructure Fund	Not subject to these constraints and opportunities.

<sup>104</sup> This excludes the PIDG Infrastructure Crisis Facility – Debt Pool (ICF-DP) which DFID does not contribute to financially.

<sup>105</sup> Financial returns stated according to information from the respective institution, not based on the same methodology given differences in operations and jurisdiction.

<sup>106</sup> The financial return is based on PIDG's gross portfolio return adjusted for operating costs including movements in impairment provisions (i.e. net return). It excludes ICF-DP.

<sup>107</sup> There is no commonly agreed methodology on mobilisation. Comparing figures needs to be treated with utmost caution as assumptions on causality, time frame and attribution heavily impact on figures.

	class / offer a range of instruments and products (e.g. derivatives & hedging) that is unique.	leverages its balance sheet to attract commercial funding and thus needs to take into account lenders' requirements.	
<b>Governance</b>	<p>Multilateral</p> <p>Being part of the World Bank Group allows to draw on instruments and political relationships from across the Bank.</p> <p>The UK is one of many shareholders at the IFC (4.48% voting power).<sup>108</sup> The IFC's programmes and activities are guided by the Board of Executive Directors, on which the UK is one of 25 representatives. The UK's position on the Board, gives the UK more influence over IFC strategy.</p>	<p>Multilateral</p> <p>The UK is the largest donor; other shareholders include Germany, Norway, Australia, Switzerland, the Netherlands, Sweden, IFC, KfW and FMO.</p> <p>Investments are decided by the Boards of Directors for the respective facilities, subject to the mandate set by the donors of the particular facility, whilst the Governing Council (which donors sit on) sets the overall strategy. A PIDG wide board will be set up to ensure greater coherence between the various PIDG facilities.</p>	<p>Bilateral</p> <p>The UK is the sole shareholder.</p> <p>This means the UK is able to set strategic direction of CDC, maximising coherence with our overall objectives on economic development as evidenced in CDC's new 5 year strategy.</p> <p>CDC approves investments consistent with an overall strategy agreed with DFID. This enables it to move more quickly and for decisions to be less politicised.</p>
<b>Climate change and gender</b>	<p>Significant efforts over the last five years to put climate at the forefront of its thinking and it has done the same on the issue of gender, to the extent that this is now a factor in the remuneration of staff. These continue to be key themes in the new IFC Strategy.</p> <p>IFC's Climate Implementation Plan, is focused on (i) scaling climate investments to reach 28% of IFC's annual financing by 2020, (ii) catalysing \$13bn in private sector capital annually by 2020 for climate sectors.</p> <p>The IFC developed a Gender Strategy Implementation Plan (FY17-19), with a commitment to (in addition to non-discrimination) e.g. double its lending to</p>	<p>Significant efforts to put climate and gender impacts at the forefront of its thinking. All projects now disaggregate results by gender in terms of beneficiary and PIDG implements some specific actions across its portfolio to encourage a more deliberate focus on positive outcomes for women.</p> <p>All projects are rated with regards to their impact on climate change mitigation and adaptation.</p>	<p>Climate change and women's economic empowerment as important themes in the new 5 year strategy with commitments on better monitoring, taking advantage of opportunities, addressing risks in investment decisions.(more in section 10)</p> <p>On climate change, CDC has a strategy in place and DFID has required CDC that CDC will for all new infrastructure investments ensure they are resilient to the impacts of climate change and take consideration of the low carbon transition.</p> <p>On women's economic empowerment, CDC will develop a gender strategy by 2018 which will go beyond non-discrimination look at</p>

<sup>108</sup> Voting power on the Board is in line with shareholding of each Executive Director's country.

	<p>women owned enterprises, providing access to non-financial and financial services; closing gender gaps in value chains as well as in companies' workforces; spearheading efforts to increase women in company leadership</p>		<p>ways in which CDC's investee companies can actively create value by promoting women's economic participation in CDC's markets.</p>
<p><b>Higher risk experience</b></p>	<p>As part of the IDA18 replenishment, a \$2.5 billion IDA18 Private Sector Window (PSW) is created to mobilize investment in IDA-only countries, with a focus on IDA Fragile and Conflict Affected States (FCS).</p> <p>Since 2012 the IFC has blended more than US\$500 million in concessional investment capital to support more than 90 investment projects that have leveraged over US\$5 billion in third party financing (including over US\$270 million in concessional investments to IDA countries)</p>	<p>PIDG pushes the frontier of its investments, in terms of where it operates (DAC I/II, FCAS), what it does (early stage development, greenfield), and how it operates (local currency guarantees to mobilise local capital markets). PIDG can also provide technical assistance as well as viability gap funding for pro-poor projects where commercial return requirements would otherwise be prohibitively high.</p>	<p>CDC has already piloted innovative activities in the higher risk space, taking a different approach to typical blending approaches (as per the strategic case). Since 2012, CDC has undertaken the management of funds under DFID's Impact Programme.</p>

# Smart Guide

## The Business Case:

- Sets out the case for a programme, adapted to suit the context
- Explain clearly and succinctly what the programme will do within what timeframe and is explicit about the risks and uncertainties and how they will be managed
- Records an understanding for DFID, our partners and intended beneficiaries about what we are planning to do and the results we expect to achieve
- Allows DFID to report to the UK public on what we are doing with taxpayers' funds
- It should be as proportionate as possible. Consider using sub headings and paragraph numbers.

The Business Case is structured around the Treasury 5-case model. Within this broad framework the design should be adapted to suit different contexts and investment types. The content is indicative, not prescriptive and teams are encouraged to use judgement in making a logical argument to make the case in a way that suits the individual investment.

Refer to the considerations below, and the 10 delivery & 10 approval questions in the Smart Rules.

### **Intervention Summary (2 Pages)**

Start with a half page maximum narrative summary of what the programme will do, ensuring you cover the points set out at the top of that section. Then use bullet points to answer the ten approval questions that follow. Do not delete the headings/questions in bold, but do delete any square brackets which provide steers about what to think about.

### **Strategic Case**

This makes the case for DFID intervention by setting out the overarching context and the problem to be addressed. It should be clear what the programme will do (impact and outcome) and how with evidence. It should link to, but not repeat, the Business Plan with a clear illustration of how the programme contributes to DFID's global and portfolio priorities. Retain the two sub-headings and provide the information required under each of them (deleting the square brackets). It is up to you where in the Strategic Case the sub-headings go. But it might make most sense at the end.

### **Appraisal Case**

The Appraisal Case explores how we will address the need in the Strategic Case in a way that optimises value for money. It appraises genuinely feasible options for achieving the objectives, including high level commercial choices, with a summary of the quality of evidence. The appraisal considers delivery mechanisms including capability and capacity, costs and benefits, risks and likelihood of success. It concludes with a summary VfM statement for the preferred option.

### **Commercial Case**

This section provides more detail on implementation and how value for money will be achieved. It sets out the procurement approach and requirements, proposed funding instrument and how the choice of instrument will be used to ensure vfm. It considers the market place response to this intervention with an explanation of how supplier performance would be managed. It sets out the procurement policies, capabilities and systems of the third party entity to ensure we get vfm.

### **Financial Case**

This section sets out issues of affordability and the sources of funding. It includes a high level budget which does not impair VfM in procurement exercises for individual contracts. It sets out how funds will be disbursed and how expenditure will be monitored, reported and accounted. It highlights the evidence underpinning a judgement that funds will be used for the intended purposes.

### **Management Case**

This section focuses on governance and management arrangements and the ability to deliver. It sets out the management implications for the business unit/ level of effort with realistic timings for mobilisation and start up. It outlines the expected roles and responsibilities, including DFID's own resourcing strategies (SRO, programme team etc.). It sets out how it will respond to changes in context and the key elements of the Delivery Plan, key milestones and decision points where we can course correct. It includes a clear illustration, ideally set out in a risk matrix, of the risks and risk appetite. It should include the envisaged approach to escalating risks and issues as well as exit and possible closure scenarios.