CDC Group and DFID Response

7 May 2019

Joint response from CDC Group, the UK's development finance institution, and the Department for International Development to the Independent Commission for Aid Impact's recommendations on: CDC's investments in low-income and fragile states, March 2019

CDC Group, the UK's development finance institution, and the Department for International Development (DFID) welcome the Independent Commission for Aid Impact's (ICAI) performance review and its resulting recommendations.

The review recognises the significant progress made in a fundamental transformation of the organisation since 2012 (ICAI p.3, para 2). CDC and DFID are pleased that many of ICAI's recommendations are aligned with the ambitious commitment made in CDC's Strategic framework 2017-2021: Investing to transform lives, published in July 2017.

21 months into the phased five-year implementation of the strategic framework, this review is a timely contribution as CDC focuses efforts in achieving its ambition to maximise impact from its activities. We look forward to working with all stakeholders as we continue this process.

The recommendations of the review address activities of both CDC and DFID. This response is therefore a joint response and represents the views of both organisations.

Recommendation 1: CDC should incorporate a broader range of development impact criteria and indicators into its assessment of investment opportunities and ensure these are systematically considered in the selection process.

Accept: CDC implementing

CDC has been working with industry leaders to develop new approaches to impact management and is now implementing a new framework that adopts the Impact Management Project's approach, a global consensus of over 2,000 impact investment organisations. The framework ensures a systematic assessment of who benefits from our investments and by how much.

To support this, since 2018, CDC has:

- broadened the range of development impact criteria and indicators it monitors to include sectoral and investment specific indicators;

- significantly invested in the design and scrutiny of impact cases for each investment, publishing the impact thesis online and managing the investment against the case;
- grown its impact team to 56 (from three in 2012) including embedding impact specialists in its investment teams and appointing a Chief Impact Officer;
- recruited specialists to lead the next stage of their sector work and published its gender strategy.

This reflects significant progress against the CDC's July 2017 commitment to expand its impact criteria to support the UN's Global Goals. It builds on the foundations in place since 2012 that ensures:
- investments are directed to the poorest countries and the most job-creating sectors via an innovative screening tool, designed under the guidance of DFID's chief economist – resulting in CDC being "more geographically concentrated on difficult markets, including fragile and conflict affected states, than other DFIs" (ICAI, para 4.10);
- sub-sector strategies inform individual investments in key areas such as power generation and microfinance;
- the development impact rationale of each investment is assessed and interrogated at every CDC Investment Committee.
- a quarterly review of development impact considerations and environmental and social issues for priority investments;
- data on jobs, mobilisation of capital and taxes paid is gathered from the portfolio to assess impact at a company and economy-wide level.

Recommendation 2: CDC should take a more active role in the management of its investments, using the various channels available to it to promote development impact during their lifetime.

Accept: CDC implementing

CDC's engagement with its investees is guided by each investment's development impact case and rigorous commercial analysis. CDC is always striving to maximise impact from its investments and its new specialists support investees not only to deliver the expected impact, but also identify additional sustainable impact opportunities over the lifetime of the investment.

To support this and in addition to the initiatives detailed in recommendation 1, since 2018 CDC has:
- enhanced the format of its quarterly portfolio reviews, chaired by its Chief Investment Officer, that track progress across the portfolio and make recommendations about how to engage with investees;
- established additional capacity to support investees on gender equality, climate change, job quality and skills and leadership initiatives, on top of existing support provided on environmental and social issues;
- launched CDC Plus – a grant making facility to support additional impact within the company and wider environment.

This builds on an extensive and active management approach CDC has undertaken before 2018 ensuring:
- CDC has invested in companies where the achievement of development impact and the success of the business are aligned.
- CDC teams identify potential impact at origination, structure the investment and agreements to provide the best chance of success, and shape company strategies through boards and advisory committee meetings to support better developmental outcomes.

- investments were additional and impact was increased by CDC's involvement – with additionality independently reviewed where required.
- time-bound Environmental and Social Action Plans were agreed with companies and implemented.
- CDC develops and promotes industry good practice with companies and fund managers through training sessions and its ESG Toolkit which has resulted in it becoming "a leader among DFIs in assessing and supporting environmental, social and governance (ESG) issues" (ICAI, para 8, p.ii).

Recommendation 3: CDC should strengthen the monitoring and evaluation of the development impact of its investments and the learning from this, working with DFID to accelerate their joint evaluation and learning programme.

Accept: CDC / DFID implementing

CDC is accelerating its evaluation and learning programme by launching with DFID an impact challenge fund and doubling the number of 'deep dive' studies it conducts by 2021 (from 10 deep dive studies committed to in July 2017 to 20).

Deep dive studies inform CDC's investment decisions and portfolio management practices and were welcomed by ICAI (paras 4.136-138). Using proven techniques, such as Lean Data surveys, CDC is able to learn more about the poverty impact of its investments. For example:
- Oxford University's Martin School review of connectivity evidence enabled CDC to assess how increased connectivity would lead to economic growth in the DRC and Sudan ahead of investing in an African fibre optics company (Liquid Telecom).
- CDC's 'Rapid Insight' customer surveys in Zambia looked at how to increase access to good quality protein amongst lower income customers. CDC then worked with its investee, Zambeef, to change its strategy on new shop locations.

CDC and DFID will ensure that the lessons from these studies are fully learned and clearly shared with our investment partners and stakeholders.

This activity is in addition to the establishment of a £20m joint evaluation and learning programme. The implementation of this programme is overseen by a steering group that includes independent experts and is chaired by DFID's Chief Economist. The programme deliverables are available here.

All of this builds on progress since 2012 which has seen CDC undertake impact studies on strategically important issues including: mobilisation (Harvard Business School); energy provision (Steward Redqueen); healthcare (Imperial College); SME finance (Market Xcel and the Let's Work Partnership). This work has contributed to CDC being "recognised as a thought leader by other DFIs in some areas, particularly on ESG issues" (ICAI, para 6, p.iii).

Recommendation 4: CDC should work more closely and systematically with DFID and other development partners to inform its geographic and sectoral priorities and build synergies with other UK aid programmes to optimise the value of official development assistance.

Accept: CDC / DFID implementing

CDC and DFID are deepening their partnership in a thoughtful way to optimise the value of official development assistance. Interactions have been transformed by increased understanding of each others strengths, operating models and governance. As CDC's sectoral work and regional presence has expanded, CDC and DFID are:

- Establishing strong links between their sector specialists;
- Creating connections between DFID's country offices and CDC's regional network (see recommendation 6);
- Increasing strategic engagement, for example, CDC inputting into HMG's Country Development Diagnostics.

CDC is also resourcing a new Global Affairs function to systematically deepen relationships with DFID and a broader range of development partners.

This builds on work undertaken since 2012 to develop a close and systematic shareholder relationship structured through an Annual Shareholder Meeting with the Permanent Secretary, Quarterly Shareholder Meetings with the Director General for Economic Development and weekly meetings between the DFID Shareholder team and CDC.

Targeted partnership activity has resulted in "positive examples of DFID's economic development programmes supporting the work of CDC in Africa" (ICAI, para 4.58: 8) and South Asia. For example, in Pakistan CDC arranged a knowledge sharing workshop for Karandaaz Board (a DFID Pakistan supported initiative for MSME lending) to share experience on business models.

CDC has also sought close relationships with more development partners, particularly other development finance institutions (DFIs), and will continue to do so. For example, CDC has:

- Co-hosted with Oxford University and the International Finance Corporation (IFC) a fragile states DFI forum to tackle barriers to investing in the most fragile environments
- Developed Modern Slavery Guidance note with DFID, IFC and the European Bank for Reconstruction and Development;
- Launched the 2X Challenge with the G7 DFIs with a goal of mobilising $3 billion of investment to further women's economic empowerment in developing countries.

Recommendation 5: In the presentation of its strategy and reporting to stakeholders, CDC should communicate better its approach to balancing financial risk with development impact opportunity, and the justification for its different investment strategies.

Accept: CDC implementing

Every investment CDC makes balances developmental opportunity, strategic fit, commercial viability and business practices. Achievement of impact happens best when these are aligned. As CDC finalises its sectoral work that will guide its two investment approaches (Growth Portfolio and Catalyst Strategies) CDC will launch more external communications detailing the ambition, returns and impact of both approaches.

Since 2012, CDC has openly communicated its two main development targets: the 3.5 per cent financial return hurdle and the 2.4 score on CDC's Development Impact Grid. CDC has always reported its historical financial returns in its annual reports and has explained to the Public Accounts Committee that as its portfolio moved to harder geographies and more innovative investments its financial returns would come down – as they continue to do.

In its July 2017 Strategic framework CDC explained how it manages risk and introduced its two investment approaches:

- Growth Portfolio – individual investments to support more proven enterprises that will drive economic development
- Catalyst Strategies – these aim to tackle persistent market failures and cultivate new markets where a broader risk appetite is required to test new solutions.

Reflecting the higher risk of the Catalyst Strategies, CDC published a new Investment Policy in 2017 stating its additional annual financial target: to preserve its balance sheet. This increased risk tolerance has permitted CDC to make innovative investments such as MedAccess, an innovative finance mechanism that makes medical products more affordable and accessible across Africa and South Asia, bringing the total committed under this approach to $499 million (Q4 2018) with an ambition to commit up to $1.6 billion by 2021. As CDC introduces more strategies it will communicate further about the aims of its approach, including publishing the financial performance of these strategies once they are further established.

Recommendation 6: DFID's business cases for future capital commitments to CDC should be based on stronger evidence of achieved development impact and clear progress on expanding their in-country presence.

Accept: DFID implementing

Any new business case to increase the level of equity invested by DFID in CDC will follow departmental guidelines. It will consider the context, the need and the rationale for the additional capital, as well as the outputs and outcomes expected from the new investment. Evidence of the development impact already achieved by CDC and progress in expanding its overseas country presence will be two of the factors that DFID would consider when assessing any case for further investment capital.

As outlined in responses 1-3, CDC are increasing the breadth and depth of monitoring and evaluation activities to capture and report on a wider range of impact indicators. DFID will also commission an independent review of progress achieved against CDC's strategic objectives before the end of its current strategy cycle. DFID would draw on this information for any future business case.

Since 2013 CDC and DFID have had a clear ambition to build a CDC network of offices. CDC have been mindful of the both the management challenges involved in the transformation of CDC and the need to build a strong organisational culture. CDC have thoughtfully planned their expansion based on the development of its pipeline, its actual investment commitments and prioritising available management capacity.

CDC took a conscious decision to open offices in India where it had the largest amount invested and an established Director. Across Africa it used a network of Regional Directors as a precursor to setting up offices. It has since established offices in Johannesburg (2017), Kenya and Pakistan (2018) with full-time representatives in Ethiopia, Zimbabwe and Myanmar. CDC expects to have permanent staff in place in Nigeria and Bangladesh before the end of 2019. DFID receives quarterly updates on the roll-out of the country coverage plan.