Ministry of Foreign Affairs – (Department for Sustainable Growth and Employment, BVB)

Meeting in the Council for Development Policy 29 October 2019
Agenda item 6

1. Overall purpose	For discussion and recommendation to the Minister
2. Title:	Contribution to IFU for High Risk – High Impact Investment in Africa. Capital contribution to IFU to engage in concessional blended finance
3. Presentation for Programme Committee:	26 June 2019

High Risk – High Impact Investment in Africa

Key results:
This commitment to a blended concessional finance initiative will enhance IFU's capacity to invest in projects in lower income countries in Africa, which are facing severe development challenges. These are countries that have difficulties attracting capital for SDG-investments, but where significant development outcomes are possible.

Important development outcomes are expected to be achieved in relation to several SDGs including number of decent jobs generated, number of smallholder beneficiaries, installed capacity of affordable renewable energy, mitigated CO_2 emission, women's financial inclusion and where possible overall beneficiaries of investments.

Justification for support:
- *The enhanced focus on lower income countries in Africa is fully in line with Danish and international development priorities, and the recommendations of the recent evaluation of IFU*
- *Commercial investments in lower income countries in Africa are particularly challenging due to inadequate regulatory framework, inadequate infrastructure, inadequate access to finance, shortage of bankable projects, tedious bureaucracy and corruption etc.*
- *Special efforts are needed to mobilise private capital for SDG investments in lower income countries in Africa, otherwise they will be bypassed and locked in their poverty and fragility*
- *Blended concessional finance is a useful approach to catalysing transformative impact investments that cannot be implemented on commercial terms*

Major risks and challenges:
- *Political and financial instability, a poor business environment, climatic chocks etc. are major contextual risks which affect investments in the least developed countries in Africa. IFU will apply a number of risk mitigation measures, but the risk will always be relatively high.*
- *Reputational risks due to local partners violation of human rights, Occupational Safety and Health, environmental standards, corruption etc. may be relatively high in the concerned countries.*
- *The staff resources needed to bring these projects to closure are higher than for projects in more mature markets and this may prove to be a challenge.*

File No.	2018-31327					
Country	Africa region					
Responsible Unit	BVB					
Sector	MSME, renewable energy, agriculture, water etc					
Partner	IFU					
DKK mill.	**2019**	**2020**	**2021**	**2022**	**2023**	**Tot.**
Commitment	200					
Projected ann. disb.	200					
Duration	2020-2022					
Previous grants	Capital contribution: DKK 300 million in 2017; DKK 100 million in 2018					
Finance Act code	§06.38.01.11					
Head of unit	Ole Thonke					
Desk officer	Jørn Olesen					
Financial officer	Marie Gro Svendstrup					

Relevant SDGs

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 enhance IFU's contribution to job creation, structural transformation and inclusive green growth in lower income countries in Africa facing particular challenges in attracting private investments in the SDGs. This will be achieved through the introduction of a blended concessional finance initiative.

Justification for choice of partner:

It is important to strengthen IFU's capacity to invest more in the lower income African countries. This contribution will further accelerate IFU's development of procedures for and experience with identifying and managing projects with high development outcomes in lower income countries in Africa.

Summary:

Every year around 12 million young people enter the African job market , but only around 3 million jobs are created meaning that the remaining are left in an unsecure situation with unemployment, under employment or forced self-employment. This is a worrying source to poverty, instability and migration, which particularly are affecting the lower income countries of Africa, and these challenges are increasingly exacerbated by climate changes.There is a need for IFU to invest more in these difficult markets. A number of other European development finance institutions have recently initiated similar lines of work with new capital contributions from their owners (Governments).

Budget:

Earmarked capital contribution to IFU	DKK 199.5 million
MFA mid-term review	DKK 0.5 million
Total	**DKK 200.0 million**

Ministry of Foreign Affairs of Denmark **Danida**

Project Document

High Risk - High Impact Investment in Africa

Capital contribution to IFU to engage in blended concessional finance

October 2019

File: 2018-31327

Cover Page

Countries:	The least developed countries in Africa
Project title:	High Risk – High Impact Investment in Africa
Start-End-Date:	2020 – 2022 – investment period
Budget:	DKK 200 million – capital contribution to IFU for investment
Oversight:	The new blended concessional finance initiative will be integrated into IFU's governance structure, and be managed according to current policies and strategies. An agreement between IFU and the MFA will specify countries eligible for investment under this initiative. IFU's guidelines and procedures will be amended in order to implement the new initiative.
Main features:	IFU has assumed an important role in Danish international development efforts. This raises the stake for the alignment and appropriateness of IFU's strategies and instruments to deliver on development priorities. The IFU managed Public-Private Partnership (PPP) investment funds have proved to be able to catalyse relevant investments in economic and social sectors in developing countries that could otherwise not be realised or only in a less ambitious way. However, preliminary experience shows that such PPP based investment funds are mainly targeting middle-income countries, and only to a limited extent the lower income countries and where the risk-return balance is challenging. The purpose of this contribution is to enhance IFU's investments lower income African countries. The country focus will be complemented with a high-impact focus in order to priorities investments, which are expected to generate high development outcomes closely related to the SDGs in local economies, but where the expected risk adjusted return would be lower than what IFU would consider a commercial return. The focus will e.g. be on generation of decent jobs, women and youth, bottom-of the pyramid, smallholder agriculture, access to affordable and clean energy, access to clean water and MSME.

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Abbreviations

AGF	African Guarantee Fund for Small and Medium-Sized Enterprises
Danida	Danish International Development Assistance
DCIF	Danish Climate Investment Fund
DFI	Development Finance Institutions
DKK	Danish Kroner
DIM	Development Impact Model
IFC	International Finance Corporate
IFU	Investment Fund for Developing Countries
LIC	Low Income Countries
MFA	Ministry of Foreign Affairs of Denmark
M&E	Monitoring and Evaluation
MSME	Micro, Small and Medium Enterprises
PPP	Public Private Partnership
SDG	Sustainable Development Goals
MSME	Micro, Small and Medium Enterprises
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
UNCTAD	United Nations Conference on Trade and Development
USD	United State Dollar
WB	World Bank

Currency	
1 USD	DKK 6.75
1 DKK	USD 0.15

1. CONTEXT

1.1 Background

The Danish 2019 finance act includes an earmarked core funding commitment to IFU in support of IFU's new strategic priorities. One of the engagements of the programme comprises a commitment of DKK 200 million to IFU for the development of a high risk – high impact investment initiative focusing on investments with high development impact in the least developed countries and fragile states in Africa.

The policy and investment context of IFU has changed considerably in recent years. This change is driven by a number of factors - including IFU's new untied mandate and the establishment of the SDG Investment Fund - in a context where many developing countries are graduating to middle-income countries and therefore increasingly attract private investors. IFU has also assumed an important role in Danish international development efforts. This raises the stakes for the alignment and appropriateness of IFU's strategies and instruments to deliver on development priorities. The recently published evaluation of IFU indicated, in line with international research on DFIs, that IFU investments in the lower income countries are insufficient, and recommended IFU to do more. On that background, there is a need to update IFU's toolbox in order to ensure that IFU has an optimal set of complementary financial approaches that allow for increasing investments, also in markets in lower income countries and fragile states where the investment risk is high. There is further a need to develop procedures that makes it possible to identify, select, monitor and report on investments with a high development impact.

Comprehensive and innovative private sector participation is a necessary, although not a sufficient condition for achieving the SDGs in developing countries. The Ministry of Foreign Affairs (MFA) and IFU have been pro-active in mobilising private capital, technology and knowhow for SDG investments in developing countries through the establishment of PPP based investment fund arrangements such as the SDG Investment Fund and the Danish Climate Investment Fund (DCIF). This is an important achievement in line with Danish and international development priorities. Denmark has with the DCIF and the SDG Investment Fund set out to achieve promising development results inspiring other donors and DFIs. The PPP based investment funds have proved to be able to catalyse relevant investments in economic and social sectors in developing countries that could otherwise not be realised or only in a less ambitious way. However, preliminary experience shows that such PPP based investments funds prioritise investments with a relatively predictable and adequate risk-return balance – meaning that investments are mainly targeting middle-income countries and rarely low-income countries where the risk is high. Special efforts are required to also promote the mobilisation of private capital for investments in the lower income countries and fragile states, and particularly in Africa where some of the world's most challenging poverty and fragility problems are rooted.

Most of the world's poorest and fragile countries are in Africa. The political, economic and social situation in most of these countries is very fragile with significant risk to further deteriorate unless major efforts are made to stabilise and improve the situation. The challenges are many and diverse, but a dominating challenge is the need to annually generate millions of new decent jobs for the large generation of young people that are entering the job market. Every year around 12 million young people enter the African job market, but only around 3 million jobs are created meaning that an additional 9 million young people every year are facing an unsecure future with unemployment, underemployment or forced self-employment. This is a worrying source to poverty, instability and migration unless many more jobs can be generated.

It is primarily the private sector that needs to generate the many new jobs in Africa, but the African private sector is still relatively weak, and Foreign Direct Investments (FDI) are marginal and mainly concentrated in a few countries. FDI in the least developed African countries is extremely marginal due to a challenging risk-return balance. This is also exemplified by the fact that the average FDI return on investment in Africa has dropped from about 12 per cent in 2010 to 6.5 per cent in 2018 due to decreasing commodity prices and various structural factors[1]. However, even with these challenges the African private sector has promising potentials to grow faster and generate jobs, income and public revenue, and here the Development Finance Institutions (DFI) can play a crucial role to catalyse investments through the provision of strongly needed risk capital and knowhow.

IFU has generally been successful in investing in low and lower middle-income countries in accordance with its current investment mandate[2]. However, IFU's investments in projects with high risk and high impact in these countries have so far been limited. IFU's new untied mandate provides better opportunities to identifying interesting investment opportunities and partners in these challenging countries, but an unfavourable risk-return balance remains an obstacle for expansion. Some of IFU's sister organisations including Norway (Norfund), UK (CDC), Finland (Finfund), the Netherlands (FMO) as well as IFC of the World Bank have already agreed with their owners to take steps to expand the use of blended concessional finance to support such investments, allowing the DFI's to take more risk when impact is high. A similar set-up is needed for IFU in order to expand its investments in lower income countries in Africa[3]. It is therefore proposed that IFU introduces a blended concessional finance initiative where concessional donor funds are combined with other types of finance on commercial terms[4].

The blended concessional finance instrument and its integration into IFU's entire financing toolbox is illustrated in annex 4. The concept has potential to mobilise public and private capital and catalyse high-impact private sector investments in these markets. Focus should not only be on specific countries but also on thematic areas and markets with high development potentials but characterized by high risk.

IFU has done a few investments using a blended concessional finance approach. A 2018 equity investment in African Guarantee Fund (AGF), which is envisaged to only provide a modest return, was a successful result of a blended concessional finance arrangement between MFA and IFU. Another example is IFU's investment in a SME investment fund in Somalia, which was made possible based on a similar arrangement including a first loss guarantee structure. The ambition is to significantly increase investments in this segment and in a much more strategic and formalised way.

1.2 Preliminary international experience with blended concessional finance

Estimating global use of blended concessional finance for investments in developing countries is still associated with some uncertainty due to inadequate harmonisation of definitions and data systems. However, it is estimated that DFIs and MDBs in 2017 financed projects with a total volume of USD 8.8 billion of which USD 1.2 billion was financed with concessional funds, USD

[1] UNCTAD: World Investment Report, 2018 and 2019

[2] At least 50 per cent of IFU's investments must over a rolling period of three years be made in poorer developing countries with a maximum GNI per capita of 80 per cent of the upper limit for Lower Middle-income Countries according to the World Bank's classification. This GNI threshold was in 2018 USD 3,164 per capita. During the 2016-2018 period 66 per cent of IFU's investments were below the threshold.

[3] The definition of lower income countries in Africa is presented in section 2.4 (Country focus), and the list of countries is presented in annex 5.

[4] The DFI Blended Finance Working Group defines blended concessional finance as: "Combining concessional finance from donors or third parties alongside DFIs' normal own account finance and/or commercial finance from other investors, to develop private sector markets, address the Sustainable Development Goals (SDGs), and mobilise private resources". Source: DFI Working Group on Blended Concessional Finance for Private Sector Projects, Joint Report, October 2018.

3.9 billion with DFI/MDBs own-account resources, and the remaining with finance mobilised from the private sector[5]. The blended concessional finance is invested in a broad range of sectors including infrastructure and finance, and a significant share is invested in Sub-Saharan Africa where the needs of blended concessional finance are particularly high.

IFC has worked with blended concessional finance for more than 10 years and the blended concessional funds available to support projects have increased from less than USD 1 billion in 2010 to about USD 4 billion in 2019. IFC is currently assessing the preliminary results and trends, and IFC increasingly consider blended concessional finance as a promising tool to unlock opportunities for the private sector to contribute to achieving the SDGs. About 75 percent of IFC 2018/2019 blended concessional finance commitments were in Low-Income-Countries (LIC). The 2010 – 2019 investment portfolio indicates that 1 donor USD is accompanied by USD 4 from IFC own sources and USD 5 from other sources. The mobilisation of private capital varies significantly by sector/thematic focus and the specific investment case. The concessionallity level can vary significantly from project to project, but it has never exceeded 10 percent. The average concessionality level is around 3.5 percent, but it is likely to increase, because IFC increasingly deploy highly needed local currency solutions and guarantees in challenging markets that need these solutions.

2. PROJECT PRESENTATION

2.1 Objectives and targets

Development objective: Enhanced IFU contribution to job creation, structural transformation and inclusive green growth in lower income countries in Africa.

Immediate objectives:

1. Blended concessional finance initiative developed and in operation with increased volume of IFU investments in projects with high development outcomes in the lower income countries in Africa.
2. Promote and accelerate IFU's development of procedures for and experience with identifying and managing projects with high development outcomes in lower income countries in Africa.

To enhance IFU's investments in high impact projects in lower income African countries with a challenging risk-return balance, the MFA will initially provide DKK 200 million to IFU for this purpose. The funds are expected to be invested within two years. Additional MFA capital contributions to the initiative may be provided in the years to come to enable further expansion. The target will be that IFU, over the next two to three years, depending on further capital contributions, on an annual average will invest at least 30 percent of its own capital in the lower income African countries.

The initiative will contribute to the achievement of a number of the SDGs through the implementation of selected high risk – high impact projects that would otherwise not be financed and implemented due to a challenging risk-return balance. The investments are envisaged to mainly support the following SDGs: 1) No poverty, 2) No hunger, 3) Gender equality, 6) Water and sanitation, 7) Affordable energy, 8) Decent jobs, and 13) Climate action. The specific investment projects will be selected based on their ability to generate significant development outcomes as measured using development indicators such as number of decent jobs with specific focus on women and youth, number of smallholder beneficiaries, installed capacity and

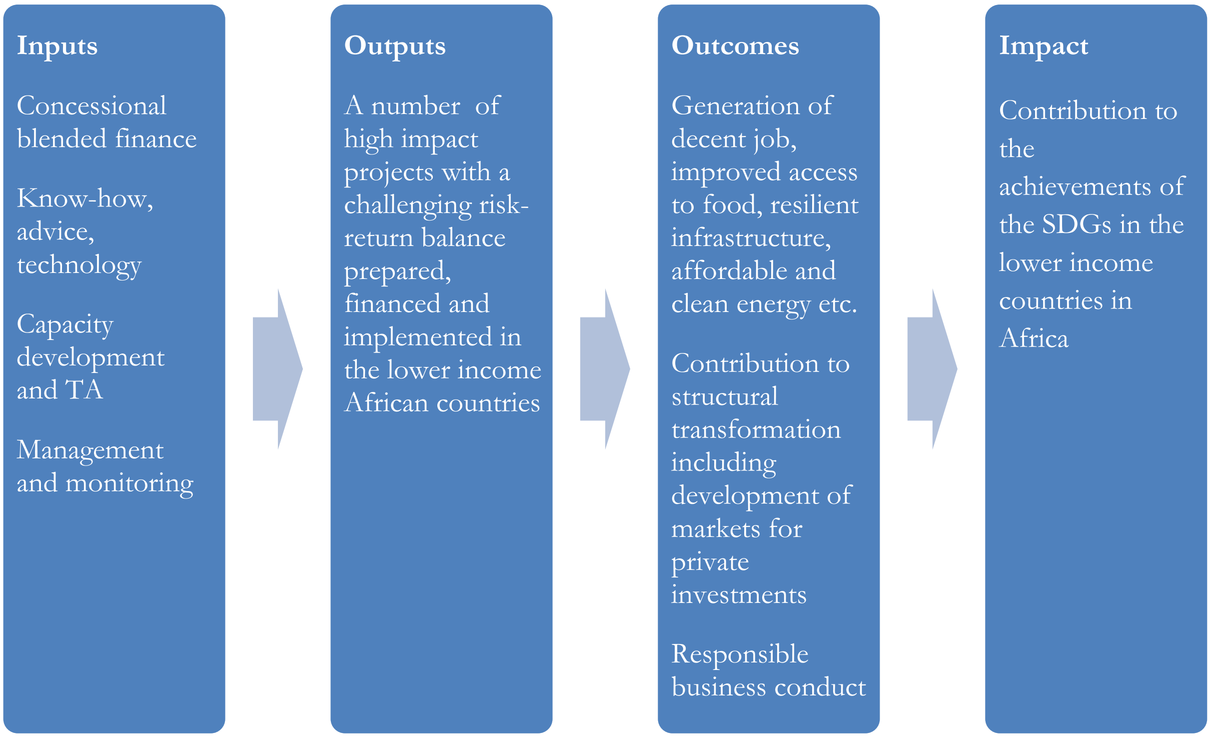
[5] Source: DFI Working Group on Blended Concessional Finance for Private Sector Projects, Joint Report, October 2018.

production of affordable renewable energy, and number of poor beneficiaries with access to clean water. Annex 6 provides a list of examples of pipeline projects.

IFU is in a process of strengthening the assessment of potential development impacts in the investment decision process, and further improve the development results measurement of investments. It involves efforts at strategic level, in human resources and in relation to procedures. It is envisaged that the blended concessional finance initiative will accelerate and further promote these efforts and enable IFU to test impact tools (ref. section 4.3).

2.2 Theory of change

At the overall level the Theory of Change for the blended concessional finance initiative can be described as follows: The mobilisation of private capital, technology and knowhow for high impact investments in the lower income countries in Africa is at present marginal due to limited market knowledge and a challenging perceived or real risk-return balance. Donors and DFIs therefore need to facilitate the involvement of private investors through the provision of blended concessional finance instruments that can finance and de-risk the investments to ensure that the private investors gain experience and gradually become more willing to invest in these markets.. **If** Danida and IFU, were able to provide blended concessional finance solutions, **then** it would be possible to increase IFU's investments in high impact projects in lower income African countries where IFU's current investment portfolio is low.



The theory of change is based on a number of assumptions including: a) Investments in lower income and high-risk markets are to a large extent held back by perceived risks and lack of market knowledge; b) IFU will have access to a satisfactory pipeline of relevant eligible projects; c) qualified private investors are willing and committed to participate in such blended concessional finance initiatives; and d) it is possible to establish a satisfactory balance between development objectives and commercial objectives throughout the entire investment period.

2.3 Justification

Relevance: The proposed commitment to IFU for the establishment of a blended concessional finance initiative that can complement the existing financing instruments, and promote high risk – high impact investments in lower income countries, is highly relevant and fully in line with Danish and international development policies and priorities, and the recommendations of the recent evaluation of IFU. Special efforts must be taken to mobilise private capital, technology and knowhow for SDG investments in these countries in order to avoid that they are bypassed and locked in their poverty and fragility. This is particularly needed for the Africa region, where the most of the world's lower income countries are found. Commercial investments in many markets in these countries are challenging due to several factors including inadequate regulatory framework, inadequate infrastructure, inadequate access to finance, poorly developed markets, shortage of bankable projects, political instability, corruption etc. which all contribute to an unfavourable investment environment. It may therefore not be possible to promote investments without concessional capital with high risk appetite, which provide a certain subsidy that can ensure an acceptable risk-return balance, including the private investors. Blended concessional finance is in this respect a useful, flexible and relatively cheap instrument to catalyse transformative impact investments, that cannot be implemented on fully commercial terms on a short term basis and therefore need some facilitation or risk mitigation to materialise and develop the market for commercial investors.

Efficiency: The concessional blended finance approach will be an integrated part of IFU's institutional structures and procedures, and efficiency is therefore envisaged to be satisfactory. A complex investment environment and relatively small investments compared with the average size of IFU's investments may cause higher transaction cost, including human resources, which, from the MFA's point of view, is acceptable in the present context.

Effectiveness: The effectiveness is envisaged to be high, as the instrument will deliver high additionality contributing to sustainable investments with high development impact that would otherwise not take place. It is also envisaged that a more complete IFU toolbox of financial products and approaches will allow IFU to offer a better and broader mix of financial solutions to potential investors and co-investors. The involvement of private sector investors is also envisaged to promote the implementation of new business models that can demonstrate business opportunities and hereby open markets for pure commercial investors.

Impact: The commitment will promote increased focus on commercially based impact investments in some of the most challenging developing countries. The instrument will support a number of the SDGs, but the most significant outcomes are envisaged to be in relation to: 1) No poverty, 2) No hunger, 3) Gender equality, 6) Water and sanitation, 7) Affordable energy, 8) Decent jobs, and 13) Climate action.

Sustainability: IFU will have strong focus on sustainability in accordance with its new sustainability policy and international sustainability standards. Promotion of the sustainability agenda will in itself be an important outcome in the lower income African countries, where sustainability may not be adequately prioritised. Sustainability of the development outcomes achieved during the investment period should furthermore be considered when exiting the investment.

2.4 Strategic considerations

Types of investments: The new initiative will target commercial investments with likely significant development outcomes in some of the most difficult African markets. Investment projects must be designed with the purpose of generating strong development outcomes. This should be the key driver. Obviously, investments should generate adequate return to the investors, but a lower than usual rate of return should be accepted in favour of higher impacts and market transformation. The blended concessional finance initiative will ensure that local private investors can obtain finance for relevant investments proposals that they would otherwise not be able to obtain.

Test period: Blended concessional finance for commercial, sustainable and transformative investments in developing countries is a relatively new approach for IFU, and it will therefore be necessary to further assess market opportunities, test investment approaches and strategies, develop and fine-tune procedures etc. The first two to three years of the implementation should therefore be considered as a test period in order to gain experience, and, if required, adapt approaches and procedures. It may also be necessary to adapt targets.

Country focus: The new blended concessional finance engagement will target lower income countries in Africa to address a strong need to increase SDG investments in these countries. The country focus will be delimited based on established thresholds for GNI per capita[6]. Focus will be on countries with a GNI per capita of max 40 percent of the upper limit for Lower Middle Income Countries according to the World Bank's classification, currently corresponding to USD 1,598 per capita. To ensure stability, a country will graduate if its GNI per capita is above the limit for three consecutive years[7]. Based on that the country focus comprises a total of 35 African countries. IFU has currently active direct investments in 12 of these 35 countries, and the investments are concentrated in a few countries including Kenya, Mali and Benin. The list of the 35 African countries is presented in Annex 5. Indirect investments through funds with a regional focus, covering countries above as well as below the threshold, are included based on the actual fund's existing portfolio below the threshold and estimates for possible future investments. For new funds, the expected distribution of investments will be used. The ex-ante estimates will be supplemented by annual reporting on the actual investments in the funds.

Thematic focus: The country categorisation should be complemented with a thematic/market focus in order to prioritise investments, which are expected to generate high development outcomes on defined key indicators in local economies, but where the risk adjusted return would fall outside the scope of what would consider commercial. Sustainability including ambitious transformational climatic investment flows that can significantly contribute to zero greenhouse gas emission and climate-resilient development will be a thematic focus area in all investments. More specifically the thematic focus would include generation of decent jobs, focus on women and youth, climate, access to affordable and clean energy, bottom-of-the-pyramid, smallholder agriculture, access to clean water, MSME etc. A complete and stringent list of criteria for the thematic focus will not be elaborated in order to maintain adequate flexibility, but the planned and actual development outcome should be very clearly presented and documented in the investment proposals.

Investment targets: The target is that IFU on average in 2020 and 2021 will invest at least 30 percent of its own capital in the concerned countries. This is an adequate investment target during the test period, e.g. because several of the most interesting countries, including Kenya, may graduate and fall out of the country list within the next few years. On average, IFU has invested 40 percent of its capital in Africa during the last five years, but it is only about 25 percent[8] which has been invested in African countries with the above mentioned GNI threshold of max USD 1,598 per capita.

6 Using World Development Indicators, GNI per capita Atlas methods (current USD)

7 Figures are published every year in July, which means that the list of eligible countries changes mid-year. Countries that were above the threshold for the first time in July 2019 can thus be ineligible at the earliest from July 2022.

8 The 25 per cent includes direct investments and investments with a regional focus (typically indirect fund investments). Direct investments constitutes about 16 per cent, whereas the remaining 9 per cent comprises investments with a regional focus based on weighted actual distribution for similar investments.

Governance consideration: International best practices and guidelines states, that concessional blended finance to some extent requires specific governance procedures. The MFA commitment will be allocated as earmarked core funding in order to ensure that it will be fully integrated into IFU's governance system. The establishment of a specific concessional finance facility will be avoided, as this would require more administrative resources and hamper a satisfactory integration into IFU's organisational culture. The initiative will have to be aligned with IFU's new strategy execution plan, which is envisaged to be approved by the board before the end of 2019. In the further development of the initiative, various IFU guidelines and procedures will be looked at in order to ensure adequate documentation that an investment fulfils the criteria of being high risk, high impact investment. These amendments may include specific requirements to IFU's assessments and documentation of the need and intended use of concessional funds, expected development outcomes, expected profitability, and not least additionality. These procedures will be fully developed during the test period.

Concessionality approach: Two basic business financing models are applied for blended concessional finance. The most common model applies two or several assets classes where the concessional funds are allocated to a special assets class which mitigates the risk of the private investors, and in some cases also the DFI, through various risk mitigation arrangements such as first loss cover. This model is relatively good at mobilising private capital, because the private investors obtain a more predictable and acceptable return. The other model operates with one assets class only, where all investors will obtain the same, and normally a relatively lower return. The second model will mainly be able to mobilise capital from DFIs and private impact investors, whereas the expected return often will be too low to attract significant capital from commercial private investors. IFU will, depending on the character of the specific investments, apply both models. The first model is envisaged to mainly be used in relation to indirect investments.

Project pipeline: IFU has already developed an initial pipeline of interesting projects that would require financing from the new initiative in order to materialise. It is envisaged, that it will be possible to maintain a strong pipeline of promising high risk projects with high development outcomes, rf. Annex 6. Blended concessional finance should only be used to catalyse promising market opportunities that would not take place without a special temporary effort. The subsidised investments should address market shortages, and demonstrate opportunities which can pave the way for subsequent commercial finance. It is therefore important that the market shortages are carefully assessed to ensure that they can be effectively addressed to achieve the required results with concessional support.

Financial products: Most of the blended investment capital is expected to take the form of equity, as is the case for IFU's general investment portfolio. Equity, being the most risk oriented product, is strongly needed in these markets. The remaining part of the investment capital will mainly be provided as senior or mezzanine loans, where the subsidy element will allow IFU to provide loans with more favourable terms and interest than IFU would normally be able to provide to an investment on the concerned conditions. Various types of guarantees can also be considered.

Risk-return balance: The new instrument will be applied for investments that are outside IFU's normal comfort zone with regards to risk and return. Not only will the risk in terms of country risk, commercial risk etc. be relatively high, but the risk adjusted return would also be lower than what is normally accepted.

Sustainability and responsible business conduct: IFU will have strong focus on the sustainability of the investments. The financial sustainability of the investments will be relatively challenging compared with IFU's other commercial investments, but careful preparation and monitoring shall ensure that the investments on average will achieve satisfactory financial sustainability. IFU will apply sustainability standards, including UN guiding principles for business and human rights, in accordance with its new sustainability policy.

Additionality: The additionality of the investments, both financial and value additionality, will be carefully assessed and documented in order to ensure the initiative generates commercial investments and development outcomes that would otherwise not have been achieved or achieved in a much less ambitious way. Considering the use of concessionality it is important that IFU will be able to document strong additionality, and evidence that market distortion will be avoided. Overall the additionality is expected to be significant due to the challenging risk-return balance related to the investments.

Leverage: A key purpose of blended finance is to use donor funds as leverage for the mobilisation of private capital, technologies and knowhow. In the case of indirect investments the private capital mobilisation will occur at two levels, respectively at the level of a special purpose investment fund and at the level of the specific investment projects. A target for the leverage factor has not been defined, but the leverage factor will be measured. The leverage factor is expected to be significantly lower than for IFU's traditional investments reflecting the less mature markets and significant higher risks of the intended transactions.

3. BUDGET

The overall budget of the commitment to the new instrument is estimated at DKK 200 million as indicated below:

	DKK million
MFA's earmarked capital contribution to IFU	199.5
MFA mid-term review	0.5
Total capital contribution	200.0

The MFA commitment does not include separate funds for technical assistance, capacity building etc. which may often be needed for the preparation and implementation of concessional blended finance investments. These costs will be covered by IFU according to needs. However, specific funds have been reserved for an MFA midterm review (ref. section 4.2).

4. GOVERNANCE AND MANAGEMENT SET-UP

4.1 Governance structure

The new blended concessional finance initiative will be integrated into IFU's governance structure, and be managed according to current policies, strategies and procedures for IFU's financing and investment activities. IFU is currently preparing new strategic directions in which the new initiative will be an integrated part. It is also necessary for MFA and IFU to reconsider certain oversight and governance procedures. The initiative will be an important part of IFU's new strategy execution plan, which is envisaged to be adopted by the board later this year, and the revised investment targets will be specified in the cooperation agreement between MFA and IFU. It is also envisaged that the initiative will require certain amendments of specific IFU guidelines and procedures to ensure clear and transparent management and documentation of the initiative e.g. with regards to the specific country and thematic investment requirements, the use of concessional finance, the specific reporting requirements on progress, performance and not least planned and actual development outcome. Since the initiative comprises a number of new priorities and modalities where unexpected issues may arise, IFU will keep the MFA informed about planned investment initiatives. The dialogue with MFA could e.g. address key issues in relation to type of investment, additionality, development outcomes, result measurement, sustainability, risk and rate of return. The discussions will further allow assessments of possible synergies with planned and ongoing MFA development programmes and instruments. The preparation of the specific procedures will be completed during the early start-up phase.

The new initiative will, in line with the recommendations of the IFU evaluation, require that IFU develop a stronger development culture within the organisation including recruitment of additional staff with strong development expertise and experience. This is acknowledged by IFU which has initiated the process. IFU is also strengthening the development agenda in relation to the Board, e.g. through a stronger focus on additionality and development outcomes in Board papers. The delegation of responsibility of the daily management of the initiative will be determined by IFU during the project preparation process.

4.2 Financial management

The MFA commitment will be allocated as earmarked core funding to IFU, which will invest the funds according with the investment mandate and procedures. Financial reporting on the initiative will be integrated into IFU's overall financial reporting. It is envisaged, that IFU contribute to the initiative with own resources. Reflow of funds from the investments will be an integrated part of IFU's capital and business activities in line with the investment mandate. The specific procedures for the operation of the initiative incl. financial management will be elaborated during start up and testing.

4.3 Monitoring and evaluation

The investments under the initiative will be part of the overall IFU portfolio and reported in the annual report, which will include data on the share of investments undertaken in the countries targeted through this initiative as well as a narrative description of the investments.. IFU's annual report will also provide data on IFU's total annual investment in Africa.

IFU undertakes financial and Environmental, Social and Governance (ESG)/impact monitoring of its investment through annual reporting from investment companies and in most cases also through board representation. Since 2017, IFU uses the Development Impact Model (DIM) to estimate the expected development outcomes of the investments based on key indicators including:

- Number of employees distributed on female, youth and unskilled
- Local tax contribution
- Mitigated CO_2 emission during project lifetime
- Renewable energy capacity/production
- Smallholder farmers supported
- Number of female financial inclusion beneficiaries

The DIM score of the investment is used in the investment decision and for reporting purposes. The total number of jobs supported and the amount of local tax paid for all IFU investments are reported in the annual report. An assessment of ESG aspects is undertaken ex-ante for each investment and reported upon annually by the investee.

IFU is presently in the process of developing the DIM further to include a broader array of development outcomes as well as new procedures for investment screening and reporting. This will include specific targets for each investment in relation to both direct and indirect development effects of the company. The development effects to consider will depend on the sector and type of investment, and could include for instance effects in the value chain, development effects obtained through the investment (e.g. financial services), positive or negative effects on the community, effects on gender equality etc. The potential development effects of an investment will be considered early in the investment decision phase, and concrete steps for improving the development effects of investee companies (impact value creation) during the investment period will be considered as part of the investment period.

In addition, mid-term and ex-post studies of development outcomes will be prepared for a selected part of the investment projects in order provide more detailed documentation on performance and development outcomes, as well as contributing to learning about this new financing initiative and the continued development of DIM.

An MFA midterm review assessing progress and performance of IFU's development of the instrument will be conducted 1 – 1½ years after the initiative has been initiated. The review will among other assess progress against targets, the investment procedures, the approved investment projects, the development of the results measurement system, and the amendment of guidelines and procedures. The initiative may furthermore be subject to independent evaluation if and when required by Danida's evaluation department.

5 RISK

The projects to be financed by the instrument are by definition high risk and beyond IFU's normal comfort zone. The risks are of country, political, thematic and commercial nature. However, IFU has a well-developed risk management system, and the individual investments projects will as far as possible be assessed according to IFU's risk management principles. Adequate measures will be taken to manage and minimise the risk. The investments will be spread on a number of countries and thematic areas, and a significant part of the investments are envisaged to be conducted together with other DFIs or made indirectly through specialised investment funds in order to mitigate and/or spread the risk. The main contextual, programmatic and institutional risks are presented in Annex 7.

Annexes

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:
- IFU has achieved promising results with its PPP based investments funds. However, preliminary experience shows, that such investment funds prioritise investments with a relatively predictable and adequate risk-return balance, and the investments are therefore mainly made in middle-income countries. - Special efforts are required to also promote the mobilisation of private capital in the least developed countries and fragile states. - Several DFI's including Norfund, CDC, Finfund and IFC have already agreed with their owners to make steps to support such investments. - A similar process is needed for IFU to promote investments with high development outcomes in the least developed countries, particularly in Africa,, where the risk-return balance is challenging.
List the key documentation and sources used for the analysis: - A large number of documents prepared by DFIs, the World Bank Group, donors and international organisations.
Are additional studies / analytic work needed? How and when will it be done? - 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 support is closely linked to fragility, conflict, migration and resilience. It is important to promote SDG relevant private sector investments in the least developed countries and fragile states, but this can only be done through concessional blended finance initiatives that can demonstrate opportunities an ensure private investors a relatively predictable and acceptable rate of return.
List the key documentation and sources used for the analysis: - A large number of documents prepared by DFIs, the World Bank Group, donors and international organisations.
Are additional studies / analytic work needed? How and when will it be done? - No need to conduct additional contextual studies and analyses.

3. Assessment of human rights situation (HRBA) and gender[9]
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) - The investments will be conducted in a complex environment across a number of the least developed countries and challenging sectors, in Africa, where the stakeholders may not always give high priority to sustainability standards. IFU will apply its new sustainability policy and procedures which are based on international standards incl. the UN Guiding Principles.
Universal Periodic Review - IFU will regularly report on progress and performance of the investments. A review of the instrument will be conducted after 1-1½ years.
Identify key rights holders in the programme
Identify key duty bearers in the programme
Human Rights Principles - All IFU investments will be subject to a stringent due diligence process, which will ensure that the investment projects adhere to the principle of good corporate governance, comply with the principle of good business conduct etc. IFU will apply sustainability standards, including UN guiding principles for business and human rights, in accordance with its new sustainability policy.
Gender - The investments under the instrument will give special priority to gender equality and the promotion of women entrepreneurs.
Youth - The same as for gender
List the key documentation and sources used for the analysis: -
Are additional studies / analytic work needed? How and when will it be done? No

4. Inclusive sustainable growth, climate change and environment -
Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:
- The IFU investments will strengthen the sustainability agenda among the involved stakeholders. This can be a challenging task considering that the instrument is envisaged to promote investments in a number of the least developed countries, hereby addressing a broad and diverse group of stakeholders. - IFU has a well-developed set of policies and procedures which will be applied to address the sustainability agenda in relation to the investments.
List the key documentation and sources used for the analysis: - IFU's sustainability policies and related policies on tax, climate etc.

[9] 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.

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:
- These issues will be assessed by IFU on a case-by-case basis in relation to the specific investment proposals. - IFU is untied, but is often working with Danish investors and economic interests. However, the concessional blended finance instrument is targeting the least developed countries in Africa and the opportunities of involving Danish investors with adequate interest and capacities are envisaged to be relatively limited.
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 are required.

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 IFU and the new concessional blended finance instrument are: - Other donors and DFIs, international commercial investors and companies, and local investors in the countries where the investments will take place.
List the key documentation and sources used for the analysis:
Are additional studies / analytic work needed? How and when will it be done? - No additional studies are required.

Annex 2: Partners

1. Summary of stakeholder analysis

No additional stakeholder analyses have been conducted due to the fact that IFU is a well-established organization, and the planned commitment to the new instrument will only to a minor extent effect IFU's current governance procedures and business activities.

IFU offers risk capital and advice to companies that want to invest in commercial investment activities in developing countries. IFU has built up a strong experience with investments in developing countries including low-income countries, and IFU has the required capacity and networks to develop and implement the new instrument.

2. Criteria for selecting programme partners

N/A, ref. above.

3. Brief presentation of partners

Ref. above.

Annex 3: Preliminary results framework

<table>
<tr><td colspan="2"></td><td>High risk – high impact investment: Capital contribution to IFU to develop and operate a concessional blended finance initiative.</td></tr>
<tr><td colspan="2">Development objective of the fund and immediate objective of capital contribution</td><td>Development objective: Enhanced IFU contribution to job creation, structural transformation and inclusive green growth in lower income countries in Africa..

Immediate objective:
1. Blended concessional finance initiative developed and in operation with increased volume of IFU investments in projects with high development outcomes in the lower income countries in Africa.
2. Promote and accelerate IFU's development of procedures for and experience with identifying and managing projects with high development outcomes in lower income countries in Africa.</td></tr>
<tr><td colspan="2">Impact Indicators</td><td>The impact of the initiative will be determined on the basis of the individual investment projects which will be implemented across countries and thematic areas/sectors. Impact assessment will be based on the indicators of IFU's DIM system, which will be further developed to better capture transformative impact investments, and these indicators will also be used in relation to specific ex-post studies of selected investment projects.</td></tr>
<tr><td colspan="2">Engagement Title of Fund</td><td>Same as above</td></tr>
<tr><td colspan="2">Outcome indicator</td><td>The outcome indicators will be based on IFU's DIM system which will be further developed to address broader range of development outcomes. The present DIM outcome indicators most relevant for the initiative include:
• Number of direct jobs distributed on female, youth and unskilled
• Number of smallholder beneficiaries
• Installed capacity of renewable energy
• Mitigated CO_2 emission
• Female financial inclusion beneficiaries</td></tr>
<tr><td>Baseline</td><td>Year</td><td>An ex-ante baseline will be prepared by IFU before a new investment project is initiated. Follow-up include annual reporting on selected indicators as well as ex-post assessment at exit. A final evaluation report will be prepared for each investment project, and in-depth outcome or impact studies will be prepared on selected investment projects.</td></tr>
<tr><td>Target</td><td>Year

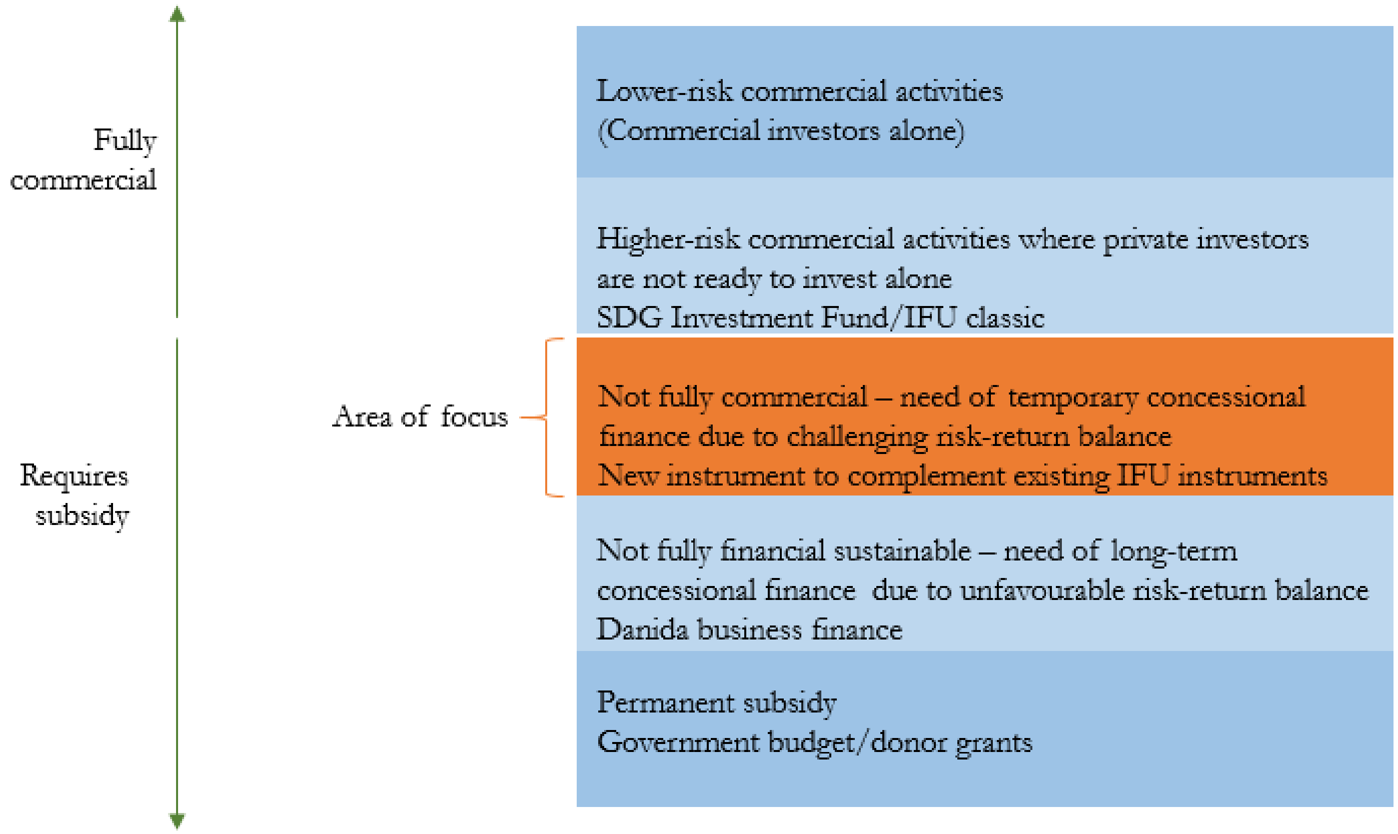
2022</td><td>Targets of the blended concessional finance investment initiative:

IFU will in 2020 and 2021, on an annual average invest at least 30 percent of its own capital in the least developed African countries with a GNI of less than 40 percent of the upper limit for lower middle income countries, such that countries that were above the threshold for the first time in July 2019 can thus be ineligible at the earliest from July 2022.

The overall measurable targets for the initiative furthermore include:
• New system for development impact screening of investment tested and ready for upscaling to IFU investment portfolio
• Improved DIM system tested and ready for upscaling to IFU investment portfolio
• Channels for sourcing high impact projects in the target countries enhanced
• IFU investment officers have obtained experience with identifying and developing high impact investments
• Initiative aiming at enhancing development effects during the investment period, involving for instance technical assistance and training, have been tested (impact value creation)
• Approach for mid-term impact studies of investments has been developed and tested on investments under this initiative

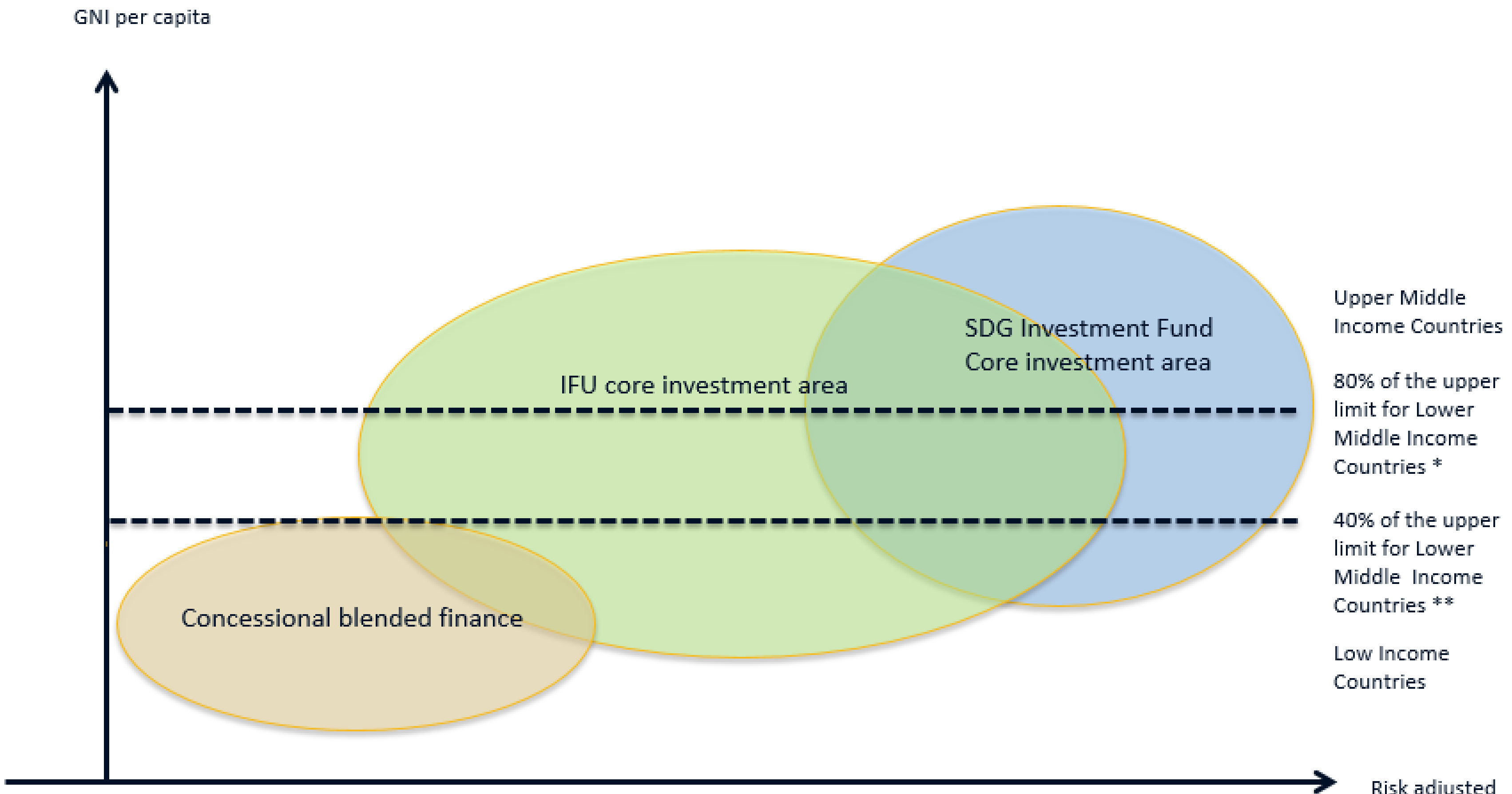
The specific targets of the indicators are established prior to the investment decision for each investment in collaboration with the investee. They will be based on projections of outreach and deliveries on the specific investments.</td></tr>
</table>

Annex 4: Positioning the new blended concessional finance instrument, figure 1



Source: Adapted from IFC: When blended concessional funds make sense. "Blended concessional finance: Governance matters for impact", March 2019.

Annex 4: Positioning the new blended concessional finance initiative, figure 2



* At least 50% of IFU's investments, according to the current investment mandate, over a rolling period of three years, to be made in poorer developing countries with a maximum GNI per capita of 80% of the upper limit for LMICs according to WB's classification.
** New initiative: An intentional 25% of IFU's annual investments with own funds, over a rolling period of three years, to be invested in African countries below a maximum GNI per capita of 40% of the upper limit of LMICs.

Annex 5: List of eligible countries for the initiative

List of countries eligible from July 2019-June 2020. Based on GNI per capita, Atlas methods (current USD) from World Development Indicators[10]

	GNI per capita, Atlas method (current US$)		
Country Name	**2016**	**2017**	**2018**
Benin	820	800	870
Burkina Faso	600	590	660
Burundi	270	280	280
Cameroon	1,380	1,340	1,440
Central African Republic	410	420	480
Chad	730	640	670
Comoros	1,320	1,280	1,320
Congo, Dem. Rep.	470	460	490
Congo, Rep.	1,820	1,480	1,640
Cote d'Ivoire	1,530	1,480	1,610
Eritrea			
Ethiopia	660	740	790
Gambia, The	620	650	700
Guinea	770	830	830
Guinea-Bissau	650	680	750
Kenya	1,360	1,440	1,620
Lesotho	1,360	1,300	1,380
Liberia	620	620	600
Madagascar	400	400	440
Malawi	340	340	360
Mali	780	770	830
Mauritania	1,160	1,120	1,190
Mozambique	490	430	440
Niger	370	360	380
Rwanda	720	730	780
Senegal	1,270	1,280	1,410
Sierra Leone	490	520	500
Somalia			
South Sudan	460		
Sudan	2,130	2,390	1,560
Tanzania	970	970	1,020
Togo	610	590	650
Uganda	660	620	620
Zambia	1,380	1,300	1,430
Zimbabwe	1,290	1,370	1,790

[10] African countries with a GNI per capita of max 40 percent of the upper limit for Lower Middle Income Countries according to the World Bank's classification which corresponds to USD 1,598 per capita, according to the latest figures (published July 2019). Eritrea, Somalia and South Sudan have no data, but are assessed to be eligible.

Annex 6: Examples of pipeline investment projects

<u>"African power intermediary"</u>[11]

"African power intermediary" is a company with expected support from the Green Climate Fund, ADB, EU, DBSA, NEPAD and others.

The objective of the company is to procure renewable energy from independent, private power producers in Southern Africa and sell power to off takers – including public electricity distributing companies and private companies – across Southern African countries, where there is a regional grid, Southern African Power Pool. The company would reduce risk for independent power producers as these would not be dependent on the ability to pay on time of a single off-taker (national electricity distributing company) in each country, which is the common practice now. African power intermediary would further mitigate the single customer risk by having a solid equity buffer (promotors, possibly the Green Climate Fund – and DFIs like IFU) on its balance sheet and multiple commercial contracts to divert power to in case of non-payment by one off taker. An international IFI and EU has furthermore indicated an interest in providing a guarantee, if the equity buffer were exhausted. IFU would invest equity, which is the investment instrument that has the highest degree of additionality and that would help mobilise guarantees – and over time debt financing.

The reduced risk would provide incentives for more private investment into renewable power generation supporting economic and social development with reduced greenhouse gas emissions. The cost of power could be reduced due to reduced risk and due to more investments in renewable (including solar, wind and hydro energy) which is cheaper than fossil fuel generated power. Net revenue would be generated by the Africa power intermediary through a margin on the cost of procurement from the independent power producers – a margin that would still render the cost of power for the utility and consumer lower than at present.

The Southern Africa power pool trading would create stability in the regional grid and like the Nordic Power pool, it would create synergies between countries' resource comparative advantages (hydro, wind, solar, fossil). Also, regional trading revenue for Africa power intermediary would create upside for the investors such as IFU, which is what happened in the Indian equivalent

This would be a first of its type of business in Africa, a start-up with all the risks this entails, which would bring the risk-return relationship outside the normal scope of DFIs, not to speak of private investors. Key risks relate to political, regulatory and licensing, off taker payment, countries, operational.

If successful, the business could be scaled up in the region and be replicated in other African regions and become commercially viable, attracting private investors.

The business model of the company is known from other parts of the world, including India.

African power intermediary is also a partnership under P4G.

[11] The names of the potential investee companies/funds have been anonymised as no decisions to further pursue these potential investments has been taken yet.

Potential investment: DKK 35-70m

African financial intermediary

African financial intermediary is a private financial institution established with support from the Danish development cooperation aiming at improving access to finance for players in agricultural value chains in combination with technical assistance to upgrade stakeholders´ productivity, sustainability etc. African financial intermediary does this through credit lines and guarantees to financial institutions in to enable them to fund investment capital and working capital for farmers and farmers groups as well as companies supplying inputs to farms etc., processing or trading in produces from (or to) agri-businesses. African financial intermediary works closely with a technical assistance facility with funding from Danida and others that provide capacity building of stakeholders in the agricultural value chains.

African financial intermediary has a proven track record promoting economic growth and job creation and being financially self-sustaining, with governance and E&S policies in place as well as an impact monitoring system. Impact is high and significant in relation to the country's economy.

The risk return relationship would however be outside the normal scope of DFI´s as the interest and guarantee fees charged to the banks would have to be adjusted to get more banking engagement into agricultural value chain financing with inclusion of smallholders. This could change over time as African financial intermediary grow and economies of scaleare achieved.

The EU has allocated EUR 10m to invest in African financial intermediary on the condition that IFU manages the investment and invest in African financial intermediary. This would require that IFU is approved by the EU (pillar assessed in EU terminology) to manage EU funds. Such pillar assessment of IFU is ongoing.

IFU expects to prepare for an investment in African financial intermediary during 2020.

Potential investment: DKK 50-70m

African rural development fund

African smallholder fund will invest in small companies in the agricultural value chain with the aim of promoting financing of companies that improve irrigation and renewable energy access and productivity in the agriculture value chain in selected African countries in West and East Africa. The fund would also have access to a TA fund that would provide training to investee companies to improve profitability and impact.

A fund size of EUR 45m would create 6,500 new jobs, provide improved irrigation to 15,000 farmers and improve production and market opportunities for more the 100,000 farmers.

Equity investments could be in a small company that processes pineapple and other fruits sourcing from smallholder in Cote d´Ivoire, a company that provides solar powered irrigation systems to smallholder farmers in Kenya, companies in Benin and Cameroon that provide solar based power to SMEs and households in rural areas or an MFI in West Africa providing finance to smallholders etc.

The fund will be managed by joint venture between a French based NGO/fund manager with teams on the ground and experience in West and East Africa.

Due the small sizes of each of the investments (around Euro 1.5m on average) and companies, there is need for technical assistance to mitigate risk (improve profitability and impact) and potentially for a higher management fee. The expected risk adjusted net return for investors in the fund is therefore assessed to be below what is normally required by DFIs commercial investments.

Potential investment: DKK 30-50m

African small business impact fund

Fund manager with 10 years track record in East Africa investing in small companies with high impact on the local economy, either as the companies are sourcing inputs from smallholders and adding value to these or as the companies produces goods and services for the bottom of the pyramid. Focus on agriculture value chains. Fund manager has a strong track record on gender equality and empowering women. Fund manager has developed a model for measuring the social economic impact of investments (economic return), including income, consumer benefit etc. which are gender specific. Investments in companies would typically be with loans that have some equity kicker (e.g. fix interest rate, repayment in full after several years and a share of profits).

The fund would be an evergreen fund with different classes of capital where DFI/impact investors would provide first loss capital, which would attract private investors, including lenders over time.

The fund would be looking for grants to share the cost of TA for the investee companies in areas such as governance, finance, technology, market development etc.

The small ticket sizes (investments in each company) of around EUR 1m and the type of businesses (typically family owned), in which the fund invests would require more handholding by the fund manager. The risk is relatively high, and the management fee is higher that commercial funds. This would render the risk adjusted return lower that what IFU would normally require, down to around 2%. The fund is in dialogue with the African Guarantee Fund to get guarantees on individual company investments. This would further reduce risk adjusted returns.

An IFU investment could help raise additional investments into the fund from external sources and from the local markets, by taken more risk in the fund.

Potential investment: DKK 30-50m; possibly need for TA

Annex 7: Preliminary Risk Management Matrix

Contextual risk

Risk factor	Likelihood	Impact	Risk response	Residual risk	Background to assessment
Possible global financial instability and economic slow-down	Possible	Medium	A thorough involvement of IFU and the other involved investors can mitigate the impact.	Minor	Financial turbulence and economic slow-down triggered by global political or financial crises.
Political and/or financial instability in some of the concerned African countries challenging Foreign Direct Investments	Possible	Major	The investments are envisaged to be conducted in a number of different African countries, and IFU will therefore not be heavily exposed to any single country. IFU will try to mitigate possible consequences on ongoing investments, whereas new investments will only be conducted if sufficient risk mitigation is in place.	Medium	During recent years political and financial turbulence have taken place in many developing countries, particularly in the least developed countries and fragile states, including Africa.

Programmatic risk

Risk factor	Likelihood	Impact	Risk response	Residual risk	Background to assessment
Inadequate interest among investors	Possible	Medium	A broad geographical and thematic approach will limit the risk. In addition IFU's untied mandate provides better opportunities to identify qualified investors including other DFIs and foreign impact investors.	Minor	Many private investors will be reluctant to investing in the least developed African countries and fragile state due to a relatively high risk exposure.
Commercial failure of individual investments	Medium	Major	IFU has a well-developed risk management system designed to mitigate risks during the preparation, implementation and operation of the investments. However, the risk of investing in the least developed	Medium.	Unless investments in the concerned African countries are carefully prepared and appraised they can easily lead to commercial failure

			countries and fragile states will remain relatively high.		
Shortage of bankable projects	Medium	Major	IFU is aware of the importance of maintaining a solid pipeline of investments projects, and efforts to develop a satisfactory pipeline are ongoing. IFU's untied mandate will make it relatively easier to maintain a solid pipeline..	Minor	Overall there is a shortage of bankable investment projects in developing countries, and that is in particular an issue in the least developed countries and fragile states in Africa where the risk-return balance is relatively challenging.

Institutional risk

Risk factor	Likelihood	Impact	Risk response	Residual risk	Background to assessment
Reputational risks due to violation of human rights, OSH, environmental standards etc.	Medium	Major	IFU has well-established sustainability policies and procedures which will ensure that sustainability issues are professionally addressed during investment preparation and operation	Minor	Various studies indicate that international and not least local companies often violate human rights, OSH, environmental standards etc.
Misuse, corruption and fraud by participating international and local partners	High	Medium	These risks can never be avoided, but IFU has developed a number of monitoring and control procedures to mitigate the frequency and impact of these risks.	Minor	According to international business environment indexes, including the Transparency International Index, corruption, fraud and misuse of funds is widespread in the concerned countries.

Annex 8: Process Action Plan - preparation of 2018 capital contribution to AGF

Time line	Activity	Documentation	Responsible
April – June 2019	Preparation of concept note	Concept Note	VBE
17 June	Concept note forwarded to KFU	Concept Note	VBE
27 June	Programme Committee	Concept Note	VBE
May - September	Preparation of project document	Project document	VBE
16 Sep. – 11 Oct	Completion of formulation and quality assurance process	Final Project Document and Appraisal Note	VBE/KFU
11 October	Project document and appropriation cover forwarded to KFU	Final project document and appropriation cover	VBE/KFU
29 October	Council for Development Policy	Minutes from meeting	KFU
1 November	Appropriation bill forwarded to UPR	Appropriation bill	VBE/UPR
8 November	Presentation to Minister for Development Cooperation	Signature	KFU
5 December 2019	Appropriation bill presented to the Parliamentarian Finance Committee	Appropriation bill	UPR
Beginning of December	Signing of agreement with IFU	Agreement	VBE and IFU
Medio December	Capital contribution	Disbursement	VBE, IFU

Formulation and quality assurance

It is suggested that the IFU commitment be exempted from the normal appraisal procedures. The main reason is that the responsible department (Growth and Employment - VBE) has good financial sector capacity. However, VBE would like to establish a quality assurance group with specialists from Technical and Quality Support (KFU) and VBE in order to discuss key quality assurance issues connected with the formulation of the support. The group should meet as required during June – September. The issues to be discussed may include:

- The overall strategic approach and related development priorities
- The results framework, results measurement and reporting according to international standards

Annex 9: Signed Quality Assurance Checklist

Annex 9 - Quality Assurance checklist for appraisal of programmes and projects[1]

File number/F2 reference: 2018-31327

Programme/Project name: High Risk – High Impact Investment in Africa – Capital contribution to IFU to engage in blended concessional finance,

Programme/Project period: 2020 – 2022 (Investment period)

Budget: DKK 200 million

Presentation of quality assurance process:
The quality assurance process has been conducted as in-process sparring and commenting during project formulation by the Technical Quality Support (TQS) department. No independent appraisal has been carried out neither by TQS or by in external consultant. This procedure was agreed when the Concept Note was presented to the Programme Committee on 26 – 27 June 2019.

The design of the programme/project has been appraised by someone independent who has not been involved in the development of the programme/project.
Comments: see above

The recommendations of the appraisal has been reflected upon in the final design of the programme/project.
The Programme Comittee discussion was based on a detailed Concept Note that included all the elements found in the final programme document. TQS provided written comments to the Concept note (attached to this note), and highlighted a number issues to be clarified and detailed in the final programme document. These issues are listed below together with a comment from BVB explaining how the comments have been addressed in the final document.

- The role of "The High Risk – High Impact investment in Africa" in IFUs overall strategy and portfolio.

TQS recommendation: Strengthen the description of IFU's current portfolio, how this initiative is expected to change the overall portfolio composition in the future, and strengthen the justification of proposed capital increase in 2019 (and possibly again in 2020) in the related target of 25% of portfolio being "impact projects" in least developed African countries.

[1] This Quality Assurance Checklist should be used by the responsible MFA unit to document the quality assurance process of appropriations where TQS is not involved. The checklist does not replace an appraisal, but aims to help the responsible MFA unit ensure that key questions regarding the quality of the programme/project are asked and that the answers to these questions are properly documented and communicated to the approving authority.

BVB response: The description and assessment of the investment portfolio has now been strengthened in the project document. Special efforts have been made to prepare clear procedures for country portfolio assessment of indirect investments through funds with a regional focus covering countries above as well as below the threshold in order to ensure that the project portfolio below the set threshold can be assessed precisely and consistently. The established target is, that IFU in 2020 and 2021 will invest at least 30 percent of its own capital in the concerned countries. This is 5 percent above the current portfolio below the threshold, and this target is adequate considering the limited size of the capital contribution compared with IFU's annual investments. At this stage it is not possible to establish targets beyond 2021 due to a number of external factors affecting the basis of the set target. The target, the investment threshold and the development of the portfolio composition will be monitored closely during the test period in order to gain experience. The 2019 commitment for the blended concessional finance initiative is necessary to allow IFU to invest in high impact projects with a challenging risk – return balance. The test period will provide information on the average concessionality level and the actual return of this type of investments which will be useful for the future design and development of the initiative. IFU's sister organisations have also received funding from their owners to initiate their blended concessional finance investments.

TQS Recommendation: describe in more detailed the expected types of projects? The ToC and results framework indicate that these will be in fields of job creation, improved access to food, resilient infrastructure, renewable energy and water access. Is there a potential pipeline that can be shared?

BVB response: This issue has now been addressed in the project document. IFU has already developed a solid pipeline of possible investment projects that need financing from the initiative in order to materialise, and additional project opportunities are continuously being identified and screened. Anonymised examples of possible investment projects are presented in annex 6. The thematic focus of these projects are e.g. renewable energy, MSMEs in the agricultural value chain, small companies with high impact on local economies and women entrepreneurs. A significant part of the investments is expected to be invested indirectly through specialised impact funds. The investments through such funds will facilitate IFU's assessment work because these funds have the required technical and regional expertise and experience. The funds will further allow IFU to participate in small impact investments which would not be possible for direct investments due to relatively high transaction costs.

- IFUs capacity for delivering High Risk – High Impact Investment in Africa

TQS Recommendation: Assess if IFU experience, knowledge and capacity is adequate for delivering "high impact projects" in least developed and fragile countries in Africa, and consider including strengthening of this capacity in the initiative if required.

BVB response: This issue has now been addressed in the project document. IFU has the required capacity and procedures in place to satisfactory prepare, implement and monitore the new initiative. IFU has completed investments in a number of the concerned 35 African countries and has active projects in 12 of the countries. However, IFU needs to further develop operational experience and procedures, e.g. in relation to the enhanced impact assessment during project preparation, implementation and completion. For that purpose IFU has recruited a development impact analyst in order to strengthen development impact assessment during the project cycle. IFU is also strengthening the development agenda in relation to the Board.

TQS Recommendation: consider if project identification and investment approval cycle and the internal incentives structures are fit for ensuring delivery of "high impact" projects-

BVB response: With regards to project identification and investment approval cycle reference is made to the above response. IFU is reconsidering its investment incentive structure.

- IFU resources for complementary "soft" input and TA

TQS Recommendation: Describe existing IFU resources available for project / pipeline development as well as for accompanying technical assistance, capacity building, technical studies, etc., assess of they are adequate or if additional funds are required.

BVB response: This issue has now been addressed in the project document. The MFA commitment does not include separate earmarked funds for technical assistance, capacity building etc. which may often be needed for the preparation and implementation of blended concessional finance investments. IFU can use parts of the MFA commitment for these activities according to needs. Funds for TA, training etc. may also be available from other sources, e.g. specific impact investment funds which IFU decides to invest in. IFU has also an option to finance certain activities from its own sustainability budget.

- Reporting, monitoring and evaluation

TQS recommendation: provide more information about how the "High Risk – High Impact" programme will it be monitored and evaluated. Will it be monitored at project level, portfolio level or both? Will impact be assessed at exit and how?

BVB response: These issues are now addressed in the project document. The M&E activities will be conducted at project and portfolio level. Impact will be assessed at exit based on M&E data. In addition specific mid-term and ex-post studies of development outcomes will be prepared for a selected part of the investment projects in order to provide more detailed documentation on performance and development outcomes, as well as contributing to learning about this new financing initiative and the continued development of IFU's Impact Development Model.

❑ ***The programme/project complies with Danida policies and Aid Management Guidelines.***

BVB comments: Yes, the project falls within key priority areas of "the World 2030" and the approved organisation strategy for IFU. The programme document is fully in accordance with the AMG requirement. Thus, the only deviation from a standard programme preparation process is the QA process described in this note.

❑ ***The programme/project addresses relevant challenges and provides adequate responses.***

BVB comments: Yes, the project addresses the challenges of increasing investments in high impact projects in the least developed African countries where the risk – return balance is challenging, and it comprises a concrete initiative for enhancing IFU's investments in these countries.

❑ Issues related to HRBA/Gender, Green Growth and Environment have been addressed sufficiently.

BVB comments: HRBA/Gender, Green and Environment will be addressed at the investment project identification and approval process based on IFUs new sustainability policy and climate policy to be approved soon. The programme will contribute to mainstreaming these aspects in IFUs administrative processes and systems, including through improved monitoring and evaluation of development outcomes and impacts through the DIM (Development Impact Model) tool.

❑ Comments from the Danida Programme Committee have been addressed (if applicable).
Comments: Yes see above.

❑ The programme/project outcome(s) are found to be sustainable and is in line with the partner's development policies and strategies. Implementation modalities are well described and justified.
BVB comments: This is adequately addressed in the project document. The impact of the initiative will be determined on the basis of the individual investment projects, which will be implemented across countries and thematic areas. Impact assessments will be based on IFU's Development Impact Model, which will be further developed. Ex-ante baselines will be prepared by IFU before a new investment project is initiated.

❑ The results framework, indicators and monitoring framework of the programme/project provide an adequate basis for monitoring results and outcome.
BVB comments: Yes, ref. above.

❑ The programme/project is found sound budget-wise.
BVB comments: Yes, the MFA commitment will be allocated as earmarked core funding to ensure that it will be fully integrated into IFU's governance system.

❑ The programme/project is found realistic in its time-schedule.
BVB comments: Yes, the initiative will be implemented over a period of two to three years, after which outcome of the test period will be assessed.

❑ Other donors involved in the same programme/project have been consulted, and possible harmonised common procedures for funding and monitoring have been explored.
BVB comments: No, but several of IFU's sister organisations have already agreed with their owners to take steps to expand the use of blended concessional finance (rf. project document).

❑ Key programme/project stakeholders have been identified, the choice of partner has been justified and criteria for selection have been documented.
BVB comments: Yes (rf. project document).

❑ The executing partner(s) is/are found to have the capacity to properly manage, implement and report on the funds for the programme/project and lines of management responsibility are clear.
BVB comments: Yes (rf. above and project document)

- Risks involved have been considered and risk management integrated in the programme/project document.
BVB comments: Yes (cf. project document).

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

Date and signature of desk officer: 17-10-19 Jørn Olesen

Date and signature of management: 17/10-19

25. June 2019

KFU Comments to Programme Committee presentations

High Risk – High Impact Investment in Africa

Capital Contribution to IFU to develop and operate a concessional blended finance initiative.

I General comments

The initiative can been seen as part of the response to the recent evaluation of IFU that recommended to define a clearer mandate for "IFU classic" with more focus on poor and fragile countries and on maximising development outcomes. Through a new capital contribution of DKK 200 million it is expected that IFU will increase its investments in projects with clear development impact in least developed (defined as per capita GNI of maximum USD 1,558) and fragile African countries to about 25% of the annual IFU classic investments. It would be useful with some more background information about the current annual volume of IFU classic investments and the proportion of these already targeting similar projects and investments to better assess if the target of 25% is sufficiently ambitious and a reasonable return on a DKK 200 million additional capital contribution (with further DKK 200 million in 2020.

Further, in order to better assess the realism of the target and understand the types of projects that FU expects to invest in, it would be useful to have an overview of similar projects in IFUs current portfolio (Somalia and African Guarantee Fund are mentioned) and an indication of IFUs pipeline of potential projects?

The document states that IFU has the required capacity to develop and manage the new concessional blended finance instrument. The document could analyse IFUs actual capacity and experience with this type of investment in least developed and fragile African countries more in depth in view if identifying possible constraints within IFU that should be addressed. Does IFU have the country knowledge and networks to operate in these countries? Does IFU have the sufficient capacity and expertise related to working less developed and more fragile contexts, and for ensuring high developmental impact? Does the internal organisation and incentives structure sufficiently cater for delivering impact projects? The context will inherent be more volatile, risks higher, regulation and national systems weaker, etc... The recent evaluation indicated that there was a need to strengthen development expertise in IFU.

The Theory of change assumes that the main constraints for mobilising private capital, technology and know-how in these countries are "limited market knowledge" and "challenging perceived or real risk-return balance". What about the shortage of bankable projects? This is often highlighted as a major constraint for mobilising private (and public) investments even in less difficult countries. Should IFU engage more in upstream project development to build a strong pipeline of relevant projects?

II KFU proposed key recommendations for the PC-meeting (3-5 important recommendations relevant for the upcoming formulation process including a short explanation)

1. Strengthen the description of IFU's current portfolio, how this initiative is expected to change the overall portfolio composition in the future, and strengthen the justification of proposed capital increase in 2019 (and possibly again in 2020) in the related target of 25% of portfolio being "impact projects" in least developed African countries.
2. Assess if IFU experience, knowledge and capacity is adequate for delivering "high impact projects" in least developed and fragile countries in Africa, and consider including strengthening of this capacity in the initiative if required.
3. Further, consider if project identification and investment approval cycle and the internal incentives structures are fit for ensuring delivery of "high impact" projects.
4. Describe existing IFU resources available for project / pipeline development as well as for accompanying technical assistance, capacity building, technical studies, etc., assess of they are adequate or if additional funds are required.

III QA process and PAP (Provide an assessment of the proposed plan for QA including the proposed documentation; assess the realism of the PAP)

Proposed QA process does not include a normal appraisal but only in-process consultations with KFU through a QA-group. This is seems ok, but I may be considered to expand the group with EVAL and others to ensure that the evaluation recommendations are fully considered.

IV Other comments (May be mentioned briefly during the meeting but will be e-mailed to relevant unit after the meeting).

- *Types of investments / projects:* is it possible to describe in more detailed the expected types of projects? The ToC and results framework indicate that these will be in fields of job creation, improved access to food, resilient infrastructure, renewable energy and water access. Is there a potential pipeline that can be shared?
- *Results framework and impact:* the document has very limited information about how the "high [development] impact" will it be monitored and evaluated. Will it be monitored at project level, portfolio level or both? Will impact be assessed at exit and how?
- *Leverage:* the note states that the expected leverage factor is 4-6. How will this leverage factor by calculated? 4-6 seems very high.