Overseas Development Institute

CDC's position in the wider DFI architecture

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CDC is the UK's development finance institution (DFI). It invests in viable private businesses in poorer developing countries to contribute to economic growth that benefits the poor. CDC is the oldest in a set of bilateral, regional and multilateral DFIs, known as the wider 'DFI architecture'. The UK government is its sole shareholder and is one of several in a number of other multilateral and regional DFIs.

The UK Secretary of State for International Development recently announced a consultation period to consider possible reforms to CDC. This briefing looks at the current position of CDC in the wider DFI architecture in order to inform this consultation. It compares DFIs on their aims and objectives, ownership, general activities, the distribution of DFIs over sectors, countries and instruments, financial additionality, the type of impact assessments, and gaps and overlaps.

Aims and objectives of DFIs

DFIs' objectives are often multiple, and may include investing in sustainable private sector projects; maximising impacts on development; remaining financially viable in the long term; and mobilising private sector capital. For example, DEG and FMO have to invest in enterprises that contribute to developing country economies. CDC is different in key objectives, although not from all DFIs (e.g. EIB IF), because it invests in the creation and growth of viable private businesses in poorer developing countries to contribute to economic growth that benefits the poor *and* mobilises private investment in these markets, both directly and by demonstrating profitable investments.

Ownership of DFIs

Many DFIs are owned by the public sector only (CDC, DEG, SwedFund, NorFund, IDC and OPIC). Proparco, FMO, COFIDES and SIMEST have a mixed public and private ownership structure. SIFEM is privately owned. The multilateral and regional DFIs have multiple shareholders from various countries.

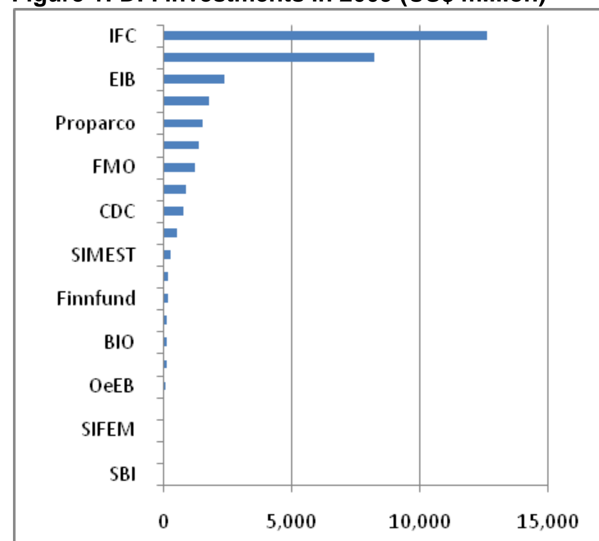
DFIs often have supervisory and management boards that make decisions within an agreed investment policy. The composition of the supervisory board varies. For example, in FMO and CDC, the supervisory board does not include direct representatives of government ministries, whereas the ministry is represented in DEG.

Activities: providing financial resources, providing technical assistance and promoting standards

DFIs' core business is to invest financial resources, but they also provide project-specific and general technical assistance and promote standards in the funds or companies in which they invest.

Investing financial resources is the core activity. Estimates based on the annual accounts of the main DFIs show around $33 billion worth of new DFI investments in the private sector in 2009 (in the form of loans, guarantees and equity positions). Figure 1 ranks new investments in 2009. IFC and EBRD are the largest DFIs. CDC ranks fourth among bilateral DFIs, ahead of many smaller bilateral DFIs but behind the larger multilateral and regional DFIs. In terms of its outstanding portfolio of investment and commitments (based on EDFI data), CDC was the third largest bilateral DFI after DEG and FMO. CDC was ranked the second bilateral when measured in terms of number of new projects.

Figure 1: DFI investments in 2009 (US$ million)



Notes: To private sector only and EBRD, EIB, AfDB, AsDB investment to public sector excluded, IFC: year to March 2010, excludes syndications. Portfolio data might be more appropriate for some: e.g. annual commitments to funds are less meaningful. Non-European bilateral DFIs such as OPIC excluded. *Source*: literature survey, European DFIs (EDFIs), annual DFI accounts, own calculations.

ADB Asian Development Bank
AfDB African Development Bank
BIO Belgian Investment Company for Developing Countries
CDC CDC Group plc (UK)
COFIDES Spanish Development Funding Company
DEG German Investment Corporation
EBRD European Bank for Reconstruction and Development
EIB European Investment Bank
Finnfund Finnish Development Finance Company
FMO Netherlands Development Finance Company
IADB Inter-American Development Bank
IFC International Finance Corporation
IFU/IØ/IFV Danish International Investment Funds
Norfund Norwegian Investment Fund for Developing Countries
OeEB Austrian Development Bank
OPIC Overseas Private Investment Corporation (US)
Proparco Investment and Promotion Company for Economic Cooperation (France)
SBI Belgian Corporation for International Investment
SIFEM Swiss Investment Fund for Emerging Markets
SIMEST Italian Development Finance Institution
SOFID Portuguese Development Finance Institution
SwedFund Swedfund International AB (Sweden)

In terms of technical assistance, IFC's total expenditure on advisory services was $268 million in 2009 alone. Meanwhile, by 2009, EBRD had administered 184 technical cooperation fund agreements, amounting to an aggregate €1.3 billion. In addition, it had administered 90 project-specific technical cooperation agreements, totalling €59 million. EIB's Investment Facility (IF) provided €11.5 million worth of technical assistance (in addition to interest rate subsidies) in 2009.

DEG received €12.2 million to carry out its programme for development partnerships with the private sector (public–private partnership, PPP), run by BMZ. DEG also created a €5 million technical assistance fund in 2007 from its own resources. COFIDES manages two Spanish Government trust funds established to support Spanish investments abroad (FIEX and FONPYME).FMO invests own resources in and manages the following government funds: financing of Dutch small and medium-sized enterprises (SMEs) that invest in developing countries (FOM); a local currency fund reaching out to SMEs via financial institutions (MASSIF); earmarked funds for infrastructure projects in low-income countries (IDF); a fund financing energy projects (AEF); and CD, which enables targeted access to know-how, bundled to meet a company's full organisational needs and which is financed by the Dutch Minister for Development Cooperation and stimulates technical cooperation between developing country companies and enterprises in industrialised nations.

Finally, some DFIs (including CDC) also provide advice on implementing standards in the funds and companies in which they invest.

All the above activities require a significant amount of staff. DEG has some 350 staff, FMO 250 and Proparco 130, but CDC has fewer than 50. IFC has 3,400 staff.

The distribution of DFI portfolios across sectors

DFIs' distribution of their portfolio of invested and committed capital is normally discussed under three dimensions: sectors, instruments and countries.

DFIs invest in a wide variety of sectors, from the financial sector to infrastructure and agribusiness. If we look at the final beneficiary, CDC in 2009 spent 23% in the financial sector (a share substantially less than Proparco, FMO and DEG); 34% on infrastructure, including telecommunications, power, water, roads and hotels (substantially more than DEG and FMO and the same as Proparco); and 6% on agribusiness (around the EDFI average, the same as IFC and well above the EIB IF share). CDC's own distribution suggests 8% is spent on narrow infrastructure and 10% on energy and utilities.

We cannot say whether CDC is overly present in one particular sector. By contrast, EIB's portfolio is concentrated in infrastructure (61% goes to energy, water and transport in the Neigbourhood Investment Facility – NIF - and 34% to transport, water, telecommunications and energy in IF) and industry (23% in IF and 24% in NIF). IFC invests most in the financial sector.

The distribution of DFI portfolios across instruments

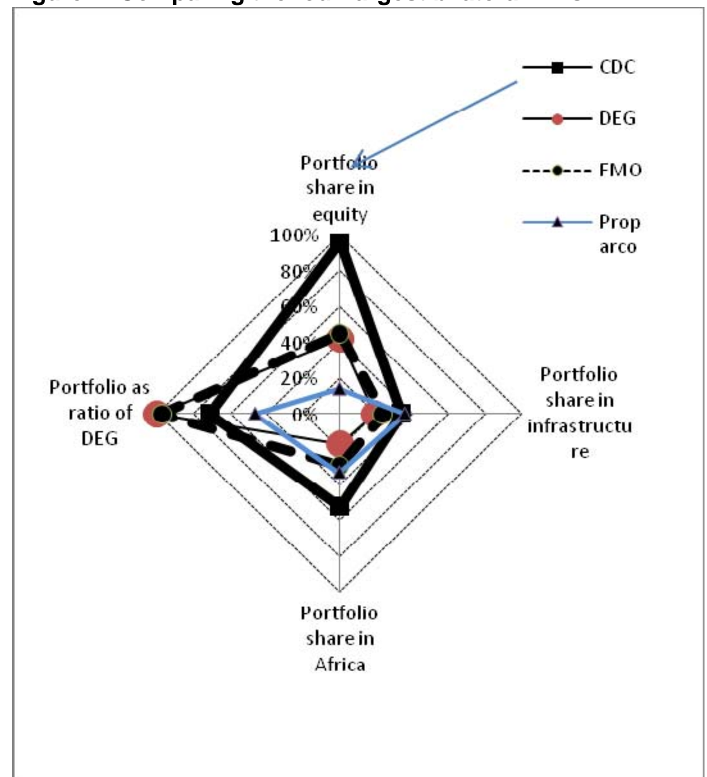
The DFIs use different investment instruments. Most do very little in guarantees. Some specialise almost entirely in equity (CDC, COFIDES, SIMEST, SIFEM, Norfund), although often not exclusively. For example, CDC also has a legacy of loans in some activities, and recently worked with EFP in providing more loans. The majority of the committed portfolio of others (e.g. BIO, DEG, Finnfund, FMO, Proparco, SOFID) is through loans. Many have stated a desire to invest more in equity funds (FMO), but CDC leads the field globally on this. IFC and EIB private equity fund investment is still comparatively small.

The distribution of DFI portfolios across countries

CDC's portfolio is much more geared towards poorer countries than the other bilateral DFIs (and multilaterals excluding AfDB and EIB IF). In absolute terms, CDC has the highest exposure in the African, Caribbean and Pacific (ACP) countries and South Africa, followed by FMO and Proparco. It also leads in South (East) Asia and China, followed by DEG and FMO. In 2009, some 52% of CDC's portfolio was invested in Africa (45% in sub-Saharan Africa) (DEG's was 17%, FMO's 29%). IFC invested 13% in sub-Saharan Africa (June 2010), meaning that total exposure of CDC and IFC in this region is at the same level.

Figure 2 compares the four largest bilateral DFIs (in 2009) and shows that, although CDC is not the largest, its portfolio has a larger share than others in Africa and in infrastructure broadly defined, and a much larger share in the form of equity.

Figure 2: Comparing the four largest bilateral DFIs



Sources: EDFIs, literature review, own calculations.

Analysing the distribution of DFI portfolios

DFIs provide a number of reasons and are set a number of targets to guide portfolio distribution over countries, sectors and instruments. These include:

- Shareholder targets or regulations with respect to countries or instruments;
- Interest of home county firms;
- Comparative advantage of the DFI in sectors, countries or instruments;
- Economic (and social) impact of the sector invested in;
- Lack of capital/market failure in specific sectors.

Several, especially smaller, DFIs (not including CDC, FMO, DEG, Proparco) are tied to the interest of home country firms. For example, Finnfund chooses sectors on the basis of its perceived comparative advantage at home: forestry, energy efficiency (bio-power) and telecommunications. SIMEST is dedicated to supporting and promoting the activities of Italian companies abroad. DEG is close to German companies for historical reasons, although not tied legally.

CDC has country targets (75% in low-income countries), sticks to one instrument (fund of funds) and allocates capital to whatever sectors need capital. It feels its comparative advantage lies in selecting good fund managers and hence in using the equity instrument. Norfund does fund management but also specialises in hydropower. DEG feels it is relatively good at investing in agriculture.

FMO has a less stringent target (40% in low-income countries). It provides the full range of financial services, but specialises (more than 75%) in three sectors: housing, energy and finance (more than 50% of the total), arguing that investments in these sectors make a real impact. FMO aims to select projects with the highest development impact – not just economic but also social and environmental. For EIB, infrastructure is a key development priority, because it delivers essential services such as clean water and access to power and plays an essential role in supporting trade, productivity and growth. Bilateral DFIs tend to select smaller firms, whereas multilaterals prefer larger projects with larger firms. For example, SwedFund feels its advantage lies in providing capital to SMEs.

Financial additionality

One of the rationales for a DFI's involvement stems from its aim to *act as a catalyst*, helping companies implement investment plans and providing risk mitigation that enables them to proceed with plans they might otherwise abandon, given perceptions of risk that are particularly high in sectors with large sunk costs. DFIs provide two types of evidence on their catalytic effects: descriptions of where their presence may have been catalytic and leverage ratios (i.e. how much the private sector or other DFI input has invested alongside). No DFI provides macroeconomic evidence of additionality in a dynamic sense, although the geographical spread of DFIs may suggest this in a static way.

It is essential for fund managers (or indeed individual projects) to secure investors early on, as a stamp of approval to attract other capital. CDC has committed to the Sierra Investment Fund, the first ever private equity fund in Sierra Leone, and to Rabo Equity Advisor's India Agribusiness Fund, the first private equity fund in India focused solely on this sector. It is also expected to finalise a $10 million commitment to Frontier Fund Private Equity, the first fund of its kind in Bangladesh.

Based on CDC's development review, we estimate that every dollar of CDC investment coincides with $5 of other investment. Since 2004, CDC has committed more than $5 billion to 65 fund managers. Alongside this, other investors have committed a total of $24.3 billion. Capital from other DFIs accounts for only $2.3 billion of this figure. Using CDC's new methodology for measuring third party capital mobilisation, third party capital attributable to CDC is $4,187 million.

IFC argues that every dollar of its investment leverages about $3 from others. For EBRD, it is around $1: it suggests that, alongside €7.9 billion investment in 2009, it attracted additional co-financing worth €5.1 billion. Of this, €2.3 billion came from private and €2.8 billion from public co-financiers, of which €2.7 billion came from the international financial institutions (IFIs) (2008: €0.4 billion).

Not all DFIs were able to play the countercyclical (and additional) role during the global financial crisis. Commitments and investment fell in a number of DFIs in 2008-2009, including CDC, DEG and IFC. Nonetheless, overall *portfolios* increased by 14% in the case of EDFIs (12% in 2008 and 21% in 2007), with no growth in the case of IFC (in euro terms).

Impact assessment

DFIs use three different types of assessment tools: IFC's Development Outcome Tracking System (DOTS), DEG's Corporate-Policy Project Rating and EBRD's Transition Impact Monitoring System (TIMS). CDC has also developed an assessment of its fund in fund business and has published two development reviews; others, such as EIB and FMO, have developed their own variants. DFIs typically examine the *direct* effects of operations on financial returns, employment, taxes paid and access by populations to basic services (e.g. phone lines). Despite a growing literature assessing the effects of individual companies, DFI projects and international capital flows, there are gaps in the research on the macro impact of DFI investments.

Some DFIs carry out *ex-ante* assessments at approval and throughout the lifecycle of a project as well as *ex-post* evaluations; others carry out *ex-ante* evaluations only. For example, IFC's DOTS tracks the development impact of all investments at approval and throughout their lifecycle, but is complemented by the *ex-post* evaluation framework developed by IFC's Independent Evaluation Group, which applies to a random sample of projects. In a similar way, EBRD's TIMS assesses the potential transition impact of its projects throughout their lifecycle, but also makes use of performance indicators to measure its overall operations *ex-post*. FMO and DEG rely on approval scoring supplemented by post-

evaluation. Meanwhile, OPIC reviews projects only *ex-ante* (at approval). CDC carries out evaluations at the mid-point and at the end of a fund's life (five to ten years).

Approaches to monitoring and post-evaluation are heterogeneous across DFIs. There are significant differences between approaches multilateral DFIs use and some bilateral DFIs use. For example, IFC, EBRD, EIB, ADB and AfDB are part of the Evaluation Cooperation Group, which has set good practice standards for tracking development results of private sector operations and therefore has tended to harmonise its members' post-evaluation practices and their *ex-ante* assessments at approval and throughout projects' lifecycles. However, harmonisation challenges remain.

One general similarity in the systems measuring the economic impact of DFI operations lies in the dimensions addressed. Most DFIs look at four key dimensions: financial performance; economic performance; environmental and social performance; and private sector development.

Where is DFI support most needed? Where are the gaps and overlaps?

In general terms, DFI support is most needed in activities where there is a lack of capital but where the private sector can be leveraged in; where market failures are greatest; where the effects of DFI interventions are greatest (compared with other instruments such as grant aid and based on the comparative advantage of the DFI); in sectors that matter most for development, using the instruments that are most appropriate; and in countries (or states in a country) that need support the most. In short, DFIs are needed most in frontier markets using appropriate instruments (e.g. equity funds may not work in some of the poorest and least secure countries).

In practice, DFIs are engaged in a wide variety of countries, sectors and instruments, with each specialising in certain areas (e.g. fund of funds and equity investments for CDC, support to African banking for FMO, etc.). There does not seem to be one overall best practice model, although consolidation could be considered to exploit economies of scale. In fact, there seems to be a case for several DFIs exploiting their comparative advantage and specialisation in countries, products and services, instruments and sectors. This can lead to useful competition and diversity: a number of bilateral DFIs have promoted innovation and choice for client companies. The large bilaterals in particular have gained significant expertise (products, countries, sectors), into which multilaterals are tapping. Meanwhile, the multilaterals are leading on more general private sector development advisory services. In some cases, DFIs compete; in many other cases, their operations are complementary (spreading risks, presence in completely different niches).

There are also reasons why DFIs may actually want to overlap. First, some large projects can be financed only by a range of DFIs, in order to spread the risks. In 2009, at least 295 projects had the involvement of more than one EDFI. Second, DFIs can work together to smooth legal procedures so the client has to deal with fewer DFIs (this occurs in the European Financing Partners (EFP), which aims to strengthen cooperation between eligible European DFIs and EIB). Finally, smaller DFIs require big DFIs to lead on project evaluation, especially when it comes to risky projects with potentially large social and environmental consequences.

Conclusions

It is clear we do not yet understand fully what constitutes an optimal DFI model. Instead, it seems useful to have a number of different DFIs which bring innovative ideas. How should CDC develop, given its current niche in the market? Here, we summarise some key points of this briefing based on a literature survey:

- CDC's objective is more geared towards mobilising private sector capital than seems to be the case for most other DFIs.
- CDC has no direct day-to-day oversight from shareholders (e.g. via the board), although this does not seem unique to it.
- CDC does not implement additional government programmes (unlike several other bilaterals) or technical assistance (unlike all multilaterals and some bilaterals). It has relatively few staff.
- CDC specialises almost entirely in equity, which is unique among the bigger DFIs.
- CDC has no sectoral niche, but is more present in low-income countries than other DFIs. CDC (and FMO) has specific targets for investments in low-income countries.
- Bilateral DFIs such as CDC bring new ideas and models to DFI practices. CDC's business is centred on its knowledge of local fund managers.
- Measuring financial additionality is difficult, but CDC seems to have relatively more co-invested finance alongside it compared with IFC and EBRD.
- Impact assessments are now held at all major DFIs. The fund of fund approach introduces further stages into the rather long measure-to-beneficiary chain, compared with the approach of a direct investment in a specific firm. It will thus be relatively difficult to prove CDC's impact.
- The reasons and incentive structures in DFIs' financing of different sectors and countries with different instruments are complex. Even within CDC there are complementary approaches: investing in a regional fund, or a general country fund, or a specifically targeted Africa Sustainable Forestry Fund initiated by CDC on the basis of a perceived lack of capital in the sector.

The future path for CDC could take these points to inform the consultation.

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