

**Ministry of Foreign Affairs** – (Department for Growth and Employment, VBE)

**Meeting in the Council for Development Policy 12 April 2018**

Agenda item 3

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|---|---|
| <b>1. Overall purpose</b>                       | For discussion and recommendation to the Minister |
| <b>2. Title:</b>                                | Capital Increase of African Guarantee Fund, AGF   |
| <b>3. Presentation for Programme Committee:</b> | 23 February 2018                                  |

# Capital Increase of African Guarantee Fund (AGF)

## Key results:

Together with other investors contribute to the achievement of AGF's 5-year Strategic Plan (2017-2021) which include a substantial capital increase to ensure AGF's growth potentials:

- Up to 10,000 SMEs per annum secured access to loans with AGF guarantees. first time borrowers represent a very significant share of these SMEs
- About 60% of benefiting SMEs are owned by youth and 30% are owned or led by women
- Creation of up to 30,000 new decent jobs annually and retention of a similar number of existing jobs
- Substantial incremental revenue from supported SMEs also leading to increased tax revenue
- Contribution to longer term behavioural changes in the Partner Finance Institutions, in favour of SMEs
- Capacities of Partner Finance Institutions and SMEs strengthened
- AGFs capacity strengthened in managing green and climate relevant financing as well as the integration of international standards for responsible business conduct

## Justification for support:

- The SME sector is of crucial importance to promote economic and social development and stability in Africa through the generation of income, employment, public revenue, innovation etc., but the majority of SMEs have no or very limited access to finance
- The total African SME financing gap is estimated at USD 150 billion
- The outcome and performance of AGF is very promising - additional capital is needed to meet demand
- The new commitment is fully in line with Danish and international development policies emphasising the importance of using donor funds to catalyse the mobilisation of private capital for investments, and thereby promote the generation of jobs, not least for youth and women

## Major risks and challenges:

- The contextual risk (Africa) is manageable as the portfolio is spread over a large number of countries, sectors and financial institutions. AGF has implemented comprehensive risk management procedures
- Inadequate investor interest is manageable. AGF has proved the validity of its business model, and obtained an AA- rating by the Fitch rating agency.

File No.	2017-39815					
Country	Africa region					
Responsible Unit	VBE					
Sector	Small and Medium sized Enterprise financing					
Partner	African Guarantee Fund and IFU					
	DKK mill.	2018	2019	2020	2021	Tot.
Commitment	100					
Projected ann. disb.	100					
Duration	2018-2020					
Previous grants	250.9					
Finance Act code	§06.32.01.23					
Head of unit	Ole Thonke					
Desk officer	Jørn Olesen					
Financial officer	Hans-Henrik Christensen					

## Relevant SDGs [Maximum 1 – highlight with grey]

 No Poverty	 No Hunger	 Good Health, Wellbeing	 Quality Education	 Gender Equality	 Clean Water, Sanitation
 Affordable Clean Energy	 Decent Jobs, Econ. Growth	 Industry, Innovation, Infrastructure	 Reduced Inequalities	 Sustainable Cities, Communities	 Responsible Consumption & Production
 Climate Action	 Life below Water	 Life on Land	 Peace & Justice, strong Inst.	 Partnerships for Goals	

## Strategic objectives:

The overall objective is to contribute to the implementation of AGF's Strategic Plan 2017- 2021, including AGF's fund raising targets, in order to enhance AGF's guarantee business and develop AGF into a commercially based guarantee institution able to mobilise capital from Development Finance Institutions (DFI) and on a longer term also private investors.

## Justification for choice of partner:

Denmark is one of three founders of AGF. The involvement of IFU represents a new strategic investor group which is required for AGF's development and mobilisation of capital from more commercially oriented investors including Development Finance Institutions (DFIs). AGF is recognised for its performance and results. AGF has since its establishment in 2012 signed guarantee agreements with more than 100 Partner Finance Institutions in 38 African counties, facilitated USD 800 million in loan disbursements to almost 8,000 SMEs.

## Summary:

AGF needs to raise additional share capital as well as grants for capacity development of Partner Finance Institutions and SMEs to address strong market demand. Special focus is on attracting Development Finance Institutions like IFU due to their financial capacity, commercial orientation and expertise. The Danish contribution will therefore be provided to IFU, which is an ideal new investor for AGF. IFU will add DKK 15 million of its own funds and purchase B-shares in AGF for a total of DKK 100 million. Several donors and DFIs are in advanced stages of assessment and due diligence processes for provision of additional share capital to AGF.

## Budget:

Output 1 Capital contribution to AGF allocated through IFU	DKK 85
Output 2 Contribution to AGF's Capacity Development Trust	DKK 13
Output 3 Contribution to AGF internal capacity development (green, climate and sustainability)	DKK 2
<b>Total</b>	<b>DKK 100</b>

**Project Document**  
**Capital Increase of African Guarantee Fund for**  
**Small and Medium-sized Enterprises**

March 2018

File: 2017-39815

## Cover Page

Countries:	Africa
Project Title:	Capital Contribution to IFU for purchase of shares in African Guarantee Fund for Small and Medium-sized Enterprises (AGF)
Start-End Date:	2018 – share capital locked until 2028
Budget:	DKK 100 million of which: <ol style="list-style-type: none"><li>1. DKK 13 million will be provided as a grant to AGF's Capacity Development Trust and DKK 2 million will be provided to AGF for capacity development of staff in order to enhance their capacity to handle climate investments and sustainability standards.</li><li>2. DKK 85 million will be channelled as a grant to the capital of IFU, which together with DKK 15 million of own resources will buy B-shares in AGF for an amount of DKK 100 million.</li></ol>
Oversight:	At present, MFA has nominated IFU's Senior Vice President to represent the Danish interest in AGF's Board of Directors until the end of 2019. The Danish board member will also represent IFU. As from 2020 it is envisaged that IFU will take over responsibility and appoint a board member following IFU's own procedures.

The entrance of IFU as a shareholder will provide AGF with a new strategic and professional investor which can contribute to AGF's future development and facilitate the mobilisation of capital from new investors including Development Finance Institutions (DFI). At the same time, it will further ensure that MFA can prepare a gradual exit which will be satisfactory for AGF and maintain the confidence of existing and future investors.

As one of the five initiatives adopted by the Africa Commission (2009), AGF was established during 2011-2012 with support of Denmark, Spain and the African Development Bank to address the financing gap of African SME with the view to create economic growth and decent jobs for youth.

The progress and performance of AGF has been successful. Today AGF is experiencing a demand for guarantees that is about the double of what it can meet, given its current share capital (USD 87.2 m) and therefore needs to raise additional share capital as well as grants for capacity development of banks and SMEs to mitigate risks. Special focus is on attracting development finance institutions such as IFU, which can be facilitated by blended finance models such as the one in this project where MFA contributes DKK 85 million to IFU's capital and IFU buys B-shares for DKK 100 million using DKK 15 million of own capital. This is the first step in a planned MFA exit strategy where IFU is envisaged to replace MFA as shareholder in AGF by a gradual transfer, during 2020 – 2024, of MFA's shares in AGF to IFU.

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## Abbreviations

AfDB	African Development Bank
AECID	Spanish Agency for International Development Cooperation
AFD	Agence Française de Développement (French Development Agency)
AGF	African Guarantee Fund for Small and Medium-Sized Enterprises
AGF-CD	African Guarantee Fund – Capacity Development Trust
CEO	Chief Executive Officer
Danida	Danish International Development Assistance
DFI	Development Finance Institution
DKK	Danish Kroner
FMO	The Netherlands Development Finance Company
GARI	Le Fonds de Garantie des Investisseurs Privés en Afrique de l'Ouest
GCF	Green Climate Fund
IFC	International Finance Corporation
JICA	Japan International Cooperation Agency
KFU	Technical and Quality Support department of the Ministry of Foreign Affairs
KfW	German government-owned development bank
MFA	Ministry of Foreign Affairs of Denmark
MSME	Micro, Small and Medium Enterprises
M&E	Monitoring and Evaluation
NDF	Nordic Development Fund
ODA	Official Development Assistance
PFI	Partner Finance Institution
Sida	Swedish International Development Cooperation
SME	Small and Medium Enterprises
VBE	Growth and Employment Department of the Ministry of Foreign Affairs
UNGP	United Nations Guiding Principles on Human Rights and Business
USD	United State dollar

Exchange rates	
1 USD	DKK 6.00
1 DKK	USD 0.17

# 1 Introduction

This Project Document presents the rationale and justification, the objectives and expected outcomes and impact as well as the management arrangements for the allocation of DKK 100 million for the African Guarantee Fund for Small and Medium-sized Enterprises (AGF), which is included in the 2018 Finance Act.

AGF was one of five concrete initiatives presented by the Africa Commission. The background of the initiative was that African SMEs are constrained by limited access to finance, in particular medium and long-term finance required for investment in new technology and productive plant. The total financing gap is estimated at around USD 150 billion<sup>1</sup>. As a consequence, the potential of African SMEs to contribute to economic growth, poverty reduction and creation of decent jobs for youth is far from utilised. Many factors contribute to this gap, including a collateral gap, unrealistically high risk perceptions among lenders, and lack of knowledge on lender and SME side about the requirements of the other. AGF addresses these issues by capacity development support and by guaranteeing part of the risk of individual SME loans or a certain SME portfolio. It also promotes loans with longer tenor by providing guarantees with long tenor, and through a special Bank Fund Raising Guarantee that allows banks to access long-term funds with African pension funds and others.

AGF was established during 2011-2012 by the three founders: the African Development Bank (AfDB), the Government of Spain through the Spanish Development Agency (AECID) and the Government of Denmark through MFA. The initial share capital of USD 50 million (MFA USD 20 m) has been increased through an additional Danish equity contribution of USD 16.5 million in 2013 and entrance of new shareholders, the Nordic Development Fund (NDF) and the French development agency AFD. At present, the total share capital amounts to USD 87.2 million of which Denmark holds USD 36.5 million or 42%. Due to limited equity, AGF has had to make use of re-guarantees to meet the demand of its clients (including Swedish SIDA: USD 50 million and GuarantCo<sup>2</sup>: USD 50 million).

AGF is registered in Mauritius as a private non-bank financial institution. Mauritius has a well-developed legal and regulatory framework enabling financial institutions to operate across the African continent, and has specialists in French and English languages and law. AGF has its operational headquarters in Nairobi, Kenya. Profits are taxed in countries where earned, meaning that on guarantee operations AGF is taxed in Kenya, whereas it is taxed in Mauritius on treasury investment profit. All staff are taxed in countries where they are domiciled. Recently, AGF has established a regional branch office for West Africa in Lomé in Togo through acquisition of GARI, a guarantee company established by the French development agency ADF.

AGF came into operation in 2012 and has since then established guarantee agreements with more than 100 partner financial institutions in 38 African countries, facilitated USD 800 million of loan disbursements to close to 8,000 SMEs which have established an estimated 68,000 new decent jobs and

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<sup>1</sup> A recent study by IFC/World Bank suggests a total financing gap of micro, small and medium enterprises, including the informal sector, of more than USD 300 billion.

<sup>2</sup> GuarantCo is sponsored by the governments of Australia, UK, Sweden, Switzerland and Netherlands through the Private Infrastructure Development Group and FMO

enhanced productivity of a similar number of existing jobs.<sup>3</sup> The majority of SMEs are first-time borrowers, and 60% are owned or led by youth and 30% by women. Furthermore, the increase in turnover, profits and salaries is envisaged to substantially increase the contribution of SMEs to government tax revenue. AGF has also achieved another of its objectives, which is to facilitate loans with longer tenor (4 years) so that SMEs can invest in new technology and productive plant. AGF has achieved financial sustainability, obtained a rating of AA- by Fitch and received three international financial sector awards.

With support from NDF, AGF has established a green guarantee facility to support climate-relevant and green investments. Thus, AGF contributes to several of the Sustainable Development Goals and is aligned with Denmark's development strategy (World 2030).

At present, AGF has insufficient capital to meet the demand, expand its country coverage and meet the targets of its Five Year Strategic Plan: (i) Easing the access of SMEs to USD 1.6 billion of financing at an average tenor of 5 years; (ii) support 10,000 SMEs per annum; and (iii) create 30,000 jobs per annum. This support contributes to achievement of these targets,

As part of its Strategic Plan AGF has engaged in the first round of a fund raising where expectations are that more than USD 100 million will be mobilised during 2018-2019 in new share capital. Several agencies are currently considering a share purchase, including AfDB, the European Commission, and the Global Climate Fund. Special attention is given to getting professional financial institutions on board, such as for example the German development bank KfW with funds expected from the German aid budget, the Dutch development finance institution FMO, and the Danish IFU.

Given the return requirements of development finance institutions (DFIs) and AGF's relatively modest return on equity during the next years, this will require blended finance where governments, using Official Development Assistance (ODA), finance part of the share purchase of the DFI. For this reason, DKK 85 million of the allocation is proposed transferred to IFU's capital on the condition that IFU mobilises DKK 15 million from own resources to buy DKK 100 million of B-shares. AGF is an interesting organisation for IFU and other DFIs due to its extensive business experience with the finance and SME sectors in Africa, and the DFIs are an attractive investor group for AGF's future development due to their financial capacity, commercial approach, expertise and networks.

DKK 13 million of the allocation is proposed transferred as a MFA grant to the AGF Capacity Development Trust (AGF-CD), which was registered in January 2013 as a non-charitable purpose trust. The objective of the AGF-CD is to improve the performance of PFIs and SMEs and thereby reduce the risks associated with the provision of loan guarantees. Secondly, combined with guarantees, the capacity development support aims at transforming the financial sector to better serve SMEs. In 2013, MFA provided a grant of USD 2.3 million to the trust. The trust is currently short of funds.

Finally, DKK 2 million of the allocation is proposed transferred as a grant to AGF to develop the internal capacity of AGF to deal with financing of climate and green investments and comply with international sustainability standards for good business conduct.

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<sup>3</sup> The employment impact figures are estimated on the basis of AGF's first impact study, conducted in 2016, based on a sample of 132 SME beneficiaries. A new impact study is envisaged to be conducted in 2019.



The involvement of IFU is also envisaged to be a first step towards a possible future MFA exit where the MFA C-shares will gradually be transferred to IFU. MFA will start the analyses and processes in 2019 aiming at a gradual transfer of the C-shares to IFU during 2020 – 2024 and with the conditions that the shares will be locked for a longer period, e.g. until 2028. Separate analyses will be made based on which the necessary documentation for approval of the transfer will be prepared and presented to the relevant authorities for approval.

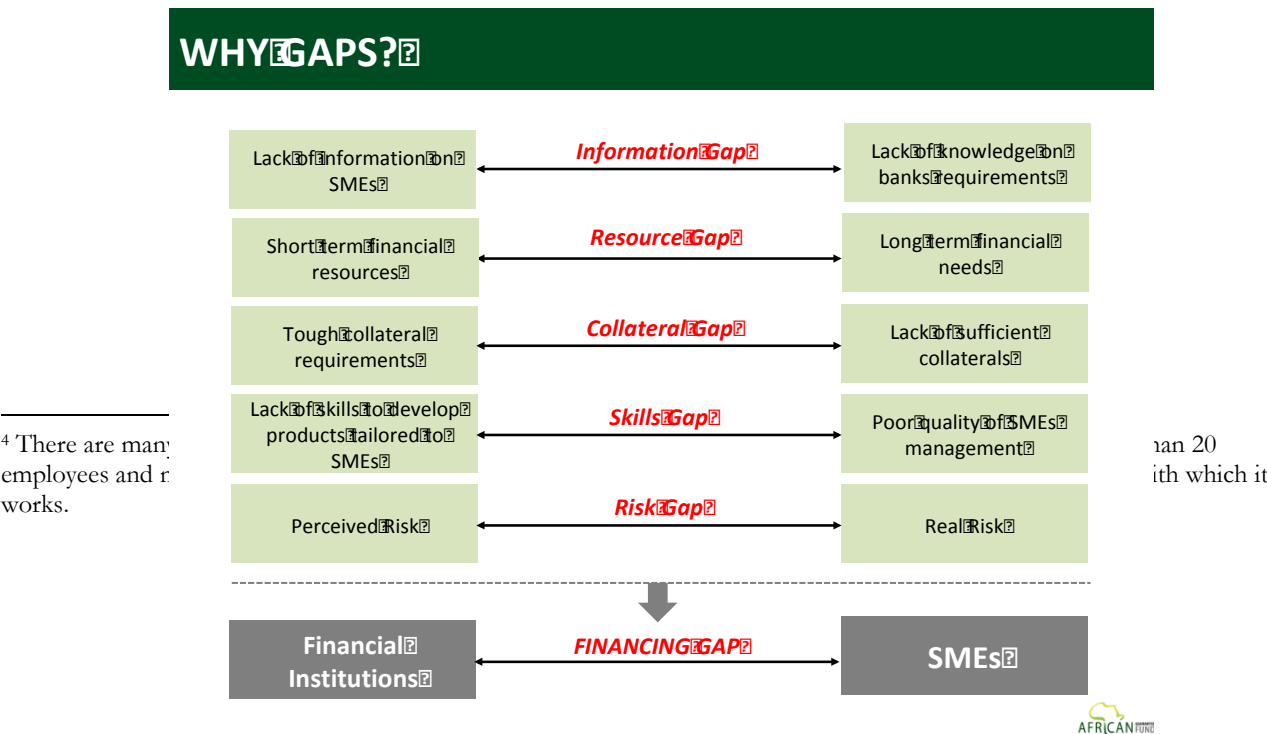
## 2 Brief summary of issues to be addressed and institutional context

### 2.1 Issues to be addressed

The total financing gap of African SMEs has by various studies (Word Bank/IFC, AfDB) been estimated at around USD 150 billion. Banks focus on corporate and multi-national companies as well as large enterprises whereas microfinance institutions serve many micro enterprises. SMEs are the un-served or under-served missing middle. Access is in particular limited for small enterprises (<20 employees)<sup>4</sup>. The World Bank estimates that only 16% of small enterprises in Sub Saharan Africa have access to formal financial services whereas 31% of medium enterprises have access.

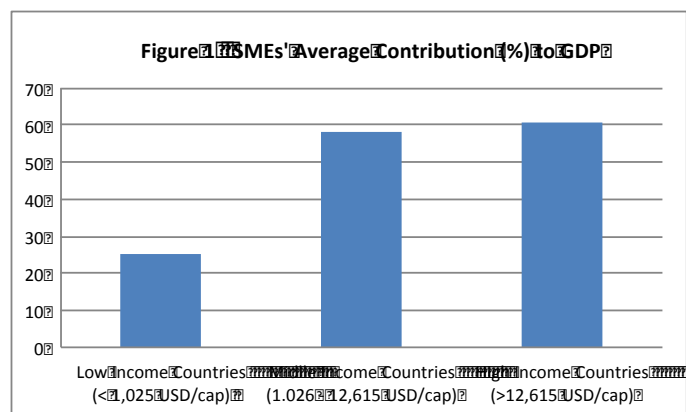
The limited access to finance of African SMEs has two main explanations: First, an information/knowledge gap where banks and lending institutions perceive the risk of lending to SMEs as much higher than the real risk; this also applies to central banks and financial sector regulators which in many cases enter the SME portfolio with a risk weight of 100% or more when calculating the capital adequacy ratio. Banks often have limited knowledge about SMEs and the financial products they need. Also among SMEs, there is insufficient knowledge on the information requirements of banks as well as management deficiencies. Secondly, there is a collateral gap, where African SMEs are unable to provide the collateral demanded by the lenders (and regulators).

The relatively short loan tenor of SME finance is caused by the fact that the banks’ resources (current accounts/deposits=liabilities) largely are short-term which places a limit on how much can be converted into long-term loans (assets). While many SMEs have access to limited over-draft facilities or short-term loans of one year or less to support their working capital needs, they do not have access to medium- and long term finance that they need to invest in machinery and other productive capital that is necessary to improve productivity and provide decent jobs.



Consequently, the growth of the SMEs is constrained and labour productivity in the SMEs is lower than average labour productivity in the economy. Thus, their contribution to employment and GDP is substantially lower than their potential. The Africa Commission considered utilisation of this potential as a priority for addressing the issue that millions of young Africans enter the labour market each year, looking for decent employment but often in vain.

In spite of accounting for most of registered enterprises and the major part of job creation, the contribution of African SMEs to GDP is only about 20%, which indicates that labour productivity is low, primarily due to insufficient equipment and productive capital, which in turn is due to limited access to finance, in particular medium and long term finance. In the EU, the GDP contribution of SMEs ranges from 40 to 60% and in some Asian economies it is even higher. This is in line with the general trend that the GDP contribution of SMEs is higher in richer countries with more developed and inclusive financial sectors.



In recent years the African banking sector has been expanding rapidly, providing for increased financial deepening. However, there are significant differences between sub-regions; for example, bank assets as a percentage of GDP is only 19% in the Central African Region but 75% in the southern Africa region (please refer to Annex 1).

## 2.2 Institutional context - AGF

**AGF's legal structure:** In 2011, AGF Ltd was registered as a private non-bank financial institution under the Mauritius Securities Act, with the African Development Bank, and the governments of Denmark and Spain as the founders.

There are several advantages of having home base in Mauritius<sup>5</sup>. Mauritius has a very well developed legal and regulatory framework enabling financial institutions to operate across the African continent. Guarantee operations involve many legal issues, related to contracts and settlement of compensation claims. The legal framework of African countries is largely defined by their different colonial past, i.e.

<sup>5</sup> In 2017, OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes noted: Mauritius has demonstrated the availability and accessibility of both legal and beneficial ownership information, as well as accounting and bank information in practice. Peers continue to be satisfied with the quality and timeliness of Mauritius' information exchanges.

primarily by French and English languages and law. The advantage of Mauritius is that it applies both and has legal specialists in both languages and systems. In case of legal disputes, the legal system of Mauritius provides for final settlement by Privy Council in the UK. AGF's legal officer has home base in Mauritius but with extended working periods at operational headquarters in Nairobi. Secondly, Mauritius has a conducive framework for money transfers to and from African countries and internationally. AGF/Mauritius holds AGF's capital, which is invested prudently in international bonds and funds, mostly in London. Treasury income from these investments is taxed in Mauritius at 3%.

AGF's operational headquarters was established during 2012 in Nairobi, Kenya as a private company to serve as the centre for AGF's guarantee operations, where operation and guarantee costs and guarantee revenue is accounted for. Being a private organisation, AGF has avoided bureaucratic red tape, and is therefore able to provide rapid response to its partners. This is a major competitive advantage over public guarantee organisations.

In 2016, AGF acquired the GARI Fund in West Africa, established by the French Development Agency, AFD. The acquisition was done through a share swap with AFD, which then became a B-shareholder in AGF with USD 14 million. GARI is located in Lomé, Togo and was when established granted tax exemption by the Government of Togo, which considers GARI/AGF important for Africa's development. GARI is today fully integrated in AGF as AGF West Africa.

In 2013, AGF established the Capacity Development Trust (AGF-CD) as a non-charitable purpose trust to provide grants on a cost-sharing basis for capacity development of PFIs and SMEs. In 2013 Denmark provided a grant of USD 2.3 million to the AGF-CD, and in 2016 NDF provided a grant of USD 1.7 million. There is a strong demand for PFI and SME capacity building activities which can improve the PFI and SME performance and hereby reduce AGF's risk. Most capacity building activities have been conducted in 2016 and 2017.

**Capital Structure:** AGF applies what is termed a *subordination waterfall structure*, with three classes of shares for allocating losses and earnings. C-shares or Junior Shares have first loss cover and target bilateral donors; B-shares or Mezzanine Shares have second loss cover and target Development Finance Institutions (DFIs) and charitable private funds; and A-shares or senior debt target private impact investors. AGF plans to target A-share investors after 2021. At the moment the share capital is composed as presented in the table 1. C-shares constitute 72%, which in reality eliminates the risk of B-shares. Thus, without increasing the C-share capital there is ample room for a major expansion of the B-share capital.

**Governance and organisational structure:** AGF's organogram is presented in Annex 2. It should be highlighted that GARI today is fully integrated in the organisation as AGF West Africa. The organisational structure provides for adequate checks and balances with separate lines for business

**Table 1. AGF's Equity Structure (end 2017)**

	USD 1000	% of Total
<b>A-shares</b>	0	0
<b>B-shares</b>	4,000	28
AFD	4,000	16
AfDB	0,000	11
<b>C-shares</b>	3,191	72
MoFA/Danida	6,500	42
AECID	0,000	23
NDF	6,691	8
<b>Total Equity</b>	<b>7,191</b>	<b>100</b>

development, risk assessment, internal control and monitoring and evaluation. Oversight is provided by the Board and its sub-committees for investments/guarantees, capacity development, audit, human resources development (HRD), and treasury management. In the Strategic Plan, there is in addition provision for establishing a board committee on risk management.

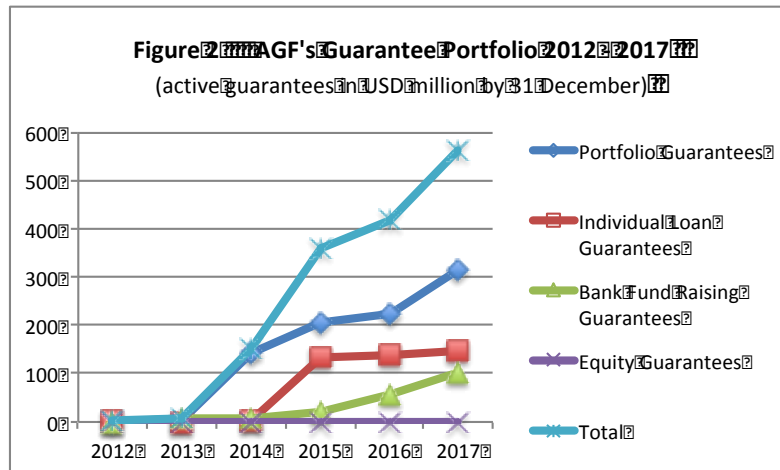
**AGF policy priorities:** Whereas AGF is obliged to give high priority to its financial sustainability, it is apparent that AGF in its strategies and daily operations assigns high priority to achieving development impact and contributing to the Sustainable Development Goals (SDGs). Focus is on creation of decent work<sup>6</sup> and business for youth and women, clean energy and sustainable use of natural resources. In terms of sector focus, priority is given to agribusiness, energy and infrastructure.

**AGF's staff:** AGF has today 40 staff, comprising 12 different African nationalities. Thus, AGF is a truly African organisation. About 40% of the staff are women, and AGF management is aiming at gender balance. Through interaction with the staff, the formulation team found that the staff is highly competent and specialised. Furthermore, there seems to be a good corporate culture including adequate staff incentives.

**AGF's guarantee products:** AGF's menu comprises four guarantee products: (i) portfolio guarantees supporting the SME portfolio of the PFIs; (ii) individual loan guarantees guaranteeing part of the lender's risk of lending to an individual enterprise (mainly medium-sized); (iii) bank fund raising guarantees enabling banks to access long-term funds from pension and private funds, thus allowing banks to increase their loan tenor; and (iv) equity guarantees reducing the risk of private equity funds and similar when investing in SMEs to increase the equity and long-term resources, enhancing the collateral of SMEs and thereby also improving access to loan finance. For further details, please refer to Annex 2.

Since 2013, there has been exponential growth in AGF's guarantee portfolio. Active portfolio (committed guarantees minus amortisation and non-activated guarantees) has reached USD 600 million, comprising

portfolio and individual guarantees and bank fund raising guarantees. The equity guarantee product has been under refinement and development. However, the first equity guarantee is expected issued in 2018. This product could, in particular, be beneficial for DFIs and private investors who invest in equity and SME funds.



<sup>6</sup> ILO defines "decent work" as involving "opportunities for work that is productive and delivers a fair income, security in the workplace and social protection for families, better prospects for personal development and social integration, freedom or people to express their concerns, organize and participate in the decisions that affect their lives and equality of opportunity and treatment for all women and men".

Portfolio guarantees account for the major part followed by individual guarantees. In portfolio guarantees, AGF only assesses the lender which then assesses the SME whereas in the individual guarantee AGF assesses both lender and borrower. Fund raising guarantees had a slow start but have recently had high growth and by end 2017 the active<sup>7</sup> fund raising portfolio had passed USD 100 million.

**AGF's Capacity Development Trust:** Since its establishment in 2013, the Trust has provided support for 26 capacity development initiatives, of which 16 have addressed the needs of PFIs. Capacity development can be part of the guarantee agreement with PFIs where AGF finds risks that need to be mitigated. Grants are provided on a cost-sharing basis where the beneficiary is to finance about 50% of capacity development costs. The Trust is currently short of funds; by end 2017, tentative pledges were more than the available balance in the fund (please refer to Annex 2).

**AGF's Achievements:** Within a period of five years, AGF has from scratch entered into guarantee agreements with more than 100 PFIs in 38 countries, which has facilitated loan disbursements (accumulated) of USD 800 million to 7,600 SMEs, with a loan tenor of 4 - 5 years (compared to 1-2 years)<sup>8</sup>, which has generated 68,000 new jobs and improved productivity and security of a similar number of jobs.

**AGF's financial performance:** After minor losses in the establishment phase 2012 - 2014, AGF turned into profit in 2015 (USD 3.6 m) and 2016 (USD 3.65 m). The annual report and audit for 2017 is currently under preparation. Though a profit is expected, it is likely to be lower than in 2015 – 2016 due to taking the full loss on AGF's first bank fund raising guarantee issued to a bank in Zambia that has gone into bankruptcy. However, AGF expects later on to recover a major part of the loss. During its first five years (2011 -2016) AGF has maintained a non-performing loan ratio of 2% while the incurred annual losses on issued guarantees have been less than 1%. For the period 2017 – 2021, AGF expects an annualised default rate (net of recoveries) of 1% and a gradual increase in return on equity from 1.3 in 2017 to 4.3% in 2021. AGF expects to start paying company tax in Kenya as from 2018.

**Compliance with standards for good business conduct:** AGF is guided by international normative standards such as the UN Guiding Principles on Human Rights and Business (UNGP) but the SME context and regulatory framework is in many African countries not conducive to ensuring compliance with international standards. Therefore, it is often a question of promoting a process of improvement rather than ensuring strict compliance. Furthermore, AGF has in many cases only indirect control/influence. For portfolio guarantees AGF relies on the PFI to assess the SME. However, guarantee agreements include lists of prohibited sectors and SMEs and provisions for sanctions against the PFI in case AGF in its sample surveys should identify violations (see Annex 2). Though this list provides safeguards against major reputational risks, it is narrow in relation to UNGP, but it is work in progress.

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<sup>7</sup> Active guarantee portfolio is different from and significantly lower than committed guarantee portfolio. Active portfolio is reduced as loans are repaid and often it may take the bank several months before starting to utilise and activate the signed guarantee.

<sup>8</sup> AGF's Annual Report 2016 informs: "average loan tenor has grown from less than 24 months in 2014 to 60 months by December 2016"

**Evaluations, Ratings and Awards:** During 2015-2016, the Ministry of Foreign Affairs/Danida implemented an evaluation of the results of the Africa Commission<sup>9</sup>. Though based on data from the start-up phase, the evaluation found AGF to be relevant and having good prospects of achieving effectiveness and sustainability. The Evaluation had the following conclusions: “It (AGF) is assessed as likely to see good results in the future and hence good potential for both expansion and replication, and may in that sense have transformative capacity”. While noting that AGF is “on a promising path towards achieving its goal”, the Evaluation also noted that the challenge will be to balance the focus on becoming a self-sustaining market-oriented entity, on one hand, and on the other, the expansion to include banks and countries with higher risk in order to enhance impact.

In 2017, AGF was rated AA- by the Fitch rating agency, and this is the second-highest rating of any African financial institution (only surpassed by the African Development Bank with a AAA rating). The high rating was based on several considerations, including strong owners with commitment, a very strong capital position, and good risk management. The rating report had amongst others the following observations: “the company was profitable in 2015 and 2016 – just three years after its incorporation in 2012 – and therefore proved its business model. AGF has a long-term return on capital target of 2.5%-5%, which we view as achievable”. “Fitch believes AGF can become a medium-sized financial guarantor”.

The AA- rating has important implications for AGF’s capital mobilisation, competitive position and the partner banks. According to AGF some financial regulators have reduced the risk weight assigned to the part of the SME portfolio guaranteed by AGF to 20% (often from above 100%) which provides space for the banks to increase their lending while adhering to the capital adequacy ratio. Thus, compared to other guarantors, who do not obtain a reduction of risk weight, AGF is becoming more attractive.

Since its launch, AGF has received the following awards: the African Banker Award for “best financial institution for financial inclusion”; an award by International Finance for “best SME financing company”; and finally AGF has been awarded inclusion in World Finance 100<sup>10</sup>.

### **3 Strategic considerations and justification**

#### **3.1 Justification of proposed support**

The Danish allocation is provided to support AGF’s 5-year Strategic Plan, 2017 – 2021 which maintains AGF’s original vision and mission (see Annex 2) and defines the ambitious targets of supporting at least 10,000 SMEs per annum to have access to a minimum of USD 1.6 billion of financing with an average loan tenor of 5 years, with the view to create at least 30,000 jobs per annum. The financial target of the Strategic Plan is to raise net return on equity from 1.2% in 2017 to 4.2% in

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<sup>9</sup> Tana for the Ministry of Foreign Affairs of Denmark, June 2016: Evaluation of the Results of the Africa Commission: Realising the Potential of Africa’s Youth

<sup>10</sup> The World Finance 100 celebrates those who have reached the pinnacle of achievement across a wide variety of fields of expertise, as well as those organisations and individuals that lead the way in driving their industries forward. Each year World Finance compiles the list of 100 individuals and companies – not according to capitalisation figures or growth (like the FTSE 350 or Deloitte Fast 500 respectively), but purely on excellence in their field.

2021. Special priority is given to agro-industry, energy and infrastructure as well as to green climate investments, including more sustainable use of natural resources.

**Purchase of B-shares:** AGF is currently experiencing a demand for its guarantee products, which according to its own estimates is about 238% more than what AGF can provide with its current capital. In order to partly bridge the gap, AGF has to use syndicated guarantees and re-guarantees which do not provide any major contribution to AGF's return on equity. Furthermore, AGF still has to launch operations in a number of African countries. Seven new countries, including some major countries in southern Africa, are planned for inclusion in the immediate future. Finally, the Five Year Strategic Plan has the target to further extend loan tenor, from 4 to 5 years. Therefore, a significant expansion of AGF's capital is required and planned for.

In order to achieve the outreach targets the Strategic Plan estimates that AGF's equity needs to be expanded by some USD 420 million, which is an ambitious target. The proposed Danish purchase of B-shares, USD 16.7 million, represents 4% of this target. In the first round of fund mobilisation 2018-2019, it is likely that AGF may raise most of its targeted USD 120 million.

While the long-term goal is to raise private capital, AGF recognises that this is unlikely before 2021. Guarantee business is inherently not a high-return business and in the next five years AGF is likely to raise its risk profile. Thus, fund raising till 2021 will focus on donors (C-shares) but in particular development finance institutions (DFIs) and private charitable institutions (B-shares) in order to create synergies with such professional financial investors. However, the expected return on equity of 2-4% is for many DFIs below their minimum return requirements. In order to attract DFIs, it would therefore be necessary to develop blended finance, blending ODA and DFI resources, along the model proposed for this Danish allocation (MFA/IFU).

**Grant for capacity development:** AGF recognises that its primary role as well as its additionality and impact consist in moving lenders out of their comfort zone and lend to new clients and/or extend loan tenor. Once a first-time borrower has performed well under the first loan and developed a relation of confidence with the lender, guarantees may no longer be required. Continuously moving the risk frontier involves risk to AGF and the PFIs, which need to be mitigated by capacity development support for PFIs as well as SMEs. While AGF in the start-up phase gave priority to large banking groups and first tier banks<sup>11</sup>, the proposed expansion will involve inclusion of third tier banks as well as countries with higher risk profiles. In order to mitigate this increased risk, the Strategic Plan considers it necessary to ensure a major increase in the resources of the Capacity Development Trust. Furthermore, with establishment of the green guarantee facility, AGF is "pushing" PFIs into new territory to finance green and climate investments in which PFIs have no or limited experience. For example, investments in energy efficiency follow a different model and logic (investment for cost savings) than what PFIs are used to (investment for revenue growth).

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<sup>11</sup> The 3-tier classification of banks may be (roughly) defined as: first-tier = commercial banks with full range of banking services and subject to and in compliance with full set of regulatory requirements; second-tier = banks that have a more limited focus and range of services; third tier = banks, often member based such as cooperative banks, that are not subject to full set of regulatory requirements.

The Strategic Plan targets additional grant contributions of USD 20 million. By 31<sup>st</sup> December 2017, the Trust Fund is facing a projected cash flow deficit considering tentative commitments and available resources (please refer to Table 2.2 in Annex 2). The proposed Danish grant of DKK 13 million (USD 2.17 m) represents 11% of this target.

**Grant for internal capacity and human resource development:** General capacity development of staff related to AGF's core business is part of AGF's human resource policy and operational budget. Most staff members are financial sector specialists with some experience in SME development. With establishment of the green guarantee facility AGF is moving into territory unfamiliar to staff. Furthermore, AGF's internal capacity for managing the demands of international standards on sustainable business, including the UNGP is still in the process of being developed. Therefore, capacity development support is required related to financing of climate-relevant and green investments, and international standards on sustainable business. A minor grant of DKK 2 million (USD 330,000) is included for this purpose.

### **3.2 Alignment with Danish development strategy**

AGF is fully aligned with Denmark's current strategy for development cooperation and humanitarian action as defined in World 2030<sup>12</sup>. Also AGF contributes to several of the UN Sustainable Development Goals (SDGs) to which Denmark subscribes.

The Danish strategy recognises that official development assistance (ODA) can only play a minor role in achieving the SDGs and therefore, that ODA needs to serve as a catalyst for leveraging and mobilising domestic resources and private funds. AGF is designed to do just that. An investment in AGF's capital of one dollar leverages loans for SMEs of six to eight dollars, using African resources, and the involvement of IFU as investor further catalyse the mobilisation of additional funds.

The SME sector is of crucial importance to promote economic and social development and stability in Africa through generation of income, employment, public revenue, innovation incl. digitalisation. A key impact objective of AGF and the Danish strategy is to create business opportunities and decent employment for youth and women. So far AGF has created an estimated 68,000 new direct jobs, of which the majority are filled by youth, and the productivity and security of some 69,000 existing jobs has in some form been improved. About 60% of the SMEs receiving guaranteed loans are owned by youth. Furthermore, 30% of the supported SMEs are owned or managed by women. African SMEs also play a major role in innovation<sup>13</sup>, and in industry and infrastructure development. Finally, SMEs provide a major contribution to government revenue, through VAT, company tax and salary/income tax.

With support of NDF the green guarantee facility was launched in 2016 and is supporting renewable energy and energy efficiency.

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<sup>12</sup> Ministry of Foreign Affairs of Denmark/DANIDA, 2016: The World 2030 – Denmark's strategy for development cooperation and humanitarian action

<sup>13</sup> SMEs account for 35% of patent applications in Africa



### **3.3 Possible future MFA Exit Strategy**

A primary purpose of Official Development Assistance and MFA/Danida is to initiate and catalyse development and not to be a permanent shareholder in a well-established going private company. AGF is expected to reach such a state in the first half of the 2020s where it then would be appropriate for MFA/Danida to exit. However, it is important that Denmark maintains a long-term role and commitment given that Denmark is the key founder of AGF. Donor/investor stability is important for AGF, for its rating and ability to mobilise capital from new investor groups. Both can be achieved by an envisaged future gradual transfer of the MFA's current C-shares (USD 36.5 million) to IFU over the period 2020 – 2024.

On 31<sup>st</sup> January 2018, IFU's Board approved a binding commitment to this proposal, including the proposal to invest DKK 100 million in B-shares, using DKK 15 million of own capital and the contribution of DKK 85 million from MFA to IFU's capital as included in this allocation. IFU's purchase of B-shares will take place in 2018. IFU's approved binding commitment also includes that IFU can only sell the purchased B-shares in 2028 at the earliest, i.e. a lock-in period of 10 years. It is envisaged that this model of blended finance will inspire other DFIs to enter as it allows DFIs to meet their requirements for a minimum return on equity, which in most cases is above what AGF expects to generate in the medium term.

It is the intension that MFA in 2019 will initiate analyses and processes aiming at a gradual transfer of the C-shares to IFU during 2020 – 2024 and with the conditions that the shares will be locked for a longer period, e.g. until 2028. Separate analyses will be made based on which the necessary documentation for approval of the transfer will be prepared and presented to the relevant authorities for approval.

The entrance of IFU as a shareholder will provide AGF with a new strategic and professional investor, which can contribute to AGF's future development and facilitate the mobilisation of capital from new investors including DFIs. At the same time, it will further ensure that MFA can prepare a gradual exit, which will be satisfactory for AGF and maintain the confidence of existing and future investors.

As compared to MFA, there are better opportunities for synergies between AGF and IFU which both work with financial institutions, and SME- and impact-funds in Africa. IFU can benefit from AGF's valuable information and knowledge on its extensive network with financial institutions in Africa, and AGF can benefit from IFU's experiences. IFU is expected to increase its investments in financial institutions in Africa with a focus on SME's to strengthen the synergy.

## **4 Theory of change and key assumptions**

An abbreviated version of AGF's theory of change is presented below whereas a more elaborate version is presented in Annex 3.

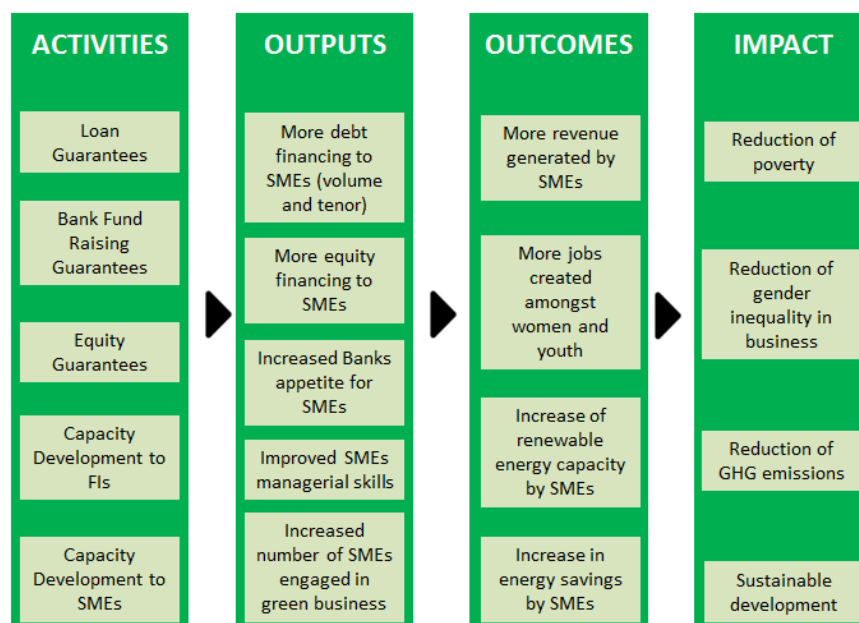
The key underlying assumption, as in all guarantee schemes, is that the increase in lending would not have happened without the guarantee or the loan tenor would have been much shorter without the guarantee, i.e. additionality. The first is inherently difficult to assess but the fact that the majority of SMEs who borrow with backing of an AGF guarantee are first-time borrowers does suggest that this

assumption is fulfilled. Of the 7,600 SMEs which so far have benefited from guaranteed loans, about 6,300 are first-time borrowers, which provides an indication of AGF's additionality and focus on youth.

With the respect to loan tenor, there is ample evidence to demonstrate that AGF has had a major impact on increasing loan tenor. Increase in loan tenor is an important objective of AGF. Whereas short loans and microfinance can help an enterprise keep on going, loans of 2-5 years can have transformative impact as they allow the enterprise to invest in new technology and productive plant.

AGF's monitoring and evaluation system is structured according to the Theory of Change and Results Framework. Whereas AGF can rely on information reported by PFIs when it comes to output and activity indicators (number of SME borrowers, loan amount, tenor etc.), AGF needs to do its own regular sample surveys to obtain information on outcome and impact indicators (jobs created for youth and women, company turnover, etc.).

## AGF's Theory of Change



AGF's ultimate goal is that PFIs change behaviour and start lending to SMEs with loans on longer terms, without the support of AGF. While the M&E system is designed to monitor such changes, it is still early days to provide confirmative evidence of such behavioural changes.

At the impact level, AGF's Theory of Change and monitoring and evaluation system only capture the more direct impacts and not important derived impacts. For example, the increased turnover, profits and salaries in the SME following from loan-financed investments do result in an increase in governments' tax revenue. Furthermore, the products and services produced by SMEs can in some cases have transformative impact on the households and communities that purchase the products and services. The example above regarding the Ghanaian SME installing solar-based mini-grids illustrates this point.

So far, AGF's monitoring and evaluation framework only captures changes at the level of PFIs and SMEs. However, there are important changes at household-level as well, among households who own and are employed by the SME. And sometimes there can be derived dynamic multiplier effects along the value chain and in the community where the SME operates.

## **5 Project objective and summary of results frame**

The proposed allocation is made in support of AGF's vision and mission and AGF's results frame 2017-2021 that is based on the 5-year Strategic Plan. The Strategic Plan maintains AGF's original vision and mission (please refer to Annex 2).

The objectives of the strategic plan 2017 – 2021 are:

1. Easing the access of SMEs to USD 1.6 billion of financing at an average tenor of 5 years
2. Support 10,000 SMEs per annum
3. Create roughly 30,000 jobs per annum<sup>14</sup>

AGF's results frame (Annex 4) is, with minor modifications, based on these targets as well as other targets of the Strategic Plan. AGF will in particular contribute to the achievement of SDG 8 (decent jobs). However, AGF will also contribute to the achievements of a number of other SDGs including SDG 1 (no poverty), SDG 2 (no hunger), SDG 5 (gender equality), SDG 7 (clean energy), SDG 9 (industry and innovation), SDG 13 (climate) and SDG 17 (partnerships). The results frame is work-in-progress and assumes that the fund raising target (USD 420 m) will be achieved. Denmark's proposed purchase of DKK 100 (USD 16.7 m) of B-shares (with DKK 85 million from the ODA budget and DKK 15 million from IFU's own resources) will contribute to these targets together with other equity.

One may ask what Denmark's purchase of USD 16.7 million of B-shares as well as Denmark's future total share capital of USD 53.2 million (USD 16.7 m + USD 36.5 m) is likely deliver in terms of results and outcomes over a 5-year cycle. Assuming that the new share capital is applied immediately, the maintenance of a leverage of 3 of the share capital (amount of outstanding guarantees provided/ AGF capital) and a loan tenor of 5 years as targeted in the Strategic Plan, the results and outcomes have been estimated below in Table 2 using historical ratios for loan size and jobs created per SME.

Conservatively, the expanded Danish share capital will facilitate creation of some 28,000 new direct jobs and strengthening of a similar number of existing jobs in each 5-year cycle. An AGF sample survey indicated that a supported SME on average created 14 new direct jobs but allowing for a statistical

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<sup>14</sup> The indicated generation of 30,000 jobs per annum may be a conservative estimate. AGF studies indicate that the guaranteed PFI loans to the SMEs on average generates 9 new jobs after a few years, but more impact studies are needed before anything can be concluded.

margin of error, a conservative figure of nine has been applied. On average, it costs in loan terms about USD 12,000 to create a new direct job plus improve the productivity of an existing job, which in turn requires AGF equity of about USD 2,000. In addition there may be derived multiplier effects and increased government revenue but also some displacement effects<sup>15</sup>.

**Table 2.7 Projected results/outcomes of the Danish Share Capital in AGF over 25-year cycle**

	Unit	New Shares	Future Total Shares
Danish Share Capital	USD 1000	116,700	113,200
Active Guarantees	USD 1000	110,100	159,600
Loan portfolio facilitated	USD 1000	110,200	319,200
Average loan size	USD 1000	11105	11105
<b>Number SME borrowers</b>	#	11954	118,040
<b>New jobs created (9 per SME)</b>	#	115,890	117,360
<b>Existing jobs strengthened</b>	#	118,665	117,603
<b>Beneficiary youth entrepreneurs (60%)</b>	#	11573	111,824
<b>Beneficiary female entrepreneurs (30%)</b>	#	11286	11912

## 6 Inputs/budget

The budget for the Danish contribution to AGF in 2018 is presented below. MFA's allocation of DKK 100 million is disbursed in 2018 through three transfers: (i) a transfer of DKK 13 million to AGF Capacity Development Trust; (ii) a transfer of DKK 2 million to AGF's human resource development budget; and (iii) a transfer of DKK 85 million to IFU's capital. Upon receipt of DKK 85 million IFU will transfer DKK 100 million to AGF as payment for B-shares, using DKK 15 million of own resources.

The budget is in DKK whereas transfers to AGF are in USD. The USD amounts given below are based on an exchange rate of USD 1 = DKK 6 and will change with changes in the exchange rate.

<sup>15</sup> Displacement effects occur for example when a supported SME becomes more competitive and out-competes its neighbour, which then has to close.

**Table 3.777 Budget for the Danish Contribution to AGF in 2018**

	MoFA	IFU	
	DKK million		USD million
<i>Utilisation of MoFA Allocation</i>			
Grant to AGF-CDT Trust	13		2.17
Grant to AGF HRD	2		0.33
Grant to IFU's Capital	85		14.17
<b>Total</b>	<b>100</b>		<b>16.67</b>
<i>IFU's Purchase of B-shares:</i>			
IFU's Own Resources		15	2.50
Grant from MoFA		85	14.17
<b>IFU's Total purchase of B-shares</b>		<b>100</b>	<b>16.67</b>

Applied Exchange Rate: USD 1.00 = DKK 6.00

## 7 Future share structure

IFU's purchase of B-shares and the share purchases of other partners will change the equity structure. At present, there are pledges from KfW, FMO, the European Commission, NDF, and the Green Climate Fund (GCF) while AfDB has indicated that they may increase their shareholding of B-shares. Several of these partners are advanced in their assessment and approval process but actual share purchase may only take place late 2018 or early 2019. If expectations are fulfilled, Denmark's share of total equity will by mid-2019 be reduced to 25% (IFU 8%, MFA 17%).

While there is reasonable probability that AGF by mid-2019 has increased its equity to around USD 200 million, there is significant uncertainty regarding developments during 2019 - 2021. There are indications from JICA to enter and these indications have been included in the projections for 2021. Though entrance of new shareholders and the recent AA-rating are likely to stimulate the interest of others, the fund raising target of USD 420 million by 2021 does at this stage seem optimistic. A range of USD 280 – 350 million would seem more realistic. In that case, Denmark's share of equity will fall to around 13%. C-shares would still account for about 47%, which appears a sufficient risk buffer for AGF to mobilise additional investments in B and A shares after 2021.

Though not AGF's preferred option, AGF may, as it does today, continue to make use of re-guarantees and syndicated guarantees to meet demand for guarantees.

**Table 4.11 Projections of AGF's Future Equity Structure**

	Mid 2018		Mid 2019		Mid 2021	
	USD million	%	USD million	%	USD million	%
<b>A-shares</b>	0	0	0	0	0	0
<b>B-shares</b>	41	39	86	39	211	53
AfDB	10	10	20	9	20	5
France/AFD	14	13	14	6	14	4
IFU	17	16	17	8	17	4
Germany/KfW	0	0	25	11	25	6
Holland/FMO	0	0	10	5	10	3
Others	0	0	0	0	125	31
<b>C-Shares</b>	64	61	132	61	187	47
MoFA/Danida	37	35	37	17	37	9
Spain/AECID	20	19	20	9	20	5
NDF	7	7	15	7	15	4
GCF	0	0	35	16	35	9
European Commission	0	0	25	11	25	6
JICA	0	0	0	0	25	6
Others	0	0	0	0	30	8
<b>Total Equity</b>	105	100	218	100	398	100

## 8 Institutional and management arrangements

The allocation is provided as a kind of institutional support to AGF and will as such be managed by AGF's management team and according to AGF's corporate guidelines and procedures, with oversight of AGF's board where Denmark is represented (please refer to section 2 and Annex 2). IFU has the required technical, financial and managerial capacity to act as AGF shareholder. IFU's senior vice-president has since 2014 been appointed and contracted by MFA to serve a director and represent the Danish interest on the Board, and this arrangement will continue until the end of 2019. After that the arrangement is expected to be changed following the initiation of a planned gradual transfer of the MFA C-shares to IFU.

During the transition period, IFU will continue to represent the Danish interest in the board and share minutes of board meetings and have regular meetings with MFA on key issues in AGF's development, until MFA has transferred all of its C-shares to IFU (end 2024). Till then, MFA will also participate in the Annual Meeting of shareholders. It is further expected, that MFA and IFU after 2024 will continue to share information on AGF.

MFA should through its Board of Directors membership encourage AGF to include reporting on AGF's carbon footprint and ethical behaviour in its published annual report.

The capital contribution to IFU of DKK 85 million will be subject to the approval of an appropriation bill by the Finance Committee of the Danish Parliament and to agreements between MFA and IFU. An outline of the main principles and contents of these agreements is presented in Annex 7.

Likewise, the grant to AGF for capacity development will be provided subject to an agreement between MFA and AGF. An outline of the principles and contents of this agreement is presented in Annex 6.

## **9 Financial management, planning and reporting**

The allocation is divided in three transfers, which are subject to different management and reporting arrangements. With respect to the grants for AGF capacity development, provisions for financial management and reporting will be included in the agreement between MFA and AGF, please refer to Annex 6. With respect to the cooperation between MFA and IFU, the agreements will have provisions on exchange of information and consultations, (Annex 7).

**Contribution to AGF's Capacity Development Trust (DKK 13 m):** The CD Trust will through 2020 submit to MFA an annual report on CD results and performance, including grants approved, and the commitments, disbursements, grant income and available resources. AGF's Capacity Development Committee, a sub-committee of the Board, will provide oversight.

**Contribution to HRD in AGF (DKK 2 m):** The funds will be transferred to AGF's HR operation, and AGF will report on and document the use of the funds and the results. The Human Resources Committee, a sub-committee of the Board, will provide oversight.

**Existing C-shares and Contribution to IFU's capital for purchase of B-shares:** MFA will as long as it is a C-shareholder receive annual reports and other information that AGF provides to its shareholders and IFU will share minutes of board meetings with MFA. The Investment Committee, which is a sub-committee of the Board, in reality the guarantee committee, will provide oversight of the guarantee operations that are facilitated by the equity, whereas another board committee, the Treasury Management Committee, will provide oversight of how shareholder funds are invested.

AGF is beginning to make a small profit. As today and until the transfer of C-shares to IFU, MFA intends to refrain from receiving dividend, considering that the other C-shareholders will follow a similar policy, and instead retain future dividends in equity to increase the value of the shareholding.

## **10 Risk management**

AGF is exposed to various risks but has a comprehensive and well-functioning risk management framework as confirmed by the AA- rating of Fitch. It includes elaborate systems and procedures for managing credit risk, foreign exchange risk, treasury risk and enterprise risk.

The MFA risk management matrix is presented in Annex 5. It should here be highlighted that the quality of management and human resources is a key factor when considering any investment in a private company. While the current situation is highly satisfactory, there is always a risk of departure of key personnel. However, the residual risk is assessed as low considering that AGF has a capable middle-level management team, who is relatively young, and the attention that is given to succession planning. Fitch observes: "Fitch views positively that the company has addressed the issue of key-man risk by setting up succession plans for its key personal".





## Annex 1 Context Analysis

### 1. Overall development challenges, opportunities and risks

***Briefly summarise the key conclusions from the analyses consulted and their implications for the programme regarding each of the following points:***

- The SME sector is crucial for Africa's economic and social development in terms of the generation of income, employment, public revenue, innovation, stability, etc. A well-functioning SME sector could employ many of the young people entering the job markets and could therefore ensure development and stability.
- Various analyses indicate that African SMEs contribute around 50% to employment generation but there are significant variations between countries, see Figure 1.1 overleaf. However, SMEs only account for about 20% of GDP, implying low labour productivity.
- SMEs are constrained by inadequate access to finance, in particular long-term finance that would allow them to invest in machinery and productive capital to increase labour productivity and create job. The financing gap is estimated at more than USD 150 billion.
- Assessments done by international financial institutions indicate that more than 70% of African SMEs have no or inadequate access to medium and long-term finance. Only 16% of small enterprises have access to finance, primarily short loans. Loan guarantees have proved to be a very relevant and an effective tool to address these challenges.
- Africa's banking sector has grown rapidly in the last decades but there are still regions with a very modest level of financial sector deepening, see Figure 1.4 overleaf.
- The proposed support is fully in line with Danish and international development policies, that emphasise the importance of promoting economic growth and job opportunities, not least for women and the huge young generations that currently are entering the African job markets. SMEs create jobs for women, and women own or lead 24% of SMEs in Sub-Saharan Africa, see figure 1.3 overleaf.
- The capital contribution to AGF will support a number of the SDGs, in particular SDG 8 (decent jobs and economic development) but also SDG 1 (no poverty), SDG 2 (no hunger), 5 (gender equality), 7 (clean energy), 9 (industry and innovation), 13 (climate) and 17 (partnerships).

***List the key documentation and sources used for the analysis:***

The issues are addressed in a number of documents from various sources including:

- A number of documents prepared by the Danish Africa Commission in relation to the preparation of AGF
- G20 financial inclusion expert group: Scaling-up SME Access to Financial Services in Developing Countries
- A number of documents and analyses prepared by international financial institutions incl. AfDB and IFC

***Are additional studies / analytic work needed? How and when will it be done?*** There is no

need to conduct additional contextual studies and analyses.

## 2. Fragility, conflict, migration and resilience

***Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:***

- The proposed investment does not directly address fragility, conflict, migration and resilience, but the development of the SME sector is envisaged to have an important positive indirect impact on fragility, stability and maybe also migration through the generation of income, decent jobs for men and women, public revenue etc.

***List the key documentation and sources used for the analysis:***

- A number of programmes and documents address this issue, e.g. the European Fund for Sustainable Development (EFSD)

***Are additional studies / analytic work needed? How and when will it be done?***

Not needed

## 3. Assessment of human rights situation (HRBA) and gender<sup>16</sup>

***Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:***

### **Human Right Standards (international, regional and national legislation)**

- AGF is working in a complex regional environment with PFIs and SMEs across 38 countries and many sectors in Africa, and SMEs may not always give high priority to sustainability standards including human rights, gender etc. AGF has implemented a number of policies and procedures to address responsible business conduct, and it will gradually develop its cooperation with the PFIs and SMEs to address these issues. It is a long-term process, and the impact can be important considering AGF's outreach and capacity. The AGF CD is an instrument that is also used to improve sustainability standards in the SMEs.

### **Universal Periodic Review**

- AGF's shareholders are donors and DFI's, and they will through the board keep the sustainability and human rights issues on the agenda and ensure that AGF addresses these issues professionally.

<sup>16</sup> The purpose of the analysis is to facilitate and strengthen the application of the Human Rights Based Approach, and integrate gender in Danish development cooperation. The analysis should identify the main human rights issues in respect of social and economic rights, cultural rights, and civil and political rights. Gender is an integral part of all three categories.

<b>Human Rights Principles</b> <ul style="list-style-type: none"> <li>- Financial institutions requesting AGF guarantees will be subject to a stringent due diligence process, which will assess the institutions' adherence to the principles of good corporate governance, the compliance with the principles of good business conduct, their compliance with international guiding principles and national standards and regulations. AGF CD will be used to implement relevant capacity building activities.</li> <li>- The aim is also, that PFIs actively assist the involved SMEs to strengthen their procedures and performance on incorporating human rights principles and standards into their business activities.</li> </ul>
<b>Gender</b> <ul style="list-style-type: none"> <li>- Management is conscious of gender equality and the promotion of women entrepreneurs. In the portfolio supported so far, 30% of the beneficiaries of loan guarantees are women entrepreneurs whereas only 24% of African SMEs on average are owned/led by women (Figure 1.3).</li> </ul>
<b>Youth</b> <ul style="list-style-type: none"> <li>- Young people who are often well educated is an interesting target group within the SME sector, and 60% of the current beneficiaries of loan guarantees are young entrepreneurs (men and women)</li> </ul>
<b><i>List the key documentation and sources used for the analysis:</i></b> <ul style="list-style-type: none"> <li>- Various international standards and guidelines on business and human rights. AGF's policies and M&amp;E procedures.</li> </ul>
<b><i>Are additional studies / analytic work needed? How and when will it be done?</i></b> No

#### 4. Inclusive sustainable growth, climate change and environment

<b><i>Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:</i></b>
<ul style="list-style-type: none"> <li>- Overall AGF is expected to gradually strengthen the sustainability agenda of PFIs and SMEs. It is a complex and challenging task considering AGF broad geographical coverage dealing with partners in a large number of African countries at different level of development and with different national regulatory framework.</li> <li>- AGF has a number of policies and procedures to address the sustainability agenda in relation to the PFIs and SMEs, and AGF's capacity building activities are very relevant in this respect.</li> <li>- AGF is already promoting SME climate investments. With support of the Nordic Development Fund AGF has established a "Green Guarantee Facility". It is envisaged that this focus will be</li> </ul>

strengthened in the future, partly due to stronger investor involvement and partly due to stronger SME demand. SME climate investments (energy efficiency and renewable energy) in Africa have generally proved to be very profitable, and the prospects to further promote climate investments are therefore good.

- EIA assessments and monitoring will normally be the responsibility of the PFIs, and in case of portfolio guarantees, AGF has no relation with the SME and is therefore not be able to follow the investments. However, guarantee agreements with PFIs include provisions that the PFI shall adhere to AGF policies and in case AGF finds violations in its sample surveys there are provisions for sanctions, see box 2.1 in Annex 2. In addition, AGF CD can provide support for capacity building to the PFIs when required.

**List the key documentation and sources used for the analysis:** AGF's policies and guidelines.

**If this initial assessment shows that further work will be needed during the formulation phase, please list how and when will it be done?** N/A

## 5. Capacity of public sector, public financial management and corruption

**Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:**

- N/A

**List the key documentation and sources used for the analysis:** N/A

**Are additional studies / analytic work needed? How and when will it be done?** N/A

## 6. Matching with Danish strengths and interests, engaging Danish actors, seeking synergy

**Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:**

- The involvement of IFU as investor in AGF will strengthen IFU's network with the financial sector in Africa, and this linkage may over time generate interesting derived effects for IFU and possible other Danish stakeholders. Also AGF may benefit from IFU experiences.
- AGF's equity guarantee product could potentially in the future be of benefit to IFU in case IFU invests in SME Funds or Impact Funds that provide equity to SMEs
- From a Danish perspective, the SMEs supported by AGF are relatively small, and therefore, the prospects of linking AGF to Danish companies and interests appear limited on a short to medium-term basis.

**List the key documentation and sources used for the analysis:** N/A

***Are additional studies / analytic work needed? How and when will it be done?***

No additional studies needed. Other donors and DFIs are currently preparing due diligence analysis of AGF, but these studies will only be completed later in 2018 and are generally for internal use.

## 7. Stakeholder analysis

***Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:***

**The key stakeholders in relation to AGF are:**

- PFIs that are obtaining guarantees from AGF in order to be able to provide loan financing to SMEs. AGF has currently signed guarantee agreements with more than 100 PFIs in 38 African countries.
- African pension funds and other institutions with long term funds which provide loans with long tenor to PFIs, supported by an AGF “bank fund raising guarantee”.
- SMEs obtaining PFI loan financing, partly guaranteed by AGF. AGF guarantees have currently ensured that 7,600 SMEs have obtained finance for investments.

***List the key documentation and sources used for the analysis:*** AGF documentation on PFIs and SMEs

***Are additional studies / analytic work needed? How and when will it be done?*** No additional studies are needed.

Figure 1.1 Contribution of SMEs to job creation in Africa (% of total)

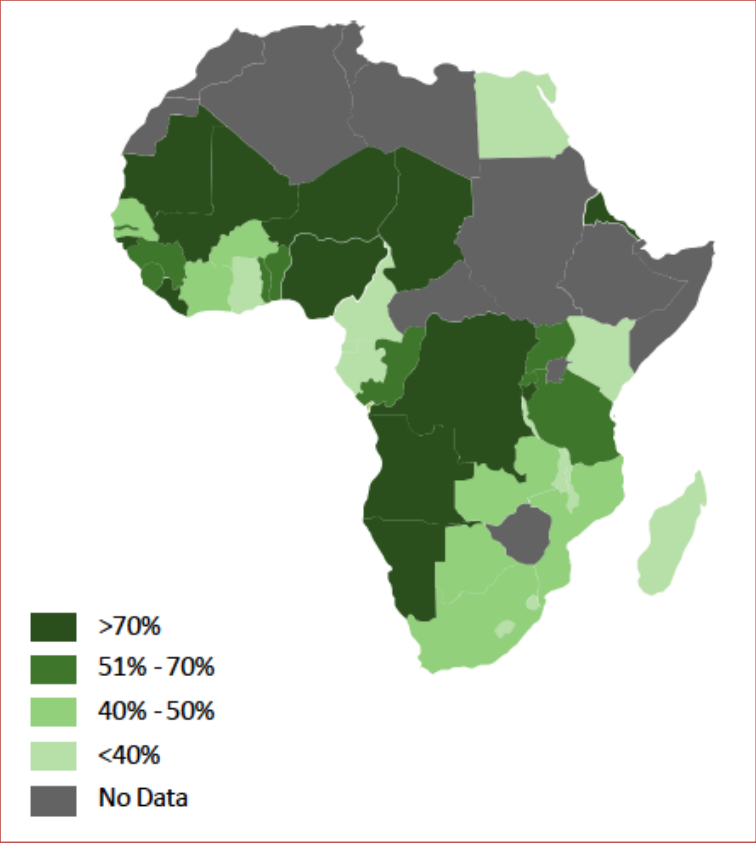
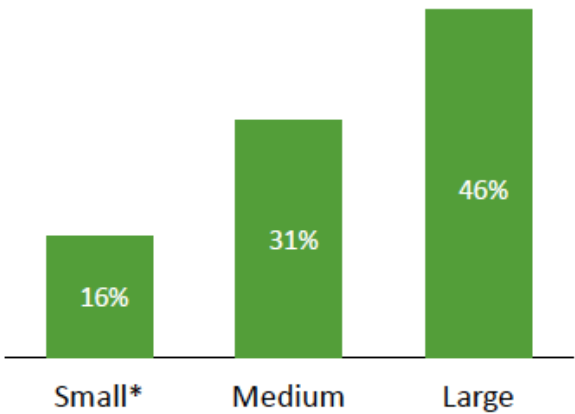
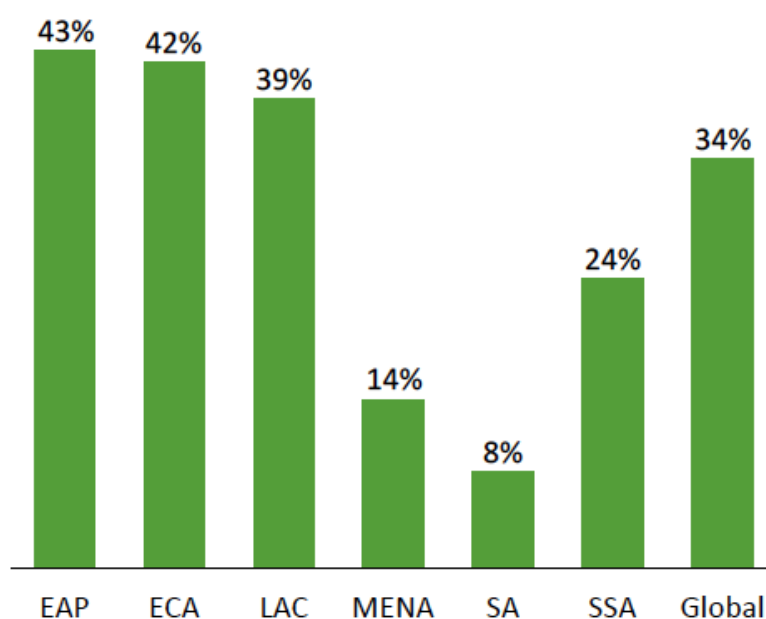


Figure 1.2 Percentage of Enterprises in Sub-Saharan Africa with access to finance



Source: SME and Growth Menon Report- World Bank Enterprise Survey Database 2010, IFC Barriers to Finance Africa's SMEs Report \*Small: 1-20 employees, Medium: 20-250 employees, Large: >250 employees

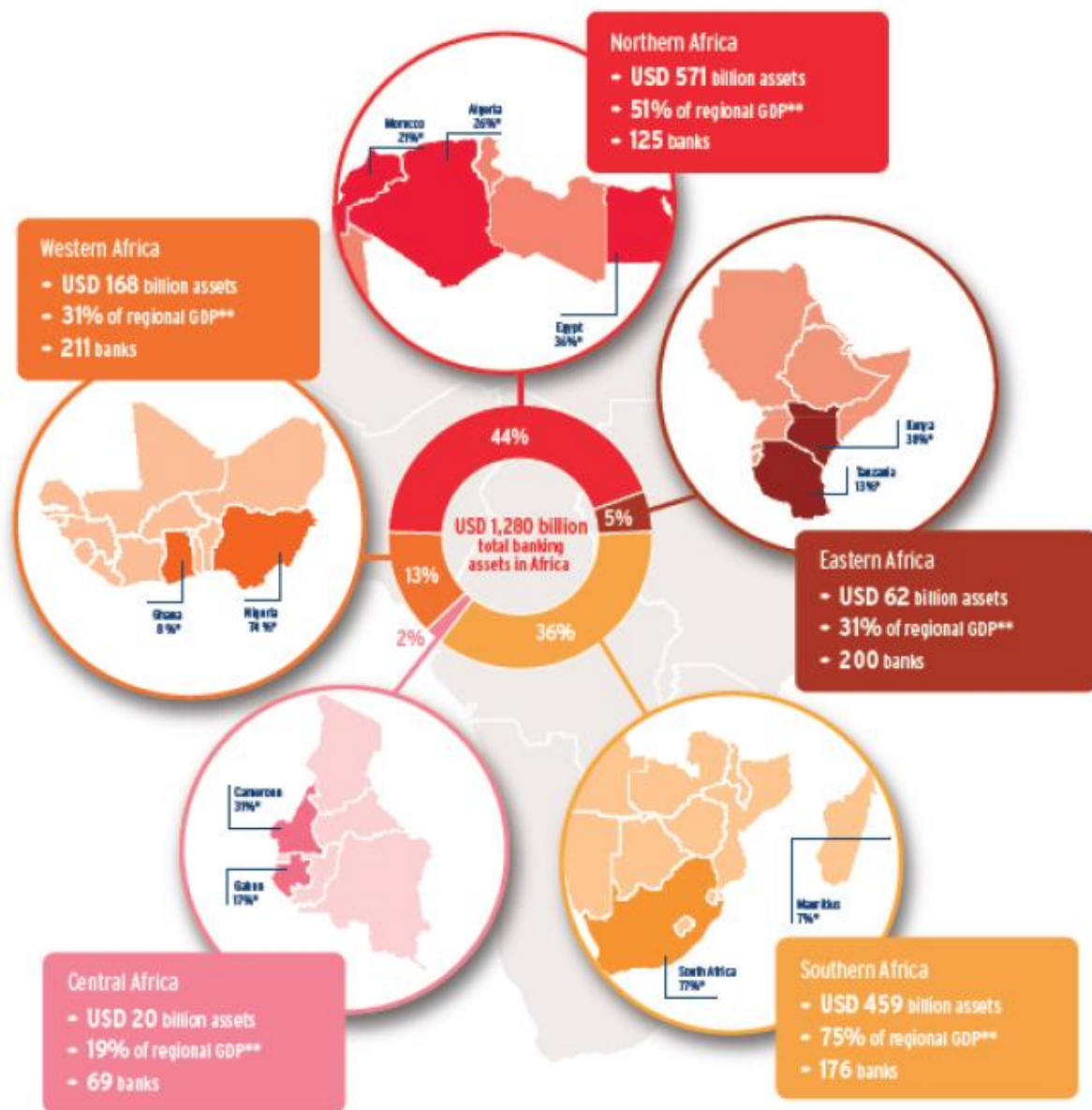
**Figure 1.3**      **Percentage of SMEs owned/led by women**



Source: World Bank, The SME Knowledge Guide 2010, IFC Advisory Services, International Energy Agency (IEA), IFC- Women Owned SMES  
Notes: EAP- East Asia and the Pacific, ECA- Europe and Central Asia, LAC- Latin America and the Caribbean, MENA- Middle East and North Africa, SA- South Asia, SSA- Sub Saharan Africa



Figure 1.4 The Banking Sector in Africa – significant differences in financial sector deepening



Source: Proparco

## **Annex 2      Information on AGF**

### **1      AGF's Vision and Mission**

The Danish capital contribution is in support of AGF's Strategic Plan 2017 – 2021 which maintains AGF's original vision and mission, defined as:

#### AGF's Vision:

“To be the leading non-bank Financial Institution which meets Africa's financing providers' needs, effectively serving SMEs, maintaining our uncompromised principal as we grow”

#### AGF's Mission:

“The promotion of economic development and poverty reduction in Africa in support of the vision above:

- To be more resource efficient;
- To build strong partnership between financial institutions and AGF;
- To reduce the inability of SMEs to provide acceptable guarantee;
- To encourage and support the banks and other financial institutions in the financing of SMEs by sharing the risk involved; and
- To support Capacity Development of our partners by seeking to build their existing knowledge and capacity.”

Also the 5-years strategic plan maintains AGF's strategic positioning within the SME sector to promote economic development and poverty reduction in Africa. During the visit to AGF, it was apparent that the strategy, the operations and the management team are guided by the Sustainable Development Goals, and not only by financial considerations.

### **2      AGF's Guarantee Products**

AGF has currently four guarantee products of which the equity guarantee product has been under development; therefore the first equity guarantee will only be issued in 2018. The main features of the products are presented below.

#### **(i) Portfolio Guarantees**

Portfolio Guarantees help PFIs to give loan access to SMEs lacking collateral requirements. In this scheme, the borrowers are not known at the origination stage, hence the risk assessment is performed only on lender to assess its internal processes and capability to select strong SMEs. The main advantage of the portfolio guarantee is that even small loan sizes can be covered as long as they satisfy the PFI's internal credit requirements. AGF's internal limit per portfolio per PFI is USD 5 million and often the agreement includes a requirement for diversification.

## **(ii) Individual Loan Guarantees**

These loan guarantees help PFIs to reach individual SMEs, mostly medium-sized, lacking collateral requirements. In this scheme, the borrowers are known at the origination stage, hence AGF undertakes risk assessment of both lender and borrower. This is used to guarantee higher amount of facilities, and AGF has an internal limit of USD 1 million per SME.

## **(iii) Bank Fund Raising Guarantees**

This product helps PFIs to raise resources, with focus on long resources, for on-lending to SMEs. The guarantees are issued in favour of institutions that lend to the PFIs.

PLIs may raise the resources in a number of ways, which may include, but not limited to, issuance of bonds, lines of credit, letter of credit, commercial papers. For this product, AGF has an internal limit of USD 5 million

## **(iv) Equity Guarantees**

This product helps Private Equity Funds and similar institutions to increase their equity financing (as opposed to debt) of SMEs. Through this product, AGF can support both direct as well as quasi equity financing. For this product, AGF has an internal limit of USD1 million.

AGF applies a risk-based pricing system, aligning the price of the guarantee to its risk, which is a weighted average of country risk, lender risk, borrower/business risk and transaction risk. While the resulting price is model-based, AGF may in negotiations of price and other terms with the PFI include considerations of potential impacts on sustainable development goals. The price includes an initial origination fee, a commitment fee, and an activation fee. The main guarantee income is from the activation fee why it is important that committed and signed guarantees are quickly activated.

## **3 Capacity Development**

AGF's support for capacity development is designed to improve long –term impact and mitigate risk. With a grant of USD 2.3 million from the Danish government, the Capacity Development Trust started operations in 2013 providing grants for capacity development to:

1. Partner Financial Institutions (PFIs) to enhance their SME lending capacity (max grant USD 250,000 – max 50% of project costs)
2. Firms providing business development services (BDS) for SMEs (max USD 50,000, max 50%)
3. SMEs themselves (max USD 150,000, max 50%)

The major part of grants has been provided to PFIs to enhance their capacity for SME lending, risk management, dealing with international business conduct standards, and for providing climate-relevant and green financing which was facilitated with the establishment of the “green guarantee facility” supported by the Nordic Development Fund. Grants for individual SMEs are relatively small and have high transaction costs.

**Table 2.1 CD grants approved 2013 - 2017**

	Number of grants	Amount USD
CD Grants for PFIs	9	1,303,195
CD Grants for PFIs (Green Conference & Trainings)	4	600,000
CD Grants for PFIs (Regional SME Credit Process Training)	3	355,264
CD Grants for BDS firms	1	50,000
CD Grants for SMEs	9	110,000
<b>Total CD grants</b>	<b>26</b>	<b>2,418,459</b>

Table 2.2 overleaf presents the cash flow of the Capacity Development Fund 2012 – 2017. After a slow start, operations and annual grants and expenditure have gained momentum, and by end 2017, there was a funding gap of about USD 1.5 million (balance available – tentatively committed but not disbursed support).

#### **4 Safeguards on responsible business conduct**

AGF has procedures to comply with international standards on responsible business conduct (please refer to Box 2.1 overleaf). The unit for legal affairs and compliance as well as the operational units are responsible for appliance of the procedures. In the case of individual loan guarantees, AGF assesses both lender and borrower, including if the SME complies with AGF's requirements in this area. However, for portfolio guarantees this is the responsibility of the PFI and the guarantee agreement includes sanctions if the PFI does not fulfil its responsibility. AGF's M&E unit may detect cases of non-compliance through its regular sample surveys.

#### **5 Organisational structure**

AGF's current organisational structure is presented in Figure 2.1 overleaf. As seen, risk assessment and business development are separate and independent from each other, ensuring an appropriate balance between risk and development considerations in development of the guarantee portfolio.

GARI has been fully integrated as AGF West Africa. The Strategic Plan does not foresee any significant increase in staff number but does have provisions for establishing new regional branch offices. A branch office in the southern Africa region is envisaged in order to handle the planned expansion to countries in this region.

At present, AGF is in a preparatory process of constructing its own operational head office building in Nairobi, which is expected completed in two years.

#### **6 AGF's position in the competition**

Though AGF is a relatively small newcomer in the African guarantee market, it does have a competitive advantage through its exclusive focus on SMEs, with an objective to increase loan tenor to allow SMEs

invest in machinery and productive capital. Another advantage is that AGF is a private and more agile company. An overview of AGF's assessment of its competitive positioning is presented in figure 2.2 overleaf.

Table 2.2 Capacity Development Fund – Cash Flow 2012 - 2017

USD	2012	2013	2014	2015	2016	2017
<b>Donor grants received:</b>						
Danida	2,300,000	-	-	-	-	-
NDF	-	-	-	-	1,700,000	-
<b>Total grants received</b>	2,300,000	2,300,000	2,300,000	2,300,000	4,000,000	4,000,000
<b>CD support and costs disbursed during the year</b>	-	139,130	283,692	578,513	679,129	1,423,389
<b>Total accumulated disbursements</b>		139,130	422,822	1,001,335	1,680,464	3,103,852
<b>Balance of Trust Fund as of 31 December</b>	2,300,000	2,160,870	1,877,178	1,298,665	2,319,536	896,148
<b>Commitments made but not disbursed</b>	-	100,000	838,264	1,297,764	1,789,159	2,418,459
<b>Potential resources gap</b>	2,300,000	2,060,870	1,038,914	901	530,377	(1,522,311)

Figure 2.1 AGF Organogram

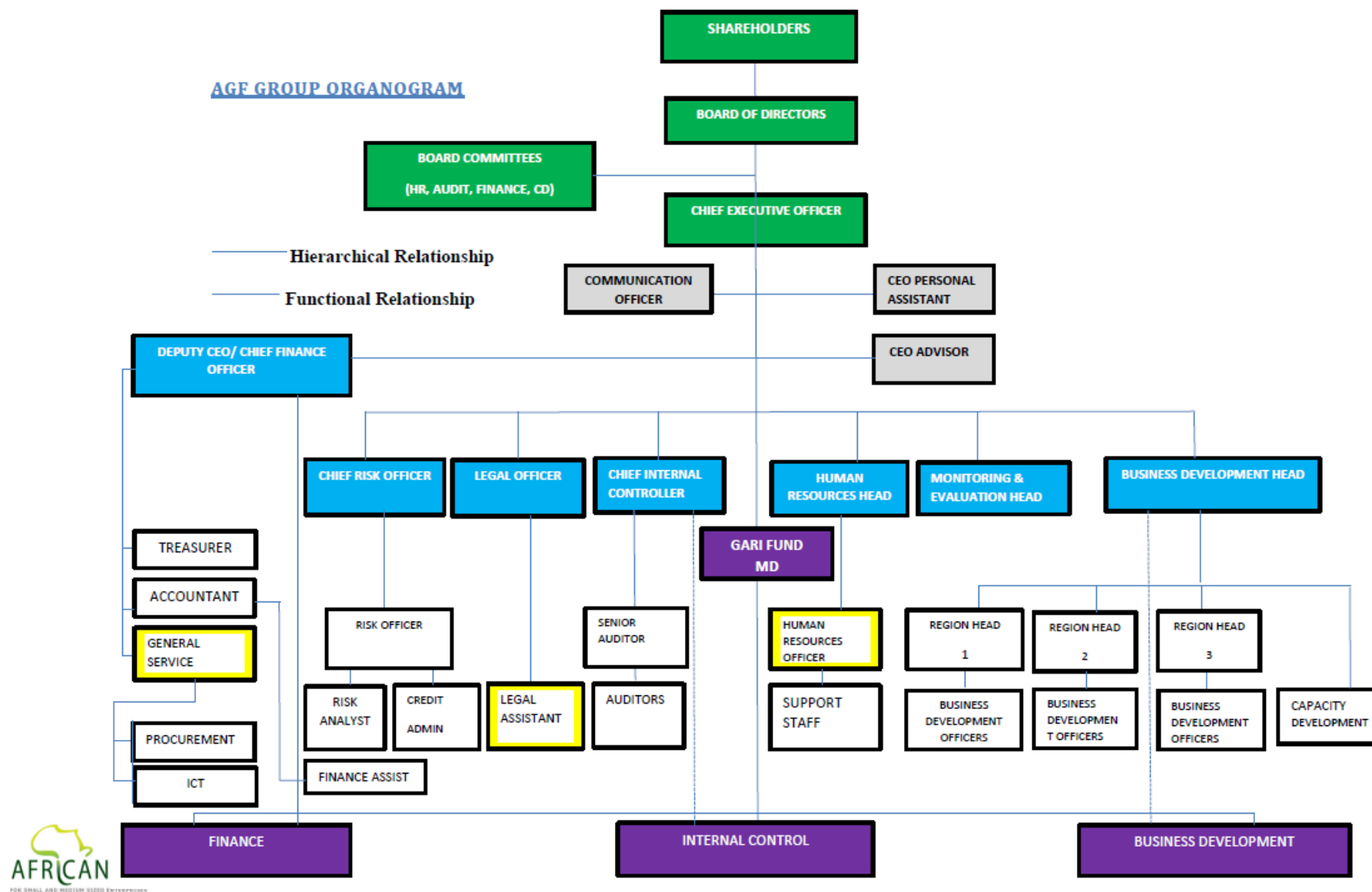






Figure 2.2 AGF's competitive position

	 AGF	 USAID DCA	 IFC	 AFD Ariz Fund	 FAGACE	 African Solidarity Fund
Focus on African SMEs	●	◐	◐	●	◐	◐
Impact on African SMEs	●	◐	◐	◐	○	○
Level of product diversification	◐	●	●	◐	◐	◐
Resources (Capital Base)	◐	●	●	◐	●	◐
Size and reach	◐	●	●	◐	◐	◐



### **Box 2.1**

#### **AGF Safeguards and Provisions for Responsible Business Conduct**

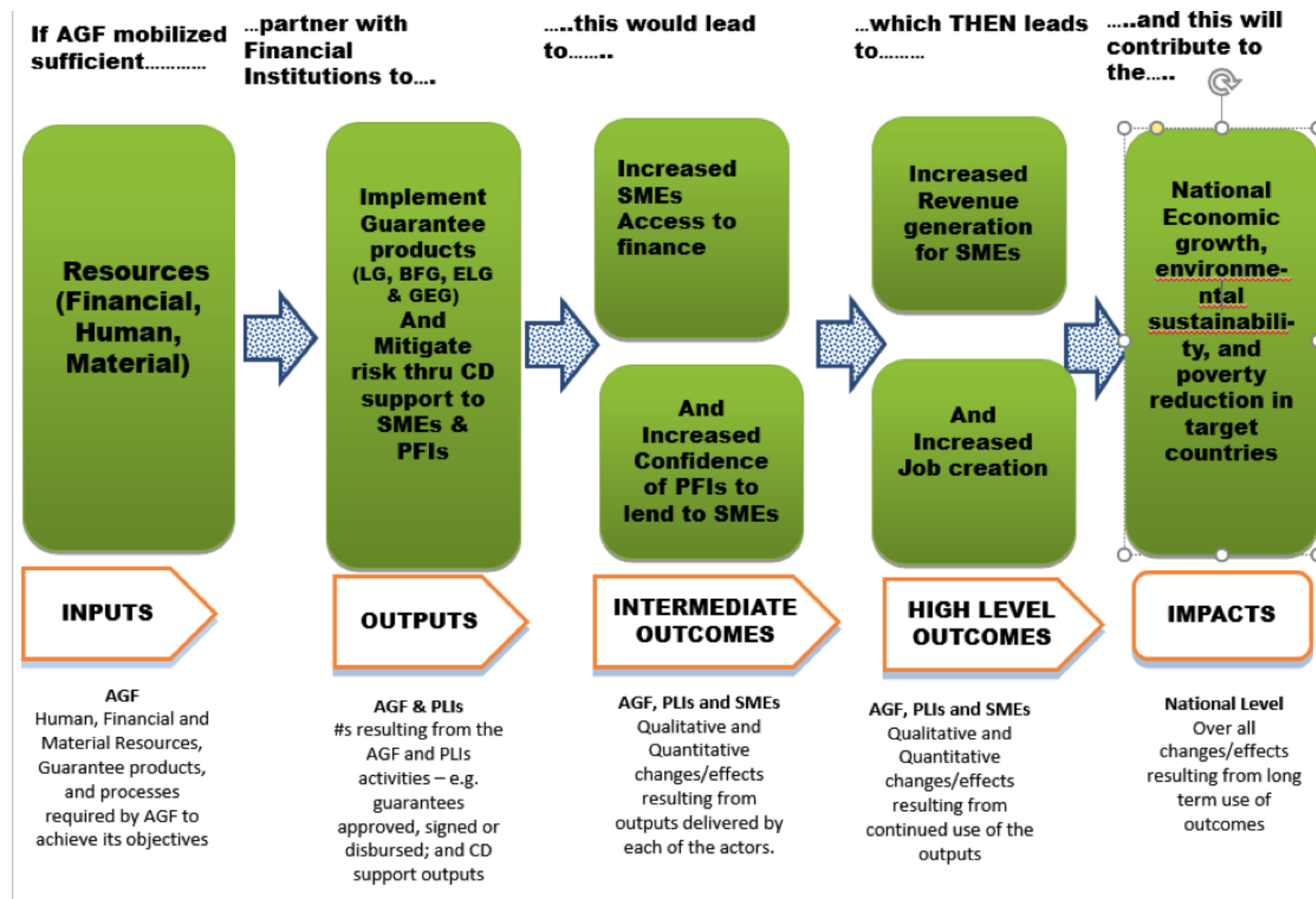
The list of excluded sectors is as set out below. No facility shall be placed under coverage in the following sectors:

1. Tobacco or Tobacco products;
2. Armament productions or where 25 percent or more of the total production output or turnover of the portfolio company is derived from military-related activity;
3. Beverages with an alcoholic content exceeding 15 percent;
4. Casino or companies where the principal source of income is gambling;
5. Speculative investments in real estate or commodities. Speculative investments are defined as those in which an SME borrows from the Bank to purchase real estate and / or commodities, with the sole intention of holding on to these in anticipation of an increase in the price of the asset or commodity, and subsequent sale of the same to realize a profit.
6. Illegal activities. An illegal activity is an act committed or omitted in violation of a law forbidding or commanding it, and for which punishment is imposed upon conviction.
7. Activities that run against generally accepted societal behavioural norms, such as pornography, businesses associated with corrupt activities, nightclubs associated with nudity, brothels, among others.
8. Production or activities involving harmful or exploitative forms of forced labour and/or child labour;
9. Trade in prohibited wildlife or wildlife products;
10. Production or trade in radioactive materials, unbounded asbestos fibers, and hazardous chemicals;
11. Investments harmful to the environment. These are investments that, through use of harmful substances or generation of hazardous wastes, have the potential to cause adverse impact on the environment and human health, if not soundly managed throughout their lifecycle.
12. Borrowers engaged in, or subsequently found to have engaged in, drug trafficking, narcotic offences, terrorist activities, terrorism financing, and / or money laundering activities.

AGF has the following clauses in our guarantee agreements:

- Notwithstanding any other provision of this Guarantee, the Facility shall not be eligible for coverage under this Guarantee and AGF shall have no obligation to pay claims in connection with the Facility, where the Borrower and or the Guaranteed Party appears on any list concerning prohibited individuals maintained by any international organisation or is designated on any sanction list maintained by the United Nations Security Council UNSC.
- Representation to be provided by the Guaranteed Party: The Guaranteed Party confirms that none of the key individuals of the Guaranteed Party has within the last ten years (i) not been convicted of a violation of, or a conspiracy to violate, any law or regulation of any other country concerning narcotic or psychotropic drugs or other controlled substances, drug trafficking, terrorism, terrorist financing, and / or money laundering activities; (ii) not been an illicit trafficker in any such drug or controlled substance or narcotics, nor engaged in terrorism and terrorist financing, and / or money laundering activities; and (iii) not been a knowing assistor, abettor, conspirator, or colluder with others in the illicit trafficking in any such drug or substance or narcotics, terrorism and terrorism financing, and / or money laundering activities.

## Annex 3 AGF's detailed Theory of Change



## Annex 4 AGF's Result Framework

The full version of AGF's result framework is presented overleaf in Table 4.2. In A4 paper format it is difficult to read and therefore, a summarised extract is presented below in Table 4.1.

**Table 4.1 AGF Results Framework – abbreviated extract excluding input level**

Main objective/result	Performance indicator	Baseline 2013	Baseline 2016	Target 2021
<b>Impact Level</b>				
PFIs behavioral changes induced by AGF facilities	Average tenor (months) of loans under AGF Guarantee	24	36	60
	Average cost of loans (Interest rate) to SMEs under AGF guarantee	20.5%	15%	13%
	Number of AGF guaranteed loans to first time borrowers	178	3,500	20,000
<b>Outcome Level</b>				
Growth of SMEs benefiting from AGF facilities	Incremental revenue generated by AGF supported SMEs - USD million	16.8	304	1,200
	Jobs created/improved in AGF supported SMEs (#)	2,214	35,350	152,000
	<i>Jobs for women</i>	<i>664</i>	<i>10,605</i>	
	<i>Jobs for youth</i>	<i>1,336</i>	<i>24,745</i>	
<b>Output Level</b>				
Increased financing	Additional loans disbursed to SMEs, supported by AGF – USD million	21	380	1,200
	<i>To women-owned SMEs (USD m)</i>	<i>6.3</i>	<i>114</i>	
	<i>To youth-owned SMEs (USD m)</i>	<i>13.7</i>	<i>247</i>	
	Number of SMEs benefiting from AGF-supported financing	178	4,000	50,000

**Table 4.2 AGF's Result Framework (full version)**

AGF RESULTS FRAMEWORK INDICATOR PERFORMANCE TRACKING TABLE: 2013-2021																						
M&E Levels	Main Indicator	Performance Indicator	Data Collection Method/Source	Baseline: 2013	2014 (Target)	Achieved	2015 (Target)	Achieved	2016 (Baseline) & Plan 2017-2021	2017 (Target)	Achieved	2018 (Target)	Achieved	2019 (Target)	Achieved	2020 (Target)	Achieved	2021 (Target)	Achieved	Overall Target	Achieved	% Achieved
Impact	Lasting effect on the landscape of financial markets and products	Average number of months of loans to SMEs in countries where AGF operates	Survey	23		24		24														
		Average cost of loans (interest rate) to SMEs in countries where AGF operates	Survey	14.50%		14.10%		14.20%														
		Collateral requirements in countries where AGF operates (Cash vs. Material goods where dominant collateral)	Survey	88%		88%		88%														
		Share of loan amount allocated to SMEs by PfIs in countries where AGF operates (SME loan portfolio)	Survey	32%		34%		31%														
		Local capital raised in countries where AGF operates (proportion of PfIs who raised local capital)	Survey	71%		71%		71%														
	Expansion of resources available for SME financing	Average number of months of loans under AGF guarantee	Survey	24		29		27	36	40	48	52		55		58		60		60		
		Average cost of loans (interest rate) to SMEs under AGF guarantee	Survey	20.50%		15.80%		15%	15%	15%		14%		14%		13.50%		13%		13%		
		Number of loans under AGF guarantee granted to first-time SME borrowers (AGF baseline survey 2015 averages 2013-2014, 2014-2015, 2015-2016)	Quarterly	178		749		2,635	3,500	5,500	6,300	7,800		11,000		15,000		20,000		20,000		
		Incremental revenue created by SMEs benefiting from AGF facilities (Average value of assets by SMEs was 0.6m in 2011, and 1.6m in 2015. Source: Survey 2015)	Survey	16.8m		54.4m		112m	304m	450m	560m	600m		750m		950m		1,200m		1,200m		
		PfIs behavioral changes induced by AGF facilities	Number of jobs supported by SMEs under AGF guarantees (No. of jobs supported among women (Average))	Survey	2,214		11,748		13,440	35,350	30,000	67,500	97,000		120,000		150,000		152,000		152,000	
Number of jobs supported among youth (Average)	Survey		664		3,524		4,032	10,605	9,000	10,600												
Number of PfIs benefiting from AGF facilities	Survey		1,330		7,050		8,060	24,745	19,500	23,000												
Number of PfIs subsidizing the AGF products	Quarterly		10		33		37	73	80	100	120		125		135		145		145			
Outcome	Growth of SMEs benefiting from AGF facilities		No. of PfIs subsidizing the AGF products	Quarterly	39		62		105	117	125	137	145		155		165		175		175	
		Additional loans disbursed to SMEs by PfIs benefiting from AGF facilities	Quarterly	21m		68m		140m	380m	500m	730m	850m		950m		1bn		1.2bn		1.2bn		
		(Additional loans provided by PfIs to Women-owned SMEs (40% of total loans))	Quarterly	6.3m		20.4m		42m	114m	200m	210m	340m										
		(Additional loans provided by PfIs to youth-owned SMEs)	Quarterly	13.7m		44.2m		91m	247m		457.6m											
		Overall volume of loans disbursed to SMEs by PfIs benefiting from AGF facilities	Quarterly	21m		68m		140m	380m	500m	704m											
	Increased financing (Loans/Equity)	Number of SMEs benefiting from AGF facilities (No. of SMEs owned by women)	Survey/Quarterly	178		441		1,300	4,000	10,000	6,920	20,000		30,000		40,000		50,000		50,000		
		(No. of SMEs owned by youth (age bracket 15-40))	Survey/Quarterly	48		119		455	1,080		2,076											
		Volume of guarantees issued	Survey/Quarterly	87		309		845	2,600		4,152											
		Overall volume of guarantees issued	Quarterly	92m	115m	120m	200m	230m	458m	170m	150m	204m		245m		294m		353m		1,265bn		
		Inputs	Capacity of PfIs strengthened through well-targeted Capacity Development Initiatives	1. Loan guarantees	Quarterly	84.7m	102m	141.4m	178m	204m	366m	68m	120m	163.2m		196m		235m		280m		1bn
2. Equity guarantees	Quarterly			0	2.0m	0	0	0	0	3.4m	0	6.1m		7.3m		7.5m		10.6m		38m		
3. Resource Mobilization Guarantee (Bank Fundraising Guarantee)	Quarterly			7.4m	9m	11.5m	15m	23m		30.6m	30m	34.7m		42m		50m		60m		215m		
% of on-performing loans (NPLs) among trained PfIs (According to the 2015 baseline survey, SME loan repayment was 5% in 2015 compared to 9% in 2011)	Survey																					
% of on-performing loans (NPLs) among trained PfIs	Survey																					
AGF's partners	Capacity development (CD) initiatives for the benefit of AGF's partners	Volume of guaranteed loans disbursed to SMEs by PfIs benefiting from AGF CD initiatives	Survey	2.9m	4m	5.9m	9.6m															
		Number of PfIs benefiting from AGF Capacity Development Initiatives	Quarterly	0	2	3	3	1	4	8	48	50		60		70		85		85		
		Number of DSIs benefiting from AGF Capacity Development Initiatives	Quarterly	0	2	4	4	6	10	4	3	5		8		10		15		15		
		Number of SMEs benefiting from capacity development	Quarterly	0	0	18	300	650	650	900	6,000	7,000		7,000		8,000		8,000		30,900		
		Number of trainings supported	Quarterly	0	0	0	5	21	25													
		Number of PfIs staff trained	Quarterly	0	0	0	5	250	255	350	1,000	2,500		3,500		5,000		6,000		6,000		
		Number of SMEs trained owned by Women	Quarterly	0	0	0	1	2	3													
		Value of CD programs in favor of PfIs	Quarterly	0	0	0	94,850	670,606														
		Value of CD assistance to business development support (BDS) services firms	Quarterly			0	0	35,000	37,950													

## Annex 5 MFA Risk Management Matrix

### Contextual risk

Risk factor	Likelihood	Impact	Risk response	Residual risk	Background to assessment
Global financial instability resulting in economic slow-down or high inflation/interest rates	Possible	Medium	A thorough involvement of AGF and the PFIs in the assessment of the proposed SME guarantees. AGF has extensive experience with assessment and mitigation of risk parameters.	Minor	A global economic slowdown or high interest rates may reduce the debt demand of SMEs and PFIs may be more cautious to participate in SME finance.
Political and/or financial instability in individual African countries affecting AGF existing and/or future portfolio	Likely	Major	AGF has a broad geographical coverage and therefore will not be heavily exposed to any single countries. AGF and PFIs will try to mitigate consequences concerning ongoing projects, whereas new guarantees will only be made if sufficient risk mitigation is in place.	Minor	Political or financial turbulence in a country could have a major negative, but isolated, impact on AGF guarantee activities. AGF's product pricing is partly based on the assessment of risk, including country risk

### Programmatic risk

Risk factor	Likelihood	Impact	Risk response	Residual risk	Background to assessment
Inadequate interest among investors to provide additional investment capital to AGF	Possible	Medium	AGF has a good track record and it has obtained an AA- Fitch rating which is an important factor for DFIs and private investors. The African SME sector has high political priority, and AGF has therefore good opportunities for mobilising interest and support among investors.	Minor	AGF return on equity is still relatively low. Investments of commercial investors will therefore only be interesting through blended finance arrangements where parts of the invested capital is coming from donors.
Inadequate demand for	Medium	Major	AGF will strengthen its structured	Minor	There is a huge uncovered demand

SME financing or strong competition			finance activities and pursues new business activities		for SME finance and competition is limited. AGF is a flexible private company, with attractive niche products, and has therefore a strong competitive position.
AGF unable to maintain its default rate below 3.5% at any time	Medium	Major	AGF has implemented a range of risk management policies and procedures, and if needed AGF can readapt its risk management procedures. AGF's broad geographical and sectoral portfolio further mitigates this risk. AGF CD activities also mitigate risks at PFI and SME level.	Medium	AGF current default rate is significant lower 3.5%, but it is still difficult to project the default rate on a medium to long-term basis.
AGF becomes less competitive over time due to its shareholders' return expectation	Medium	Medium	AGF sets realistic return expectations to its shareholders.	Low	AGF's expected future return is relatively low and may not be attractive to DFIs. However, DFIs have often possibilities to apply a blended finance approach and in this way obtain the return they require.

#### **Institutional risk**

<b>Risk factor</b>	<b>Likelihood</b>	<b>Impact</b>	<b>Risk response</b>	<b>Residual risk</b>	<b>Background to assessment</b>
Risk of departure of key personnel	Medium	Medium	Building a strong middle management team together with succession plans for key management positions	Low	Loss of key personnel can have a negative impact on the performance of an organisation.
Violation of human rights, OSH and	Medium	Medium	AGF has implemented a number of policies and procedures for the	Low	Many SMEs have still not come far with the implementation of policies

environmental standards among SMEs that have benefitted from AGF guarantees			assessment of the performance and business conduct of the PFIs and SMEs. AGF will continue to develop its practices in line with international good practice and this will be monitored closely.		and procedures for responsible business conduct, and there is a risk that bad cases could have reputational damage for AGF.
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## **Annex 6 Principles of Development Engagement for AGF capacity development**

**Introduction:** The Government of Denmark has in 2018 approved a grant of DKK 15 million for capacity development activities of the African Guarantee Fund (AGF). The grant consists of:

- 1) A grant of DKK 13 million for AGF's Capacity Development Trust (AGF-CD) to enhance its capacity development support for Partner Financial Institutions (PFIs) and Small and Medium-sized Enterprises (SMEs)
- 2) A grant of DKK 2 million for AGF's internal human resource development to enhance staff capacity for developing and managing green and climate-relevant financing and for integration and application of international standards for good business conduct, including the UN Guiding Principles on Human Rights and Business.

This Development Engagement summarises the principles and modalities for the support as described below. The present annex is not self-contained. It must be read jointly with the overall project document and its annexes including description of context, theory of change, objectives and results frame of the support, as well as governance and risk management etc.

The Government of Denmark, represented by the Ministry of Foreign Affairs (MFA), and AGF have agreed on the below principles and modalities for the proposed support..

### **1) Grant for AGF-CD**

Denmark/MFA will in 2018 transfer DKK 13 million to AGF's Capacity Development Trust as a core contribution to the resources of the Trust. The Danish contribution will thus be managed and disbursed according to the current objectives, procedures and criteria of the Trust. It is expected that the contribution will be fully utilised by 31 December 2020.

**Financial Reporting:** For the years 2018, 2019 and 2020, AGF will provide MFA and the other shareholders with an audited income statement on AGF-CD.

**Monitoring and Evaluation:** AGF will provide MFA and the other shareholders with a brief annual report on the capacity development activities supported by the Trust. The report will be based on AGF's current results framework and monitoring system, which includes the following indicators:

- a) Number of PFIs benefiting from AGF-CD initiatives
- b) Number of Business Development Services (BDS) Firms (serving SMEs) benefiting from AGF-CD initiatives
- c) Number of SMEs benefiting from AGF-CD initiatives
- d) Number of trainings supported
- e) Number of PFI staff trained
- f) Number of trained SMEs, owned or led by women
- g) Total value of CD programmes supporting PFIs
- h) Total value of CD programmes supporting BDS firms
- i) Total value of CD programmes supporting SMEs



In addition to information on these indicators, AGF shall provide MFA with data on the value of AGF-CD disbursements for capacity development activities related to: (i) green and climate-relevant financing; and (ii) application of international standards for good business conduct. Finally, AGF should report any specific positive and negative effects and lessons from the capacity development activities to MFA and the other shareholders.

Oversight: AGF's Capacity Development Committee, a sub-committee of the Board, will provide oversight of the operations of AGF-CD.

## **2) Grant for internal human resources development of AGF**

Denmark/MFA will in 2018 transfer DKK 2 million to AGF's operational budget, earmarked for human resources development activities to enhance staff capacity for developing and managing green and climate-relevant financing and for integration and application of international standards for good business conduct, including the UN Guiding Principles on Human Rights and Business. The grant will be fully utilised before 31<sup>st</sup> December 2020.

Financial reporting: For the years 2018, 2019, and 2020, AGF will provide MFA and the other shareholders with a financial statement on the utilisation of the grant.

Monitoring: For the years 2018, 2019, and 2020, AGF will provide MFA and the other shareholders with a brief report on the capacity development activities financed by the grant. The reporting should include any specific positive and negative effects and lessons from the capacity development activities..

Oversight: AGF's Human Resources Committee, a sub-committee of the Board, will provide oversight of the utilisation of the grant.

## **3) Common Conditions**

Both grants are provided subject to MFA's standard conditions:

"No offer, payment, consideration or benefit of any kind, which could be regarded as an illegal or corrupt practice, shall be made, promised, sought or accepted - neither directly nor indirectly - as an inducement or reward in relation to activities funded under this agreement, incl. tendering, award, or execution of contracts. Any such practise will be grounds for the immediate cancellation of this agreement and for such additional action, civil and/or criminal, as may be appropriate. At the discretion of the Danish MFA, a further consequence of any such practise can be the definite exclusion from any projects funded by the Danish MFA.

If serious irregularity in the implementation, or suspicion thereof, has been ascertained, either party may suspend implementation, wholly or in part, until the suspending party decides to resume the implementation.

Either party have the right to cancel the agreement, wholly or in part, and have the right to demand the cancellation of any contract financed under the Agreement, with immediate effect if they determines that corrupt or fraudulent practices were engaged in by the implementing partner or from representatives of the Danish MFA during procurement or execution of contract, without the party in

question having taken timely and appropriate action satisfactory to the party wishing the rescind of the agreement in order to remedy the situation.”

## **Annex 7 Principles of the Agreements between MFA and IFU**

This agreements between MFA and IFU comprise: A) the capital contribution to IFU (DKK 85 million) for purchase of B-shares in AGF; and B) a framework agreement for an intentional future transition and gradual transfer of C-shares from MFA to IFU which will form part of a separate future preparation and approval process.

### **A) Capital contribution to IFU for IFU's purchase of B-shares in AGF**

The following documents will be prepared for the process:

1. An appropriation bill to be presented for approval by the Finance Committee of the Danish Parliament (May 2018). The bill will summarise the objectives and rationale of the project based on this Project Document and present the rationale of blended finance (Official Development Assistance DKK 85 m, IFU's capital DKK 15 m), which will allow IFU to enter as shareholder with purchase of B-shares for DKK 100 million. The bill will also provide a brief outline of the planned MFA's exit strategy.
2. A commitment letter including applied standard annexes from MFA to IFU, specifying the conditions and modalities for provision of DKK 85 million to IFU's capital for purchase of DKK 100 million of B-shares in AGF (May 2018)
3. An agreement between IFU and AGF on purchase of B-shares for DKK 100 million (June 2018)

**The commitment letter** will include the following provisions:

#### Regarding purchase and sale of B-shares

- IFU shall augment the contribution of MFA to IFU's capital of DKK 85 million with DKK 15 million from IFU's own capital.
- IFU shall buy DKK 100 million of B-shares in AGF as soon as IFU has received the transfer from MFA and entered into an agreement with AGF. The agreement should be reconsidered if the agreement has not been completed 31 October 2018.
- The purchased B-shares shall be subject to a lock-in period of 10 years and IFU shall therefore remain a shareholder in AGF at least to 2028.
- In case IFU decides to exit AGF after the lock-in period, IFU shall consult with AGF's board and management to ensure that IFU's sale of B-shares is done in accordance with AGF's constitution and prevailing shareholder agreement at the time and does not have any disruptive impact on AGF's operations.

#### Regarding membership of AGF's Board of Directors

- Until 31<sup>st</sup> December 2019, IFU and the Danish interest shall be represented in AGF's Board of Directors by IFU's Senior Vice President, appointed by MFA, in accordance with the current contract and the related Terms of Reference.
- As from 1 January 2020, a future transition agreement will define a new organisation and financing of Denmark's participation in the Board, which will consider MFA's gradual exit during 2020 – 2024 and that IFU by end 2024 is the only Danish shareholder (see B below).

#### Regarding IFU's consultation with and reporting to MFA

For the period 2018 – 2024

- IFU shall share with MFA summaries of board meetings and board sub-committees.
- IFU and MFA will normally meet after each board meeting or at least once a year to share relevant documentation and exchange information, and IFU shall invite MFA for consultations if important and urgent issues of strategic importance to AGF's development emerge. MFA plans to continue to participate in the AGF Annual General Meeting until it has transferred all its C-shares to IFU.

#### **B) Transition and Transfer of C-shares**

The vision is that by mid-2019, MFA and IFU will negotiate an agreement on the transfer of MFA's C-shares to IFU to be prepared and presented to the relevant authorities for approval in a separate process. The agreement will specify:

- The envisaged gradual transfer of MFA's C-shares during 2020 – 2024, defining the size and timing of each lot. AGF's board and management shall be consulted on this transfer plan.
- The lock-in period for the C-shares transferred to IFU. As for the B-shares, the C-shares cannot be sold before 2028.
- The organisation and financing of the Danish director of AGF's Board of Directors.

## Annex 8 Process Action Plan

Time line	Activity	Documentation	Responsible
23 February	Programme Committee	Concept Note	VBE
5 February – 16 March	Preparation of project document	Project document	VBE
13 – 16 February	Formulation mission to AGF	Back to office report	VBE
16 – 21 March	Completion of formulation and quality assurance process	Final Project Document and Appraisal Note	VBE/KFU
21 March	Project document and appropriation cover forwarded to KFUF	Final project document and appropriation cover	VBE/KFU
12 April	Council for Development Policy	Minutes from meeting	KFU
17 April	Appropriation bill forwarded to UPR	Appropriation bill	VBE/UPR
End of April	Presentation to Minister for Development Cooperation	Signature	KFU
17 May	Appropriation bill presented to the Parliamentary Finance Committee	Appropriation bill	UPR
End of May	Signing of agreements with IFU and AGF	Legally binding agreement	VBE, IFU and AGF
End of May/beginning of June	Capital contribution to AGF	Disbursement	VBE, IFU

## Annex 9 Signed Quality Assurance Checklist

### Checklist for appraisal of programmes and projects above DKK 10 million<sup>17</sup>

*The checklist is signed by the appraising desk officer and management of the MFA unit and attached to the grant documents. Comments and reservations, if any, may be added below each issue.*

**File number/F2 reference:** 2017-39815

**Programme/Project name:** Capital Contribution to IFU for purchase of shares in African Guarantee Fund for Small and Medium-sized Enterprises (AGF).

**Programme/Project period:** 2018 - share capital locked until 2028.

**Budget:** DKK 85 million as a capital grant to IFU for investment in B-shares in AGF and DKK 15 million as a grant to AGF (DKK 13 million for AGF Capacity Development Fund and DKK 2 million for capacity development of AGF staff).

#### **Presentation of quality assurance process:**

The quality assurance process of the proposal has been conducted by Technical Quality Support department (TQS). Considering the time available for the quality assurance (QA) and the considerable experience with AGF it has been a light appraisal; this is fully in line with the Programme Committee's directions.

A number of key issues and concerns related to providing earmarked funds as a capital injection to IFU for onwards investment in AGF and the phasing out strategy have been discussed in meetings between TQS and VBE. The project document reflects the common understanding of VBE and TQS on these issues.

The appraisal is documented through the QA check-list below, completed by TQS. The appraisal has concluded that the appropriation is ready for presentation to the Council for Development Policy.

#### **The programme/project complies with Danida policies and Aid Management Guidelines:**

*Comments:* The proposal is a de-facto capital injection to AGF – albeit provided to IFU as an earmarked capital contribution to enable IFU to purchase B-shares in AGF. It is worthwhile to note that this modality is fully in line with The World 2030 (pt. 6.6. page 31). The strategy emphasizes that Denmark will strengthen IFU as the central Danish development investment institution. IFU and the IFU-managed investment funds are regarded as key instruments 'to mobilise large-scale private funding, including from pension funds, foundations and businesses with a view to investing in sustainable growth, decent employment and technology transfer for addressing e.g. climate and environmental problems in difficult markets in developing countries.'

Further, the AGF addresses Denmark's strategy for development policy and humanitarian action, "The World 2030" at the general level in relation to inclusive and sustainable growth and development, including innovative finance, climate, and the promotion of partnerships with the private sector.

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<sup>17</sup> This format may be used to document the quality assurance process of appropriations above DKK 10 million, where a full appraisal is not undertaken as endorsed by TQS (appropriation from DKK 10 up to 37 million), or the Programme Committee (appropriations above DKK 37).

The Project Document outlines well the rationale of involving IFU as a B-shareholder at this point in time; the presentation of AGF in the project document complies with Danida Aid Management guidelines.

**The programme/project addresses relevant challenges and provides adequate response:**

*Comments:* The Project Document outlines well the challenges faced by African SMEs to access finance. The rationale behind AGF and the role AGF plays in easing the SMEs access to finance through providing guarantees is well described. The capital injection is provided to enable AGF to pursue its vision to be the leading non-banking financial institution to effectively serve the African SMEs as outlined in AGF's Strategic Plan 2017 – 2021. The Strategy acknowledges the SDGs; further, AGF's operations and management are guided by a vision to promote economic development and poverty reduction in Africa and not only by financial considerations. AGF has four different guarantee products. Its portfolio guarantee instrument helps SMEs with little or no collateral to access loans from commercial financial institutions. The advantage of the portfolio guarantee combined with the capacity development program is that this approach reduce the risk associated with small and/or first time lenders and therefore allows commercial financial institutions consider also including small loan sizes and first time lenders in their portfolio. AGF operates, in principle, on private sector terms albeit with a very strong focus on the development objectives. AGF was set-up to provide guarantees for SMEs in Africa, as a private shareholding company, and as such AGF is a flexible and efficient way for development agencies to support the financing of the African SMEs. Through the IFU investment and the indicative interest from other DFIs it is expected that AGF will be able to achieve the necessary capital to significantly increase its guarantee business in line with its Strategic Plan 2017 – 2021.

**Comments from the Danida Programme Committee (PC) have been addressed:**

*Comments:* The PC noted that the proposed new capital contribution to AGF seems very relevant and well justified, but requested that implications for the proposed capital injection should be better analysed and explained, including the planned transfer to IFU of the Danish shares in and responsibility for the AGF engagement. The Project Document outlines the vision for a transfer of the C-shares held by MFA to IFU explaining that this will be subject to a separate process and further analysed; it states that the modality is to be outlined in separate documents and subject to separate approval process.

The PC also requested that the Project Document should describe how the engagement is aligned to “The World 2030” and how Danish priorities will be pursued through Denmark’s membership of the Board of Directors. While the document well outlines how the engagement, including the rationale of channelling funds through IFU, aligns to “The World 2030” it is found that the document could be more elaborate on how MFA will seek influence on issues such as HRBA, ethical behaviour (anti-corruption, anti-harassment, and green footprint). It is noted that the MFA should seek influence through its Board of Directors’ member-ship to push AGF towards include information on AGF’s carbon footprint and ethical behaviour in its published annual reports.

With regard to the request from the PC for more information of who would be the other investors and the indicative size of their investment, the Project Document highlights these. In addition, the Project Document includes sufficient information on why AGF is registered in Mauritius and on the tax-implications of this. AGF is subject to tax both in Kenya where its operational office is located as well as in Mauritius where AGF is registered and its investment office is located.

**The programme/project outcome is found to be sustainable and is in line with the national development policies and/or in line with relevant thematic strategies:**

*Comments:* Based on the track record of AGF and its business strategy it is found that the sustainability of outcomes is assured. As indicated above, the outcomes of AGF’s operations are found to be in line with Danish thematic priorities as presented in “The World 2030”. The strong focus on business

sustainability and responsible business conduct will contribute to overall sustainability, which will be monitored through the Danish membership of AGF's Board of Directors. With regard to alignment to national policies it is noted that all African countries where AGF operates have national strategies for SME development and job creation for their youth. AGF's operations are aligned to support the African countries strategies in this respect.

**The results framework, indicators and monitoring framework of the programme/project provide an adequate basis for monitoring results and outcome:**

*Comments:* The results framework and its indicators are at the overall level found to be adequate. AGF has conducted sample surveys, which document outcomes at a level, which indicates that the targets – albeit ambitious – are achievable. AGF has developed a monitoring system, which allows for comprehensive monitoring of its portfolio and achievements, inter alia, in terms of job creation and gender balance.

**The programme/project is found sound budget-wise:**

*Comments:* The DKK 85 million capital injection to IFU to enable IFU to purchase B-shares for in total DKK 100 million in AGF seems fully justified. The share capital of AGF provides the financial backbone of AGF to issue guarantees. AGF has reached its financial limits for issuing guarantees and a fresh capital injection is needed in order to increase the head-room for AGF to continue expanding its business. The growing demand for AGF's guarantee products cannot be met without a capital injection. With the present level of C-shares (first risk), there is sufficient room for capital increase in the form of B-shares. As one of the founding fathers, Denmark has an interest in the continued success of AGF, albeit without MFA continuing to be the major C-share holder of AGF. It is justified to enable IFU to purchase B-shares in AGF as it signals continued Danish support to and interest in AGF without increasing MFA's shareholding. In combination with the positive Fitch rating of AA-, it seems likely that this strategy will provide the basis for leveraging external funding from other DFIs.

AGF's support to capacity development of commercial financial institutions and SMEs is an important tool in order to improve commercial financial institutions' long-term capacity to deal with the African SME sector as well as to reduce the perceived risk associated with the SME sector. The proposed contribution to AGF's capacity development trust fund is on this background fully justified.

**The programme/project is found realistic in its time-schedule:**

*Comments:* The indicated investment period runs from 2018-28, after which it is perceived that IFU may consider de-investing in AGF. The required lock-in period of IFU's B-share holding is found to be realistic and a necessity to give AGF sufficient time to further develop its business and show the necessary return on assets to create appetite for investment with other private/pension funds investors.

**Other donors involved in the same programme/project have been consulted, and possible harmonised common procedures for funding and monitoring have been explored:**

*Comments:* AGF is a shareholding company and as such, the Annual General Meeting and the Board of Directors meetings serve as the forums for coordination and exchange of ideas among the shareholders. The shareholding agreement provides the framework for harmonised and common procedures for annual reporting. Through its Board of Directors membership, Denmark is in continuous dialogue with other investors in AGF. IFU will as a shareholder sign off on the same shareholding agreement as other shareholders. The Danish Board member will represent both MFA and IFU.

**The Danida guidelines on contracts and tender procedures have been followed:**

*Comments:* No issues to raise.



**The executing partner(s) is/are found to have the capacity to properly manage and report on the funds for the programme/project and lines of management responsibility are clear:**

*Comments:* The rationale for selecting IFU as the B-share investor is justified. IFU has a long and solid track record for investments in developing countries and it has made progress in advancing the international sustainability agenda.

**Risks involved have been considered and risk management integrated in the programme/project document:**

*Comments:* The document includes a Risk Management Matrix as required. The risk of inadequate interest among investors to provide additional investment capital to AGF is identified, however, the consequence of dwindling interest among expected investors, is that Denmark (IFU and MFA combined) may become the major shareholder of AGF. This risk is not identified, neither does the risk mitigating measurements address this. Although the risk may be deemed minor, it is proposed that the underlying assumptions are monitored closely and a mitigating measure be developed should the risk develop from minor to medium. AGF's strategy is to increase significantly guarantees to first time SME-borrowers by 2021; the document recognises that this may cause AGF not to be able to maintain a default rate below 3.5% in the medium to long term, which again makes AGF less profitable. The necessity for AGF to minimize default rates and increase profitability needs to be balanced against the development shareholders desire to push AGF towards assisting in making finance available for new/young SMEs in order to achieve the SDGs. Identified risks are relevant and mitigating measures are found adequate.

**In conclusion, the programme/project can be recommended for approval: yes**

Issues related the HRBA/Gender have been considered adequately

Issues related to Green Growth have been considered

Environmental risks are addressed by adequate safeguards when relevant

Date and signature of desk officer:

20.03.2018 Birthe Elisabeth Larsen, TQS

Date and signature of management:

20.03.2018 Ole Thonke, VBE